PRINCIPLES OF, AND ISSUES IN, LENDER LIABILITY

BY

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VOLUME I

(CHAPTERS 1 - 7)

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DECLARATION

I hereby declare that this thesis has been composed by me and is my own work, and has not been submitted for any other degree or professional qualification.

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ABSTRACT OF THESIS (Regulation 3.5.10)

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Title of Thesis ~~Principles of, and Issues, in Lender Liability~~

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his thesis looks at situations, principally in the context of a commercial loan, in which lenders can be liable to borrowers, as well some third parties, e.g., other lenders, when they have acted wrongfully towards them. The emphasis will be on Scots and nglish law, although, where appropriate, reference will be made to Commonwealth law, and, to a lesser extent, the United States d Europe.

fter a brief consideration of what is meant by lender liability, which is an inexact term, this thesis considers the banker-customer lationship, which provides the framework for the thesis, and the issue of banker confidentiality.

he next chapters concern the liability of lenders when they step outside the debtor - creditor relationship. First, the liability of a nder as a fiduciary is examined - the main difficulty being the bank having a conflict of interests. Next, the question of whether a nder is under an obligation to provide advice to a borrower on the prudence of a particular transaction is looked at. Thirdly, the otential liability of a lender for negligence under Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465 is scussed.

he following chapter looks at intentional delicts: fraud; and the economic delicts: conspiracy, intereference with a business, and ducing a breach of/intereference with a contract; the last area considers the question of a lender's liability for inducing a breach a negative pledge clause in a loan agreement.

addition, the liability of a lender as a constructive trustee for dishonest assistance and knowing receipt, under English law, is nsidered. Scots law does not recognise knowing assistance, which is likely to be regarded as a delictual claim, but it does cognise knowing receipt, which may also give rise to a claim in unjustified enrichment.

he liability of a lender in damages for breach of a loan agreement, and, to a lesser extent, the general banking contract is also amined. The discussion focuses on: the purpose and measure of contractual damages, mitigation, and remoteness of damage, the uations where lenders are in breach of contract, and damages for injured feelings.

hereafter, the situation where a lender seeks to enforce its security after a borrower defaults, and, in particular, the problem of a le by a standard security holder (in Scotland) and a mortgagee (in England) when the price realised for the property is not a oper price is looked at. A separate, but related, chapter examines the concept of the receiver, and relates it to the situation where e lender can be liable for the acts of the receiver, i.e., where the receiver ceases to be the agent of the debtor company because: it follows the commands of the lender, or (ii) the lender interferes with the receivership; this is most relevant where the price the ceiver obtains is not a proper price. The position of other security holders or encumbrancers, and guarantors is looked at in both apters.

lated to the issue of enforcement of security, is the question of liability of lenders for the clean up of contaminated land, where e lender takes possession of the land, which is found to be contaminated. The leading jurisdiction on this is the United States th its so-called "Superfund" legislation. This forms the starting point for the discussion. The position in Britain is examined in e light of this and the new Part II A of the Environment Protection Act 1990 (which is not yet in force).

stly, the issue of the liability of a lender as a shadow director for wrongful trading is discussed. The two main concerns for nders are: (i) when it appoints a representative to the board of an ailing borrower, or (ii) when the lender makes it clear that it ll, effectively, be running the company. The concepts of wrongful trading and shadow directors, and the defences available are amined.

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CHAPTER 1.

INTRODUCTION

> "The common law implies in the case of every citizen a general rule of careful conduct towards others and regard for their interests, and it makes provision in some form or other for penalising anyone who ignores that rule and causes loss or injury to another.
>
> A banker is in no different position from any other person in that respect."[1]
>
> "It is much in the spirit of the times in which we live that losses occasioned on the conclusion of a business transaction in which a professional adviser has been involved are not infrequently followed by attempts to pass the loss on to that professional."[2]

The above quotations give an insight into the sorts of difficulties involved with this topic, and the balancing of interests required.

Lender liability is an inexact term. As the name suggests, it is primarily concerned with situations in which a lending institution, through its wrongful conduct, e.g., giving negligent advice, has caused financial loss to a customer/borrower, or a third party, or

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[1] Finlayson, R., Law Lectures to Bankers (1939), at p.205.

[2] Per Rimer J. in Ginora Investments Ltd. v. James Capel & Co. Ltd., unreported decision, delivered on 10th February, 1995.

other lender.[3] Situations where the conduct of the lender results in the borrower being relieved of liability, rather than suffering a direct financial loss, such as undue influence or duress, will not be discussed. And likewise, the risks that banks can be exposed to, such as the collapse of a corporate borrower, which will affect the bank's profits in the same way that a large damages award can, will not be considered.

In the discussion which follows, the emphasis will be on Scots law and English law, but, because of the global nature of banking, reference, on relevant issues, will be made to Commonwealth law, as well as, to a lesser extent, the law of the United States and European countries.

With banking expanding into different and new areas, with the aid of new technology, in addition to the traditional areas of paying and collecting cheques and granting loans, new difficulties are created for lenders, as borrowers have greater expectations. This thesis will look at a range of topics connected with banking (primarily from a perspective of a corporate, rather than a personal, customer)[4], and the problems they give rise to for lenders. Two areas that are problematic for lenders are: (i) situations where the lender is involved in giving advice, or there is an expectation that advice will be given; and (ii) situations

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[3] A similar view is taken by Professor Cranston: see Cranston, R., "Banks, Liability and Risk" : Ch. 1 in Banks, Liability and Risk (1995) 2nd edn., at p.1 (R. Cranston, ed.)

[4] I.e., the Consumer Credit Act 1974 (as amended) will not be looked at.

where the lender is seeking to enforce security after a default by a borrower.

The foundation for the discussion in this thesis is the banker-customer relationship, which sets out the basic contractual relationship of debtor-creditor between a bank and its customer. This follows on into the separate, but related, issue of the duty of confidentiality owed by a bank to its customer, in which, amongst other things, contemporary issues, such as: (i) the recent legislation on money laundering and drug trafficking, (ii) disclosure of financial information about customers to credit rating agencies, and (iii) data protection problems are considered, as are the consequences for banks.

This thesis also looks at the liability of lenders when they step outside the debtor-creditor relationship they have with their customer, such as where they undertake an advisory role, and, hence, come under a fiduciary obligation, in which the lender has an obligation of loyalty to the customer. The most common problem is where the lender has a conflict of interests between those of the customer it is advising and its own interests. The question of when a fiduciary obligation arises, as well as how to deal with conflicts of interests, is looked at.

Because a lender is in a debtor-creditor relationship with its customer, the lender is able to look after its own interests. This means that a lender is under no obligation to advise a customer on the prudence of a particular transaction, except where the lender undertakes such a role, either expressly or impliedly; but merely approving a loan does not mean that the lender has advised that a

transaction it has lent money for will be a success. In contrast, on the Continent, to varying degrees, lenders can be liable to other creditors and third parties for improper credit transactions where the lender provides credit and the borrower becomes insolvent. It is argued that such an approach, which is contrary to the one taken in Britain, is not conducive to assisting troubled companies, and will not encourage "rescues".

A lender may also be liable, under the Hedley Byrne principle, for a negligent mis-statement, where it gives negligent advice, either to a customer or a third party enquirer. In seeking to determine when liability will arise for negligence, the issues of: duty of care, reasonable reliance, concurrent liability, remoteness, standard of care, causation and damages, and how they relate to lenders are discussed.

Where a lender's harmful conduct is intentional, rather than negligent, the lender comes within the ambit of intentional delicts/torts. The problems may be due to fraud by the lender, or where the lender has conspired to harm a borrower, or has interfered with a business, or interfered with a contract between a borrower and a third party (such as, another lender), causing the borrower to breach a negative pledge clause in a loan agreement with the other lender, for example.

The nature of the banker-customer relationship as a debtor-creditor relationship means that the bank is able to treat all money deposited by the customer as its own, which it (the bank) has to repay when the customer requests it. Where the bank is dealing with trust money, it cannot treat such money as its own, and should keep it

separate. However, under English law, problems can arise, in relation to trust money, where: (i) a lender dishonestly assists a trustee (or other fiduciary) who has committed a breach of trust, or (ii) the lender misappropriates the trust money and applies it for its own benefit, e.g., repaying, or reducing, the trustee's overdraft. In these situations, the lender may be liable to the beneficiary as a constructive trustee. Scots law does not recognise the first category of dishonest assistance as a constructive trustee; rather, such a claim is likely to be regarded as a delictual one (i.e., a claim for fraud). It does recognise the second category (knowing receipt); but, as the constructive trust is not a popular concept in Scots law, it will be pleaded as a claim in unjustified enrichment for either recompense or repetition. The problem areas are: (i) the degree of knowledge of the trust or fiduciary relationship, i.e., is it actual knowledge or constructive knowledge, and (ii) the character of the receipt - is mere receipt enough, or does there have to be some benefit or enrichment?

Where a lender has entered into a loan agreement with a borrower, but the lender wrongly decides not to provide the sum to the borrower, who has not breached the terms of the contract, the lender can be liable for breach of contract, and required to pay damages under Hadley v. Baxendale[5]. The main problem appears to be where lenders treat term loans as overdrafts, and call them in where no event of default has occurred, with the result that the borrower's business collapses. This topic involves an examination of contractual damages, and the loss suffered by the borrower,

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[5] (1854) 9 Exch. 341.

e.g., mitigation and remoteness; as well as damages for injured feelings.

Where a borrower seeks to enforce its security, because of a default by the borrower, the lender has to make sure that the property is not sold at an undervalue, as the debtor or its other creditors are entitled to any surplus after payment of the lender's debt. If the lender does sell at a price which is less than the best price (under Scots law), or the proper price (under English law), the lender can be liable to pay the difference to the borrower or the other creditors. Where a lender decides to place the borrower into receivership, the lender must be careful not to interfere with the conduct of the receivership, otherwise, on agency principles, the receiver ceases to be the debtor company's agent, and becomes the lender's agent, with the result that the lender is liable for the acts of its agent, such as where the assets are sold at an undervalue.

An area which has emerged as one of real significance in recent years is that of the environmental liability of lenders for the cleaning up of contaminated land, where the lender realises its security and takes possession of the property. The starting point for the discussion is the "Superfund" in the United States, which raises many issues, such as who is liable for the clean-up of contaminated land, and when; and should a lender, who is enforcing security, be liable for clean-up costs where the environmental damage was caused by a previous owner of the land? The issues raised by the Superfund are examined in the light of the draft legislation introduced in Britain by the previous Government. Under this legislation, where a lender knowingly

permits or causes contaminating substances in, on or under land, the lender can be liable for clean-up costs. The main difficulty for a lender will be deciding whether to enforce its security and risk being liable for clean-up costs (which may be in excess of the value of the loan), or abandon its security and treat the loan as unsecured.

Lastly, if a lender decides to rescue an ailing borrower, rather than liquidate it, the lender may appoint representatives to sit on the board of the borrower, or the lender may make it clear to the debtor company that the lender will, effectively, be running the company. In such cases, the lender runs the risk of being regarded as a shadow director, which carries the risk that the lender may be required to make a contribution to the assets of the debtor company if it trades whilst insolvent and subsequently goes into liquidation. Thus, the concepts of wrongful trading and shadow directorship are considered, as are defences available to lenders.

Thus, what this thesis will attempt to do is to identify areas (and examine the legal principles involved) where a lender may be liable to a borrower (or a third party), as a consequence of the lender's wrongful conduct. In discussing legal principles, the law has attempted to be stated as at 1st July, 1997, but, where possible, some later developments have been included.

CHAPTER 2.

THE BANKER-CUSTOMER RELATIONSHIP

The relationship between a banker and its customer is important to understanding lender liability, as it provides a framework - albeit a loose one - which defines the rights and obligations of each party *vis-a-vis* its normal dealings with the other party. Thus, it sets parameters as to what a customer can expect from its bank. This is significant when looking, in subsequent chapters, at the questions of: (i) the fiduciary obligations owed by banks to their customers, (ii) a lender's duty to advise a borrower, who wishes to borrow money from the lender for the purpose of entering into a transaction, whether that transaction is prudent, and (iii) a lender's liability as a constructive trustee of funds deposited with it.

The discussion of this relationship will look at: (i) the nature of the banker and customer relationship; (ii) the basis of that relationship; and (iii) the implied duties imposed upon a banker, such as the duty to use reasonable skill and care in relation to his customer. The implied duty of confidentiality, owed by a banker to its customer, arising out of the banker-customer relationship, is considered in the next chapter.

(a) Nature of Relationship: Debtor and Creditor

It is well-settled that the relationship between a banker and his customer is one of debtor and creditor[1], regarding deposits and withdrawals made by a customer of funds into and from its bank account: the money deposited becomes the bank's, with the bank having a personal obligation to repay an equivalent amount to the

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[1] Foley v. Hill (1842) 2 H.L. Cas. 28, at pp.36-37, per Lord Cottenham L.C., at p.44, per Lord Brougham, and, at p.45, per Lord Campbell; Joachimson v. Swiss Bank Corpn. [1921] 3 K.B. 124, at pp.126-127, per Atkin L.J. (as he then was); Westminster Bank Ltd., v. Hilton [1926] 43 T.L.R. 124, at p.126, per Lord Atkinson; Barclays Bank plc v. Quincecare Ltd. [1992] 4 A11 E.R. 363, at p.375, per Steyn J. (as he then was) (decided in 1988); Libyan Arab Foreign Bank v. Bankers Trust Co. [1989] 1 Q.B. 728, at pp.748-749, per Staughton J. (as he then was); and Lipkin Gorman v. Karpnale Ltd. [1991] 2 A.C. 548, at pp.573-574, per Lord Goff of Chieveley. See too Lord Templeman in Lord Advocate v. Ross 1989 S.C. 70, at p.116, [1986] 1 W.L.R. 1078, at p.108 4D-F. The position is the same in Scotland: see Royal Bank of Scotland v. Skinner 1931 S.L.T. 382, at p.384, per Lord Mackay (OH); Lord Penrose in Mercedes Benz Finance Ltd. v. Clydesdale Bank, 1996 S.C.L.R. 1005, at p.1012 D-E; and Lord Gill in Style Financial Services Ltd. v. Bank of Scotland (No.2) 1998 S.L.T. 851, at p.863 1997. S.C.L.R. 633, at p.651. In South Africa: see Standard Bank of SA Ltd. v. Oneanate Investments Ltd. 1995(4) S.A. 510, at pp.531I-532B, per Selikowitz J.; and in the United States: see Smith's Cash Store v. First National Bank 149 Cal. 32, 84 p.663 (1906) and Bank of Martin v. England 385 U.S. 99, 101 (1966).

customer, when demanded[2], as the money is not held on trust for the customer[3]. However, the position reverses when the customer borrows money from the bank, or the customer's current account is overdrawn - in these instances, the customer becomes the debtor of the bank.[4] In Scotland, unlike England, it is not strictly a prerequisite to seeking repayment of money deposited with a bank, that a customer should make a demand for it[5], although it is unimaginable

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[2] See Foley v. Hill, supra; Joachimson, supra, approved by the House of Lords in Arab Bank Ltd. v. Barclays Bank [1954] A.C. 495, at p.531, per Lord Reid; Geva, B., "Payment into a Bank Account" (1990) J.I.B.L. 108. See too Lord Penrose in Mercedes Benz Finance Ltd v. Clydesdale Bank, supra, at p.1012 D-E and in Sutherland v. The Royal Bank of Scotland, 1997 S.L.T. 329, at pp.336-337 (decision delivered on 4th December, 1995), and Lord Gill in Style Financial Services Ltd. v. Bank of Scotland, supra. Cf. the position where a bank wrongfully debits a customer's account. Under English law, the customer has a cause of action arising in debt: see the discussion on this, later in the text.

[3] Foley v. Hill, supra; Joachimson, supra; and Mercedes Benz Finance, supra.

[4] Foley v. Hill, supra, at p.39, per Lord Cottenham L.C., and at pp.43-44, per Lord Brougham; Lipkin Gorman v. Karpnale Ltd. [1991] 2 A.C. 548, at pp.573-574, per Lord Goff of Chieveley; and Standard Bank of SA Ltd. v. Oneanate Investments (Pty) Ltd. 1995(4) S.A. 510, at pp.531J-532D, per Selikowitz J., who provides a very good statement of the position.

[5] See Lord-Justice Clerk (Cooper) (as he then was) in MacDonald v. North of Scotland Bank 1942 S.C. 369, at p.375; Lord Mackay agreeing, at p.379. The case concerned an unsuccessful attempt by a wife to claim repayment of money in

that a Scottish customer would not make a demand.[6] The significance of this difference is relevant to the prescriptive, or limitation, period for the repayment of debts (which includes bank accounts). In

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a bank account, opened for her by her late husband, which had laid dormant for over twenty years. The wife argued that the money was repayable on demand. The court said that the prescriptive period had expired, as time ran from the date of the opening of the account.

[6] See Lord Cooper in MacDonald, supra, at p.375, who acknowledged that he could not "imagine that a customer of a Scottish bank would attempt to enforce repayment of his credit balance by any expedient except presentation of a cheque." Nowadays, money may be withdrawn from a customer's account by other methods, e.g., a direct debit, or via an automated telling machine.

However, it is not correct, as Lord Cooper appears to suggest in MacDonald, supra, at p.376, that Joachimson establishes "that, unless and until a cheque is presented, the bank is not the debtor of the customer for the sum at credit of the account." This confuses the underlying debt with its repayment. A similar view is taken by Lord Reid in Arab Bank Ltd. v. Barclays Bank [1954] A.C. 495, at p. 533, who said:

> "I think that in Joachimson's case Atkin L.J. recognized that there is a debt before any demand for payment is made . . . There is no suggestion of any anomaly in treating a sum at credit on current accounts as a debt for the purpose of garnishee proceedings [or an arrestment under Scots law] . . . It is clear that the existence of a debt does not depend on there being a present right to sue for it. Debitum in presenti solvendum in futuro is a familiar concept and a demand for payment is in my view merely that which makes the debt solvendum."

Scotland, the prescriptive period for debts is twenty years[7], with time running from the date of the deposit of the money in the customer's account[8]; whereas in England, the limitation period is six

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[7] Ss. 7(1), 10(1), and 14, of the Prescription and Limitation, (Scotland) Act 1973 (as amended), relating to the long prescriptive period of twenty years, which applies to debts, and, hence, deposits in bank accounts, as in MacDonald v. North of Scotland Bank 1942 S.C. 369. There is also a shorter period of five years: see s.6(1) (2), (3) and Schedules 1 and 2 of the 1973 Act. This covers: (i) bills of exchange and promissory notes (Schedule 1(e), pursuant to s,6(2)), and (ii) an obligation arising otherwise from, or due to, a breach of contract, such as a demand for repayment of sums outstanding in bank accounts (i.e., an overdraft): see Schedule 1(g), pursuant to s.6(2)), and Bank of Scotland v. Laverock 1991 S.C. 117.

[8] MacDonald v. North of Scotland Bank 1942 S.C. 369. Whilst the decision MacDonald may, in theory, lead to absurd results, e.g., a parent could open an account for their child and not withdraw any money for over twenty years only to find that the debt of the bank had extinguished, this is extremely unlikely to occur, as the monthly statements which banks issue would amount to a written acknowledgement of the debt, as would the statements that can be obtained from Automatic Telling Machines: see ss.7(1)(b), and 10(1)(b) of the Prescription and Limitation (Scotland) Act 1973. It is also likely that there would be deposits and withdrawals over that time, which would have the effect of creating a new debt on each occasion. Where, however, a loan facility (or a guarantee) is made "on demand", the prescriptive period runs from the date on which demand is made: not from the date when the obligation first became

years for debts, and the time period runs from the accrual of the cause of action, which is when a demand is made.[9] Alongside this debtor-creditor relationship, there is also a relationship of agent and principal, which applies to the payment and collection of cheques by a bank on behalf of its customer.[10] The agent and principal element of the relationship arises under the general banking contract between the parties (which is looked at in the next section), and places the bank, as an agent, under a fiduciary obligation to its customer, in regard to this aspect of its (the bank's) dealings with the customer.

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enforceable: see Royal Bank of Scotland v. Brown 1982 S.C. 89. Cf. MacDonald v. North of Scotland Bank, supra.

[9] See s.5 of the Limitation Act 1980, and see: Joachimson, supra, and National Bank of Commerce v. National Westminster Bank [1990] 2 Lloyd's Reports 514, at p.516, col. 2, per Webster J. Cf. s.6 of the 1980 Act, concerning loan agreements. See too Paget's Law of Banking (1996) 11th edn. (by M. Hapgood Q.C.), at pp.117-118.

[10] See Lord Atkinson in Westminster Bank Ltd. v. Hilton [1927] 43 T.L.R. 124, at p.126; Steyn J. (as he then was) in Barclays Bank plc v. Quincecare Ltd. [1992] 4 All E.R. 363, at p.375-376a; and Lord McLaren in King v. British Linen Co. 1 F. 928, at pp.932-933, cited by Lord Penrose, with approval, in Sutherland v. Royal Bank of Scotland 1997 S.L.T. 329, at pp.336, col. 2 - 337, col. 1. See too: Banking Services: Law and Practice Report by the Review Committee, (chaired by Professor Jack C.B.E.) Cmnd. 622 ("the Jack Report"), at para.6.04.

(b) Basis of The Relationship: Contract

The basis of the debtor and creditor relationship between a bank and its customer is contractual[11], i.e., it is an "arm's length" relationship, in which each party can consider its own interests ahead of the other party's. Apart from when the bank is acting as the agent of the customer in paying and collecting cheques, it is not, ordinarily, a fiduciary[12] - although it can be in very limited situations, which are referred later in this thesis[13]. A general banking contract, governing the relationship between the parties, is formed when a customer signs a bank mandate to open an account (usually a current account) with his bank. Most of the terms of this general contract are unwritten and implied and relate to matters such as: (i) the payment and collection of cheques by the bank as the agent of the customer[14],

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[11] Joachimson v. Swiss Banking Corporation [1921] 3 K.B. 110, at p.127, per Atkin L.J. (as he then was) (C.A.), approved by the Privy Council, in Tai Hing Cotton Mill Ltd. v. Liu Chong Hing Bank Ltd. [1986] A.C. 80, on appeal from the Supreme Court of Hong Kong. The position is the same under Scots law: see Waterston v. City of Glasgow Bank (1874) 1 R. 470; King v. British Linen Co. (1899) 1 F. 428, at pp.932-933, per Lord MacLaren; and Lord Penrose in Sutherland v. Royal Bank of Scotland plc, supra, at p.335L.

[12] Foley v. Hill (1842) 2 H.L. Cas. 28; Joachimson, supra; Royal Bank of Scotland v. Skinner 1931 S.L.T. 381, at p.384, col. 2, per Lord Mackay.

[13] See Chapter 4 on "Lenders As Fiduciaries".

[14] Joachimson v. Swiss Banking Corporation [1921] 3 K.B. 110, at p.127, per Atkin L.J. (as he then was) (C.A.).

(ii) the bank giving notice when it wishes to cease doing business with the customer[15], and (iii) the customer only being entitled to repayment of the money in his account at the bank where the account is held[16].

The nature of this general banking contract has prompted one commentator to remark[17]:

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15 Ibid.

16 Ibid. With automatic telling machnes, a customer can now obtain repayment of the money he has deposited at any branch of his bank, or even at a branch of another bank, which has a reciprocal arrangement with his own bank, e.g., the Bank of Scotland has such an arrangement with Barclays Bank plc and vice versa.

17 J. Milne Holden, The Law and Practice of Banking (1991), vol.1, 5th edn., at p.50. For a corporate borrower, the mandate will be more sophisticated: see, for example, The Encyclopaedia of Forms and Precedents (1995) vol.3(2) 5th edn, Sir Peter Millett (ed), Reissue, Form 5, at pp.24-28; see also pp.29-30. For an individual: see Form 1, at pp.15-17. Cf. the view in Paget's Law of Banking (1996) 11th edn. (by M. Hapgood Q.C.), in para.(2) on page v of the Preface, and at p.111 of the text, that, due to the code of banking practice (now in its third edition), the use of written terms in the general contract between the banker and customer is now "widespread"; and the view of Bankes L.J. in Joachimson, supra, that the relationship depends "entirely or mainly on an implied contract" is no longer true. Curiously, the discussion of the general banking contract in the text of Paget (pp.112-113), proceeds on the basis of Joachimson, supra.

"Little does a new customer realise when, with a minimum of formality, he opens a bank account that he is entering into a contract the implied terms of which would, if reduced to writing, run into several pages."

In addition to this general implied contract, there will be express written contracts between the parties for other, more specific, services - such as a loan contract and the requisite security documentation, or for "standing orders, direct debits[18], banker's drafts, letters of credit and foreign currency"[19], as well as debit cards[20], and credit cards - which are not included in the general contract[21], and which will be governed by their own terms.

In considering the relationship between a banker and his customer, it needs to be realised, as the Jack Committee on Banking Services

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18 On direct debits: see Lord Penrose in Mercedes Benz Finance Ltd. v. Clydesdale Bank 1996 S.C.L.R. 1005, at p.1011C-E, in which his Lordship, held, rightly, there is no difference between payment by a direct debit and by a cheque; and the decision of the Court of Appeal, in England, in Esso Petroleum Co. Ltd. v. Milton [1977] 1 W.L.R. 938, [1997] 2 All E.R. 593, where the court, by majority, held that, in modern commercial practice, direct debits are treated the same way as cheques, and, thus, are equivalent to cash.

19 Paget's Law of Banking (1996) 11th edn. (by M. Hapgood Q.C.), at p.110.

20 See Reed, C., "Consumer Electronic Banking" [1994] J.I.B.L. 451, and "Consumer Electronic Banking" : Ch. 5 in International Electronic Banking (1994) (J. Norton, ed.), at pp.98-103, on the question of contractual terms in contracts for such cards.

21 Paget's Law of Banking, supra, at p.110.

observed[22], that the nature and extent of the banker-customer relationship is now very different from when the above principles - decided, in the main, last century, or early this century - were formulated, and that the relationship will continue to change. For instance, there are now many more people holding bank accounts; banks now sell or promote other services, apart from cheque accounts, such as pensions and insurance; banks are more global in nature; they are more centralised and less regionalised than they were pre-World War II; there has been a reduction in, or rationalisation of, the branch network has occurred[23]; a lot of building societies are now becoming banks; and there has been a rise

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22 Jack Report, Cmnd. 622, Feb, 1989, at paras.2.16-2.19, 2.25 and 2.30. See commentary on the Report by Goode, R.M., "The Banker's Duty of Confidentiality", Centre Point, [1989] J.B.L. 269; and Arora, A., "The Jack Committee Report on Banking Services: Law and Practice" (1991) 12 The Company Lawyer 127.

23 See Rich, M., "Banks accused of withdrawing from deprived areas" *The Financial Times*, 13th February, 1997, p.9, referring to a report by the New Economics Foundation, an environmental think-tank. The closing of branch networks by banks was regarded as being "like pulling the plug on the local economy", according to Mr. Ed. Mayo, the report's author. This is because they are less likely to locate to an area without a bank branch. In London, between 1990 and 1995, 271 bank branches (i.e., twenty per cent) were closed, with one-third of London wards having "no local bank".

in new technology and electronic banking[24], with the vast majority of individual cash withdrawals being by automatic telling machines[25] - there are also telephone banking services. These are matters which, together with legislative intervention, have shaped, and will shape and influence, the nature of the banker and customer relationship in the future in an increasingly global and competitive banking environment; an environment in which banks are becoming multi-functional. Nonetheless, the flexibility permitted by the implied general banking contract was praised by the Jack Committee Report on Banking Services[26], although the need to inform customers of what their rights and obligations are is important. Moreover, it appears that, as a result of the code on banking practice, The Banking

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[24] For a discussion of electronic banking: see Reed, C., "Consumer Electronic Banking" [1994] J.I.B.L. 451; Paget's Law of Banking (1996) 11th edn. (by M. Hapgood Q.C.) : Ch.19 by R.J.A. Hooley; Reed, C., "Consumer Electronic Banking": Ch.5 in International Electronic Banking (1994) (J. Norton, ed.); and Jack Report, Chs. 7, 8 and 9. See too Algudah, F., "Banks' Duty of Confidentiality in the Wake of Computerised Banking [1995] J.I.B.L. 50; Rowe, H., "Virtual Banking and Electronic Payments" - Privacy and Related Issues" (1997) B.J.I.B.F.L. 20; and The Banking Code (1997) (3rd edn), at paras.3.9-3.12 and 4.8-4.16.

[25] Cmnd. 622, Feb, 1989, at para.2.24.

[26] Cmnd. 622, Feb, 1989, at paras.6.08 and 6.23.

Code,[27] introduced after the Jack Report, more general banking contracts are now express.[28]

(c) Implied Terms in General Banking Contract

In the general contract between a banker and his customer, the two most important implied terms are: (i) the implied duty upon a banker to act with reasonable skill and care in relation to its customer; and (ii) the implied duty of confidentiality owed by the banker to the customer.

This section will focus on the implied duty of reasonable skill and care, together with the related topics of: (i) the wrongful dishonour of a customer's cheque, and (ii) the wrongful debiting of a customer's account; the duty of confidentiality is examined in the next section.

Implied Duty of Reasonable Skill and Care

Under this implied term, a duty is imposed on the banker to act with reasonable skill and care towards his customer in carrying out the customer's business, such as, when the banker, as agent, is paying

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[27] 3rd edition, March, 1997, which takes effect from July, 1997.

[28] Paget's Law of Banking (1996) 11th edn. (by M. Hapgood Q.C.), at p.111. An example of an express mandate is found in The Encyclopaedia of Forms and Precedents (1995) Reissue, vol.3(2), Form 1 (Individual) at pp.15-17 and Form 5 (Company), at pp.24-28.

and collecting cheques on behalf of the customer.[29] This duty has also been held to apply, and to have been breached, when a lender failed to advise a customer, who had sought advice from the lender on a foreign currency transaction, to seek a hedging contract to protect himself (i.e., the customer) against fluctuations in currency values[30]; and when a lender failed to advise a borrower that it had reduced the borrower's overdraft limit, with the result that a cheque

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[29] Selangor United Rubber Estates Ltd. v. Cradock (No. 3) [1968] 1 W.L.R. 1555; Schioler v. Westminster Bank Ltd. [1970] 2 Q.B. 719, at p.726, per Mocatta J; Karak Rubber Co. Ltd. v. Burden [1972] 1 W.L.R. 602; Redmond v. Allied Irish Banks plc [1987] F.L.R. 307, at p.310-311, per Saville J. (as he then was); and Barclays Bank plc v. Quincecare Ltd. [1992] 4 All E.R. 363, at pp.375-376, per Steyn J. (as he then was). Cf. May L.J. in Lipkin Gorman v. Karpnale Ltd. [1989] 1 W.L.R. 1340, at pp.1355H-1356F, criticising both Ungoed-Thomas J. in Selangor United Rubber Estates, supra, at p.1591, and Brightman J. (as he then was) in Karak Rubber, supra, at pp.628-629, regarding the paying banker. The view of May L.J. was not challenged on appeal in Lipkin Gorman: see [1991] A.C. 548 (H.L.(E.)). The position in Germany is similar to Britain, as German banks "must use due diligence and care when handling the customer's affairs": see Horn, N., "The Bank/Customer Relationship In German and European Law" (1995) B.J.I.B.F.L. 116, at p.117. See also, generally, Ogilvie, M.H., "Banker and Customer Revisited" (1986) 65 Can. Bar Review (N.S.) 3, at p.29.

[30] See Lee J., in the unreported case of Fernyhough v. Westpac Banking Corpn., in the Federal Court of Australia, delivered on 18th November, 1991; there was also a successful cause of action in negligence, amongst other things.

was dishonoured, suppliers of the customer could not be paid, and, ultimately, the customer became insolvent.[31] Similarly, a bank has been held to be under a contractual duty to a customer to forward information to the customer when the bank knew that the customer was relying on the bank to do so *vis-a-vis* a proposed transaction the bank knew about.[32]

The remedy for a customer, in such situations, will be damages for breach of contract; there may also be delictual liability for breach of a duty of care.

In addition to this implied contractual duty, there is, in England, an implied statutory duty on the supplier "of a service acting in the

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[31] Raypath Resources Ltd. v. Toronto Dominion Bank (1995) 170 A.R. 81, in which there was also a successful action in negligence. See too another Canadian case: C.I.B.C. v. 3L Trucking Ltd. (1995) 176 A.R. 245, at pp.265-266, where it was held that the failure of a bank to explain fully to a customer the nature of a mortgage over her interest in the matrimonial home was a breach of the bank's implied duty of care under its contract with that customer. Cf. Barclays Bank plc v. O'Brien [1994] 1 A.C. 180, under English law, and Smith v. Bank of Scotland 1997 S.C. (H.L.) 111, under Scots law, in which the House of Lords extended the O'Brien principle to Scotland, on the basis of a duty of good faith, rather than constructive notice.

[32] Cunnington v. Barclay's Bank plc, unreported decision of Potter J, delivered on 3rd April, 1996 (Commercial Communication 58, The New Law Publishing Co.) Here, the bank was found to be in breach of its contractual duty, but the loss was considered too speculative.

course of business of reasonable skill and care"[33], breach of which sounds in damages; a bank would be a supplier of a service for these purposes.

(i) Wrongful Dishonour Of Cheques

Where a bank does not comply with its customer's instructions to pay a cheque (and there are sufficient funds in the customer's current account[34] to meet the cheque), the bank is in breach of the general banking contract, and the bank can be liable to pay damages for the customer's loss of credit or business reputation caused by the cheque's wrongful dishonour[35]. Damages are normally assessed on the basis of Hadley v. Baxendale[36], with a distinction being made in

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[33] S.13 of the Supply of Goods and Services Act 1982. This section of the Act does not apply to Scotland.

[34] It does not apply to a deposit account: see Gibb v. Lombard Bank Scotland Ltd. 1962 S.L.T. 288. This is consistent with a current account being on demand.

[35] See King v. British Linen (1899) 1 F. 928, at pp.932-933, per Lord McLaren; Joachimson v. Swiss Banking Corporation [1921] 3 K.B.110; Royal Bank of Scotland v. Skinner 1931 S.L.T. 381, at p.384, col 1, per Lord Mackay; Wilson v. United Counties Bank Ltd [1920] A.C. 102 (H.L.(E.)); Rae v. Yorkshire Bank plc [1988] F.L.R. 1; and Kpohraror v. Woolwich Building Society [1996] 4 All E.R. 119 (C.A.)

There may also be an action for defamation: see Paget's Law of Banking (1996) 11th ed. (by M. Hapgood Q.C.), at pp.337-339.

[36] (1854) 9 Exch. 341, [1843-60] All E.R. Rep. 461.

the old case law between trading and non-trading customers. The former could recover damages without proof of special damage, as the dishonour of a trader's cheques was "so obviously injurious to the credit of the trader"[37], whereas the latter could not.[38] However, in England, the Court of Appeal[39] has, very recently, decided that a non trader no longer needs to prove special damage, and can now recover more than just nominal damages.[40] This is the preferable view, as it means that recovery now depends on the loss the plaintiff has suffered, and is consistent with recovery of damages in contract, under Hadley v. Baxendale, which is concerned with the knowledge of the contract breaker.[41]

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[37] See Lord Birkenhead L.C. in Wilson v United Counties Bank Ltd [1920] AC 102, at p.112.

[38] See Laurence J. in Gibbons v. Westminster Bank Ltd [1939] 2 K.B. 882, at p.888. See too the discussion in Paget's Law of Banking (1996) 11th ed. (by M. Hapgood Q.C.), at p.337; and Wallace & McNeill's Banking Law (1991) 9th ed. (by D. Caskie), at p.11.

[39] See Kpohraror v. Woolwich Building Society [1996] 4 All E.R. 119. (C.A.); noted by Enonchong, N., "Contract Damages for Wrongful Dishonour of a Cheque" [1997] M.L.R. 412.

[40] There cannot be a claim for damages for injured feelings or mental distress as a result of the breach of contract by the lender: see McConville v. Barclays Bank plc [1993] 2 Banking Law Reports L.R. 211.

[41] See Koufos v. C. Czarnikow Ltd; the Heron II [1969] 1 A.C. 350, at p.388E, per Lord Reid; and Balfour Beatty Construction (Scotland) Ltd. v. Scottish Power plc

A similar approach to that of the Court of Appeal is taken under Roman-Dutch law, which says it is not necessary for a customer to allege that he was a business man or trader, but only that, in his occupation, credit was an essential element in the conduct of his business, and that this credit was harmed by the wrongful dishonour of the cheque. The customer is entitled to recover from the bank such patrimonial loss as was caused by the breach and was within the parties' contemplation.[42]

(ii) Wrongful Debiting of a Customer's Account

Where a bank wrongfully debits a customer's account (in breach of its mandate), then, strictly speaking, under English law, the customer's cause of action is one in debt - averments relating to breach of contract and breach of duty are not necessary[43]; however, it is submitted that a claim for breach of the implied contractual duty of reasonable skill and care could be brought.[44]

1994 S.C. 20, at p.29F-I, per Lord Jauncey. See the note on this case by Hood, P., "Remoteness of Damage in Contract Revisited: *Balfour Beatty v. Scottish Power*" (1996) 1 Edinburgh Law Review 127.

[42] First National Bank of South Africa Ltd. v. Budree 1996 S.A. 971.

[43] Staughton J. (as he then was) in Limpgrane v. Bank of Credit and Commerce International S.A. [1986] F.L.R. 36, at p.47. This was followed by Webster J. in National Bank of Commerce v. National Westminster Bank plc [1990] 2 Lloyd's Reports 514.

[44] Implicit support for this view can be found in the judgement of Webster J. in National Bank of Commerce v. National Westminster Bank plc, supra, at

The customer's claim is for the sum debited, plus interest (and any related overdraft charges). This may be important where money has been debited from one customer's account and issues of set-off arise, particularly in an insolvency[45]; also, in a claim for debt, as opposed to damages for breach of contract, the party suing is under no obligation to mitigate its loss.[46]

The position has not arisen in Scotland, but it is likely that, despite procedural differences from English law, such a case would be

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p.517, col. 1. However, a claim for mental distress cannot be brought: see McConville v. Barclays Bank plc [1993] 2 Banking L.R. 211.

[45] Staughton J. (as he then was) in Limpgrane v. Bank of Credit and Commerce International SA. supra, at pp.47 and 61. Cf. the Canadian case of Clansman Resources Ltd v. Toronto Dominion Bank (1992) W.W.R. 72 (B.C.C.A.). See too the Court of Appeal in Esso Petroleum Co Ltd v. Milton [1997] 1 W.L.R. 938, [1997] 2 All E.R. 593, where it was held (by majority) that: (i) a direct debit was the same as a cheque and should be treated as equivalent to cash; and (ii) under the English law of equitable set-off, a payment for goods or services by direct debit precluded a defence of set off. See the note on this case in "Banking and Insolvency Law" Section (1997) B.J.I.B.F.L. 91. Equitable set off does not exist in Scots law. Set-off, under Scots law, is governed by the Compensation Act 1592 c. 143: see Wilson, W.A., The Scottish Law of Debt (1991) 2nd edn., Ch.13, at pp.157-163, especially at p.159.

[46] See Jervis v. Harris [1996] 1 All E.R. 303, at pp.307j-308c.

characterised as a claim for the repayment of a debt, and the customer would bring an action for payment.[47]

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[47] See on this last point, regarding bringing an action for payment: Wilson, W.A., The Scottish Law of Debt (1991) 2nd edn., at para.11.3.

CHAPTER 3.

THE BANKER'S DUTY OF CONFIDENTIALITY

The most important duty arising out of the implied general banking contract is the obligation on the bank, which is not an absolute one, to keep its customer's financial affairs confidential.[1] In this chapter,

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[1] Tournier v. National Provincial and Union Bank of England [1924] 1 K.B. 461 (C.A.). For a discussion of the lender's duty of confidence: see Walter, J.McI., and Ehrlich, N., "Confidences - Bankers and Customers: Powers of Banks to Maintain Secrecy and Confidentiality" (1989) 63 A.L.J. 404; Paget's Law of Banking (1996) 11th edn. (by M. Hapgood Q.C.), at pp.120-129; and W. Fowler (with Scots Law noter up by I. Meiklejohn), "Great Britain": Ch. 13 in International Bank Secrecy (1992) (D. Campbell, ed.). See also McDougall, J.L., Q.C., "The Relationship of Confidence": Ch. 8 in Equity, Fiduciaries and Trusts 1993, Carswell, (Professor D. Waters Q.C., ed.). The duty of confidentiality could also be expressly set out in any written contract between the parties, although this is unlikely in a straight lending situation.

In France, banks are also under a duty of confidentiality, pursuant to art. 57 of the French Banking Act 1984. An unauthorised disclosure is a criminal offence under art. 378 of the Code Penal: see Moully, C., "France": Ch. 3 in European Banking Law: The Banker-Customer Relationship (1992) (R. Cranston, ed.), at p.43. See too on art. 57, the decision of the Court of Appeal of Versailles, 23rd March 1994, noted in, News Section, [1995] 11 J.I.B.L. N-226. Whilst in Germany, the duty of confidentiality arises from the express

the duty of confidentiality will be considered under four headings: (a) the nature and basis of the duty; (b) what is confidential information?; (c) the remedies a borrower has for breach of the duty of confidentiality; and (d) the four exceptions to confidentiality, including the important requirements now imposed upon bankers under the recent drug trafficking and money laundering legislation, the latter being introduced into the United Kingdom, pursuant to a European Union Directive on money laundering[2].

(a) The Nature and Basis of the Obligation of Confidentiality

The banker's obligation of confidentiality applies even when the customer's account has been closed, or where the banker obtains information about a former customer.[3] As well as being contractual, this duty of confidentiality may also be imposed by equity, under

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banking contract between the parties. Confidentiality is also protected by art. 2 para.1 of the German Federal Constitution. For a fuller discussion of Germany and France: see Lajoix, O., and Billau, M., "France": Ch. 10 in International Bank Secrecy (1992) (D. Campbell, ed.); and H. Jung, "Germany": Ch.11 in International Bank Secrecy, op. cit.

[2] EC Directive on money laundering: 91/308/EEC, O.J. 1991 L166/77. It is understood that consideration is being given to strengthening the provisions of this Directive: see "Calls for Tighter Money Laundering Regulations", Update Service Section (1997) B.J.I.B.F.L. 93.

[3] Tournier, supra, at pp.485-486, per Atkin L.J. (as he then was).

English law.[4] Scots law, too, has recognised a general duty of confidentiality, independent of any right of property or contract[5]. This duty, which has been described as being "in a nascent state"[6], is

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[4] See the speeches of Lord Keith of Kinkel, Lord Griffiths and Lord Goff of Chieveley in Attorney-General v. Guardian Newspapers Ltd. (No.2) ("Spycatcher") [1990] 1 A.C. 109, at pp.255D-E 268A-B and 281D-E, respectively (H.L.(E.)); Lord Denning M.R. in Seager v. Copydex [1967] 1 W.L.R. 923, at p.931; and the Court of Appeal, in Taylor v. Co-Operative Bank plc, an unreported decision, delivered on 18th May, 1994, in which the Court of Appeal, in England, reluctantly refused to strike out a claim regarding alleged breaches of confidentiality by a banker. See too the High Court of Australia in Moorgate Tobacco Co. Ltd. v. Phillip Morris Ltd. (1984) 56 C.L.R. 414, at p.438, per Deane J. (Mason, Wilson and Dawson JJ. agreeing).

[5] Both the Inner House (Second Division) and the House of Lords in Lord Advocate v. The Scotsman Publications Ltd. 1989 S.C. 122. In the Inner House: see Lord Justice-Clerk (Ross), at pp.141-143, Lord Dunpark, at pp.151-152, and Lord MacDonald, at p.160. In the House of Lords: see Lord Keith of Kinkel, at p.164, with whom Lords Griffith and Goff of Chieveley agreed. Lord Jauncey of Tullichettle, at p.171, did not disagree with Lord Keith. Lord Templeman, in a separate speech, did not deal with the issue. See also Lord Coulsfield, in the Outer House, supra, at p.134, and the decisions of Lord Robertson, in the Outer House, in Levin v. Caledonian Produce 1975 S.L.T.(N) 69 and Roxburgh v. Seven Seas Engineering 1980 S.L.T.(N) 49. See further: MacQueen, H.L., "Breach of Confidence", in the Stair Memorial Encyclopaedia, Vol. 18, at paras.1451ff, and the Scottish Law Commission, "Breach of Confidence" (S.L.C. No. 90), in Part II.

to the same effect as that under English law.[7] Consequently, although "the juridical basis" of the duty of confidentiality in Scotland is different from that in England[8], Scottish courts have indicated it is permissible to refer to English authority for guidance.[9]

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[6] MacQueen, H.L., "Breach of Confidence", in the Stair Memorial Encyclopaedia Vol. 18, at para.1451.

[7] In William Morton & Co. v. Muir Brothers & Co. 1907 S.C. 1221, at p.1224, Lord MacLaren - in a passage approved by the Lord Justice Clerk (Ross) in Lord Advocate v. The Scotsman Publications Ltd. 1989 S.C. 122, at p.142 - said that, in relation to confidentiality and restraining third parties, "I have no doubt the law of England is to the same effect as our own. Indeed the laws could not well be different". See further Lord Keith in Lord Advocate v. The Scotsman Publications Ltd. 1989 S.C. 122, at p.164, approving the Second Division, who "having considered such authorities upon the law of confidentiality as existed in the Scottish *corpus juris*, came to the conclusion that Scots law in this field was the same as that of England . . . ", a conclusion his Lordship regarded as "undoubtedly correct."

See also: MacQueen, H.L., "Breach of Confidence", supra, at para.1451; and the Scottish Law Commission Paper, "Breach of Confidence" (S.L.C. No. 90), in Part II, at para.2.2.

[8] Per Lord Keith in Lord Advocate v. The Scotsman Publications Ltd, supra, at p.164, who said, "[w]hilst the juridical basis may differ to some extent in the two jurisdictions, the substance of the law in both of them is the same".

[9] See, for example, Lord Advocate v. The Scotsman Publications, supra.

The existence of an obligation of confidentiality, outside of contract, is important for prospective customers of a bank who disclose confidential information to the bank, either: (i) prior to their becoming a customer and opening an account, or (ii) if they decide not to open an account. This is because any confidential information imported by the prospective customer to the bank, in this preliminary stage, cannot be subsequently disclosed by the bank. Also, if the duty of confidentiality is confined only to contract (i.e., between the banker and its customer), it "may not extend to third parties who are not privy to the contract", but who receive confidential information about the customer[10]. The importance of the banker's obligation of confidentiality was recently re-affirmed by the Jack Committee Report on Banking Services, which opposed further erosion of it.[11]

(b) <u>When Is Information Confidential?</u>

Information will be considered confidential if three criteria are satisfied[12]:

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[10] See Walter, I., and Ehrlich, N., "Confidences - Bankers and Customers: Powers of Banks to Maintain Secrecy and Confidentiality" (1989) 63 A.L.J. 404, at pp.407-408, and McDougall, J.L., Q.C., "The Relationship of Confidence": Ch.8 in Equity, Fiduciaries and Trusts 1993, at p.159.

[11] The Jack Report, Cmnd. 622, Feb, 1989, at paras.5.08 and 5.26-5.27.

[12] Coco v. A.N. Clark (Engineers) Ltd. [1969] R.P.C. 41, at p.47, per Megarry J. (as he then was), cited with approval by Lord Griffiths in Spycatcher [1990] 1 A.C. 109, at p.268 B-C. This tri-partite test was approved by the Supreme Court of

(i) the information must be confidential in nature (i.e., not in the public domain);
(ii) the circumstances of the transfer of the information are such that the recipient is under a duty of confidence; and
(iii) the information has been used for a purpose other than that for which it was intended.

In the Spycatcher case, Lord Goff of Chieveley put the matter thus[13]:

> "I start with the broad general principle (which I do not intend in any way to be definitive) that a duty of confidence arises when confidential information comes to the knowledge of a person (the confidant) in circumstances where he has notice, or is held to have agreed, that the information is confidential, with the effect that it would be just in all the circumstances that he should be precluded from disclosing the information to others."

Canada in the important case of LAC Minerals Ltd. v. International Corona Resources Ltd. (1989) 61 D.L.R. (4th) 14, and by the High Court of Australia in Hospital Products Ltd. v. United States Surgical Corp. (1984) 156 C.L.R. 41. See also Sir Robert Megarry V.C. in both Thomas Marshall (Exports) Ltd. v. Guinle [1979] 1 Ch. 227, at p.248E-G, and Malone v. Metropolitan Police Commissioner [1979] Ch. 344, at p.375, and Lord Greene M.R. in Saltman Engineering Co. v. Campbell Engineering Co. (1948) 65 R.P.C. 203, at p.211 (C.A.).

[13][1990] 1 A.C. 109, at p.281B (H.L.(E.)). For a discussion of Spycatcher: see Jones, G.H., "Breach of Confidence - after *Spycatcher* " (1989) C.L.P. 49, and Goff, Lord of Chieveley and Jones, G.H., The Law of Restitution (1993) 4th edn., (by G. H. Jones), at pp.683-686.

To this broad principle, Lord Goff applied three limiting factors, which prevented information from being confidential: (i) that the information is in the public domain; or (ii) that the information is useless or is trivia; or (iii) that a public interest in disclosure outweighs the public interest in keeping it confidential. This third factor will be discussed later[14]. His Lordship left open the question whether detriment is required for a breach of confidence action.[15]

Although Lord Goff's principle does not actually define what confidential information is, in most instances, it will be fairly clear to a banker that information about a customer, or a customer's account, is confidential, and should not be disclosed to a third party, without the customer's consent. Furthermore, any third party recipient will be under a duty of confidence in relation to any such information it has received[16]; this third party may include a bank. For example, in a hostile takeover, the predator, using an inside informant in the target, may obtain confidential information (e.g., documents) about the target which is disclosed to its bank. If the bank acts on this information, or, if documents, distributes them to other financial

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[14] See the discussion of the second exception in Tournier v. National Provincial and Union Bank of England [1924] 1 K.B. 461, at p.473, per Bankes L.J., later in the text.

[15] [1990] 1 A.C. 109, at pp.281-282. See also Megarry J. (as he then was) in Coco v. A.N. Clark (Engineers) Ltd. [1969] R.P.C. 41, at p.48, and Lord Keith of Kinkel in Spycatcher, supra, at pp.255ff.

[16] Spycatcher, supra, and Lord Advocate v. The Scotsman Publications, supra.

institutions which have an interest in the bid, then the bank is in breach of confidence, and can be liable in damages and/or be restrained from using the information by an interdict or injunction[17].

(c) Remedies For Breach : Damages and/or Interdict/Injunction

(i) Damages

If a bank, via its employees, breaches its duty of confidentiality to a customer, by wrongfully disclosing information about that customer, the bank will be liable to the customer in damages for breach of contract; alternatively, there may be a claim, in equity, under English law, for equitable compensation[18]; or, there may be a claim, under

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17 For example, in the recent failed bid by Galileo Ltd. for Co-operative Wholesale Society ("Co-op"), a "mole" in the Co-op disclosed confidential documents to Galileo, who sent them to its merchant bank, which disseminated the documents to certain other City institutions, in breach of confidence.

18 Such a claim would be brought where the matter would not come within s.2 of the Lord Cairns Act (the Chancery Amendment Act 1858), because there are no grounds for an injunction, as the event has happened, and, thus, damages could not be awarded in addition to, or in lieu of, an injunction. For a discussion of compensation in equity: see the chapter in this thesis on Lenders as Fiduciaries, and see Capper, D., "Damages for breach of the equitable duty of confidence" (1994) Vol. 14 Legal Studies 313. This remedy has no equivalent in Scots law. Hence, care must be taken in following English authorities too closely on breach of confidence: see MacQueen, Stair Memorial Encyclopaedia, supra, at para.1489.

Scots law, where there is no contract, for damages to be assessed on the same principles as breach of statutory duty.[19]

The measure of damages for breach of the contractual duty of confidence will be the loss suffered due to the breach, and they will be assessed according to the ordinary principles of contractual damages.[20] However, the quantification of damages will be difficult, as there are many possible consequences of a breach. Some consequences will be financial, such as the loss of a business deal, because a corporate customer's finances are not perceived as being as sound as they were thought to be.[21] In such a situation, the

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[19] See the Scottish Law Commission, "Breach of Confidence", supra, at para.4.91.

[20] See later, the chapter in this thesis on Damages For Breach of Contract. A claim may also be brought in defamation against the bank, but is unlikely to be successful, due to the defence of qualified privilege and the likely absence of malice.

[21] Moreover, it is not unimaginable that, in the case of a corporate customer, the wrongful disclosure of a financial information may affect its share price and make the company susceptible to a take-over. The difficulty will be for the target company (which is the customer), to prove and quantify any loss it has suffered - as opposed to its directors, all or some of whom may be replaced by a new board, but who will have a service contract with the company under which they will be compensated. Moreover, the target's shareholders will, generally, be happy, as share prices, normally, increase during a takeover

customer is looking at damages for the loss of a chance,[22] particularly where the information disclosed by the bank, in breach of its duty of confidence, was incorrect and the third party would have contracted with the customer if it had known the true position.[23] Other consequences may be non-financial, such as embarrassment, or a loss of personal standing, or unwanted publicity. In some cases, damages have been awarded on the basis of the market value of the information[24]. The difficulty with this measure of damage, in a banking case, is that it may be hard to attribute a "market value" to information about a customer's account - especially an individual, who is not a newsworthy person; but, at the very least, a customer should receive nominal damages. If the customer was the target in a take-over, and the bank disclosed confidential information about the customer to the predator or a third party, this information will have a market value - albeit an illegal one (which means that it could not legally be disseminated to interested parties or the public-at-large).

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bid. One type of loss will be the expenses incured in fighting the takeover; this will be relevant if the takeover bid is unsuccessful.

[22] There must be a substantial, and not merely speculative, loss of a chance: see the discussion on this topic in Chapter 6 "Bank Liability For Negligence".

[23] An action may also lie for negligence.

[24] See Seager v Copydex (No. 2) [1969] 1 W.L.R. 809, and Levin v Caledonian Produce (Holdings) Ltd. 1975 S.L.T.(N.) 69, at pp.70-71, per Lord Robertson.

A banker will also want to be careful that he does not breach the insider dealing legislation.[25]

(ii) Interdict/Injunction

If confidential information has not yet been disclosed by a bank, but is likely to be disclosed, a customer may seek to restrain the bank from disclosing the information by applying for an interim interdict in Scotland, or an interlocutory injunction in England[26]. Alternatively, there may be an application for an interdict or injunction, where confidential information, e.g., documents, has been disclosed, seeking to prevent their use and requiring that the documents be returned to their rightful owner. An example of this arose recently, in England, concerning the proposed hostile take-over by Galileo Ltd. for the Co-operative Wholesale Society ("Co-op"), when a senior employee of the Co-op disclosed confidential financial information about the Co-op to Galileo. This information was passed on to Galileo's merchant bank, who proceeded to distribute it to other City institutions, clearly in breach of confidence. An injunction was granted by Lightman J., preventing the information being used.

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[25] See Part V of the Criminal Justice Act 1993.

[26] See, for example, the English cases of: XAG v. A Bank [1983] 2 All E.R. 464; A v. B Bank (Bank of England intervening) [1993] Q.B. 311 (where the injunction was varied to allow disclosure to the Bank of England), and El Jawhary v. Bank of Credit and Commerce International S.A. [1993] B.C.L.C. 396. Subject to the different principles that apply to interdicts, as opposed to injunctions, the position would be the same under Scots law.

Consequently, the take-over bid failed, and Galileo went into liquidation. The merchant bank and Galileo's legal advisers gave apologies and made a payment to the Co-op, thought to be £1 million[27].

Interdicts Under Scots Law

Under Scots law, an application for an interim interdict is governed by the principles laid down by Lord Fraser of Tullybelton, in N W L Ltd. v. Woods[28], who said, obiter:[29]

> "[T]he court is in use to have regard to the relative strength of the cases put forward in averment and argument by each party at the interlocutory stage as one of the many factors that may go to make up the balance of convenience. Whether the likelihood of success could be

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27 Jones, A., "Regan legal advisers may still face challenge", *The Times,* 5th May, 1997, at p.45.

28 [1979] 1 W.L.R. 1294, at p.1310. See also Rule 60 of the Court of Session 1994, and s.47 (1) of the Court of Session Act 1988. See too: para.60.3.2 of the vol. 2 of Parliament House Handbook.

29 See too: Cunningham v. The Scotsman Publications Ltd. 1987 S.L.T. 698, at p.706 K, per Lord Clyde; Toynar Ltd. v. Whitbread & Co. Ltd. 1988 S.L.T. 433, at p.434-435, per the Lord Justice-Clerk (Ross); and W.A.C. Ltd v. Whillock 1989 S.C. 397, at p.410, per the Lord Justice-Clerk (Ross), giving the judgement of the Second Division, who referred to "reasonable prospects of establishing a right to interdict" and the court forming "a *prima facie* view of the arguments and the pleadings as they stand".

regarded as one of the elements of the balance of convenience, or as a separate matter, seems to me an academic question of no real importance, but my inclination is in favour of the former alternative. It seems to make good sense; if the pursuer or petitioner appears very likely to succeed at the end of the day, it will tend to be convenient to grant interim interdict and thus prevent the defender or respondent from infringing his rights, but if the defender or respondent appears very likely to succeed at the end of the day, it will tend to be convenient to refuse interim interdict because an interim interdict would probably only delay the exercise of the defender's legal activities."

Injunctions Under English Law

In England, the position is set out in the speech of Lord Diplock in American Cynamid Co. v. Ethicon Ltd.[30], who said that there, first, has to be a serious question to be tried, and, then, the court looks at the balance of convenience in deciding whether to grant an interlocutory injunction.[31]

(d) Tournier and Exceptions To Duty of Confidentiality

As mentioned above, the duty of confidentiality is not absolute. Thus, a banker will be excused his disclosure if the circumstances in which it was made fall within one or more of the four following well-

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[30] [1975] A.C. 396, at pp.406-408, especially at p.408A-B.

[31] With the usual cross-undertaking as to damages, if the plaintiff's case is unsuccessful at trial.

known exceptions, set out in the judgement of Bankes L.J. in Tournier v. National Provincial and Union Bank of England[32]:

(1) where there is a duty under compulsion of law;

(2) where there is a public duty to disclose;

(3) where the interests of the lender require it; or

(4) where disclosure is made with the express or implied consent of the customer.

The Jack Committee on Banking Services observed that there has been a "massive erosion of the principle of confidentiality", due, in particular, to legislative intervention under the first exception.[33] They feared that if there was too much erosion, this would affect confidence in the banking system.[34]

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[32] [1924] 1 K.B. 461, at p.473, per Bankes L.J., a case approved by the Privy Council in Robertson v. Canadian Imperial Banking Corpn. [1994] 1 W.L.R. 1493 (on appeal from the East Caribbean Court of Appeal). The Jack Committee recommended that the exceptions in Tournier's case - apart from the second exception, which it wanted to abolish - should be made statutory: see Cmnd. 622, Feb, 1989, at paras.5.29-5.39ff. This did not happen, but the four exceptions have been set out in the code for lenders on banking practice, concerning personal customers: see The Banking Code (1997) 3rd edn., at para.4.1.

[33] Cmnd. 622, Feb, 1989, at paras.5.34 and 5.07.

[34] Cmnd. 622, Feb, 1989, at paras.5.26-5.27.

(1) Compulsion of Law

This first exception to the banker's duty of confidentiality will usually arise where a court order or a statute requires a banker to disclose information about a customer.[35] A banker's duty of confidentiality "is subject to, and overridden by, the duty of any party to a contract [in this case, the implied banker/customer contract] to comply with the law of the land. If it is the duty of such a party to a contract, whether at common law or under statute, to disclose in defined circumstances confidential information, then he must do so, and any . . . contract to the contrary will be illegal and void."[36] It is for this reason, that a banker's "duty of confidence is subject to . . . [an] overriding duty . . . at common law to disclose and answer questions as to his customer's affairs when he is asked to give evidence on them in the witness box in a court of law".[37] Nonetheless, the courts have acknowledged that "it is a strong thing

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[35] See Paget's Law of Banking (1996) 11th edn. (by M. Hapgood Q.C.), at p.121.

[36] Per Diplock L.J. (as he then was) in Parry-Jones v. Law Society of England and Wales [1969] 1 Ch. 1, at p.9; this case concerned a solicitor's duty of confidence and professional privilege. The dictum of Diplock L.J., quoted in the text, was applied in a banking case by Hirst J. (as he then was): see A v. B Bank [1993] Q.B. 311, at pp.322H-323B.

[37] Per Diplock L.J. in Parry-Jones v. Law Society of England and Wales [1969] 1 Ch. 1, at p.9.

to order a bank to disclose the state of its customer's accounts and the documents and correspondence relating to it".[38]

The quantity of legislation under which a banker is required to compromise his duty of confidentiality is considerable. The Jack Committee on Banking Services, in 1989, listed nineteen such pieces of legislation[39], and the number has increased since then[40]. In the discussion which follows, not every piece of legislation will be looked at; rather, the focus will be on recent and important developments in this area.[41]

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[38] Per Lord Denning M.R. in Bankers Trust Company v. Shapira [1980] 1 W.L.R. 1274, at p.1274, a case involving fraud.

[39] Cmnd. 622, Feb, 1989, at para.5.07 and Appendix Q. Examples include: ss.455(1), 633(3) and 721(1) of the Companies Act 1985; s.39 of the Banking Act 1987; and s.7 of the Bankers Book Evidence Act 1879 (as amended). The Jack Committee referred to the "torrent of new legislation [in the last two decades], which has become a spate in the past four years, requiring or permitting bankers, in a wide range of specified situations, to disclose confidential information in the public interest".

[40] Recent instances include legislation relating to money laundering and drug trafficking: see the Criminal Justice Act 1993, Drug Trafficking Act 1994 and Criminal Justice (Consolidation) (Scotland) Act 1995, for example.

[41] For a summary of the effect of most of the legislation: see W. Fowler (with Scots law noter up by I. Meiklejohn), "Great Britain" : Ch.13 in International Bank Secrecy (1992) (D. Campbell, ed.); and Cresswell, Blair, Hill & Wood,

(a) Subpoenas For Bankers Under English Law

As a result of the compulsion of law exception, bankers can, under English law, be subpoenaed[42], to give evidence in court and bring with them all the documents (including computer records)[43] in their

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Encyclopaedia of Banking Law at C(93)-(98.12). It is beyond the scope of this thesis to look at each piece of legislation individually.

[42] This is a *subpoena duces tecum*, which requires the recipient to attend court and bring with him all papers relevant to the matter in issue. There is no direct equivalent in Scots Law, although there can be a citation of a witness, including a haver (i.e., a person who is in possession of a document) under Rule 36.2 of the Rules of the Court of Session 1994. There can also be a commission and diligence for the recovery of documents: see s.1 of the Administration of Justice (Scotland) Act 1972, and Rules 35.2-35.8 of the Rules of The Court of Session 1994. Such documents can include bankers' books, "although it is often possible to agree excerpts with the bank and the opponent": see vol.2 of the Parliament House Handbook, at para.35.2.16. By agreeing excerpts, this overcomes the problem of disclosing too much information, as might occur under the English procedure with a *subpoena duces tecum*. Production of documents can also be ordered in the Sheriff Court: see Ordinary Cause Rules 1993, made under the Sheriff Courts (Scotland) Act 1907, especially Rules 28.2 (commission and diligence), 28.3 (optional procedure) and 28.8 (confidentiality) and see also s.81 (optional procedure). In addition, there can be citation of witnesses: see Rules 28.15 and 29.7.

[43] Computer records are subject to the Bankers' Books Evidence Act 1879 (as amended): see Bridge L.J. (as he then was) in Baker v. Wilson [1980] 1 W.L.R.

possession relating to their customer.[44] An example of this would be where a plaintiff lends the defendant money for the purpose of repaying a debt to a third party, and the defendant subsequently denies the loan. The plaintiff tries to prove his claim, indirectly, by showing that a sum of money equivalent to the amount of the loan was received by the third party from the defendant. In order to do this, the plaintiff subpoenas the third party's banker to give evidence, in court, on the plaintiff's behalf, and to bring with him the third party's bank statements.[45] In such a case, the banker is compelled to give evidence, and, thus, breach his duty of

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884, at p.887, and Algudah, F., "Banks' Duty of Confidentiality in the Wake of Computerised Banking" [1995] J.I.B.L. 50, at p.52.

[44] See also ss.3 and 7 of the Bankers' Books Evidence Act 1879 (as amended), which, respectively, provide for: (i) the proof of the contents of a banker's books without the banker being compelled to give evidence as a witness, and (ii) for an inspection order in relation to the banker's book. This Act applies in Scotland, although ss.3-5 do not apply in civil proceedings by virtue of s.6 of the Civil Evidence (Scotland) Act 1988. See also s.5 of the 1988, regarding the receipt of certified documents into evidence. See too MacSporran, A., and Young, A.R.W., Commission and Diligence (1995), at paras.158-160, on p.15.

[45] See Robertson v. Canadian Imperial Bank of Commerce [1994] 1 W.L.R. 1493 (P.C.), on appeal from the Eastern Caribbean Court of Appeal. Normally, the third party would be called to give evidence. Where the third party has died, or cannot be contacted, the evidence of the bank will be very important.

confidentiality.[46] However, prior to giving evidence, the banker should use his "best endeavours" to inform the customer of the subpoena (or any other court order)[47], which is something that the reasonable customer would expect, "as a matter of courtesy and good business practice"[48]. The banker will not be required to inform the customer of the subpoena where: (i) there is a public duty on the banker not to inform, such as where there is a criminal investigation into the customer[49], or (ii) the bank is entitled, in its own interests, not to do so.[50] Nonetheless, three questions remain open:

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[46] Per Lord Nolan, delivering the Judicial Committee's advice, in Robertson v. Canadian Imperial Bank of Commerce [1994] 1 W.L.R. 1493, at p.1498G.

[47] Per Lord Nolan in Robertson, supra, at pp.1498-1499A.

[48] Robertson, supra, at p.1498H.

[49] Robertson, supra, at p.1499A-B.

[50] See Lord Donaldson M.R. in Barclays Bank plc v. Taylor [1989] 1 W.L.R. 1066, at p.1074 G-H, speaking in the context of an order under s.9(1) of the Police and Criminal Evidence Act 1984 (which does not apply in Scotland). Croom-Johnson L.J., at p.1076, did not believe the bank had breached its duty of confidentiality by not informing the customer of the order. See the note on this case by Wadsley J., "Banks' Confidentiality: A Much Reduced Duty" (1990) 106 L.Q.R. 204. In Scotland: see s.38 of the Criminal Justice (Scotland) Act 1987, which allows a Sheriff, on an application by the Procurator Fiscal, to make an order for the production of material connected with drug trafficking investigations.

(i) Whether the banker, when he has been unable to contact his customer, is under an obligation to inform the court of this, and inform the court that the documentation he has with him goes beyond the matter in issue?

The acknowledged difficulty with the first part of this question is formulating an appropriate implied contractual term or duty of care by which the bank will be bound.[51] However, as to the second part of the question, it is submitted that there is a duty on the counsel for the party calling the banker, as an officer of the court, to conduct his examination in such a way that the evidence given by the banker is germane only to the issue which the banker has been called to help prove; failing that, the trial judge should seek to limit the ambit of the evidence given, both oral and documentary, to matters which are relevant, as not all the information in the documentation that the banker has brought with him will be relevant, and the banker will need to preserve his obligation of confidentiality for those matters not the subject of the proceedings in question.[52]

(ii) Whether a banker could be required, either under an implied contractual term or under a duty of care in negligence, to first obtain the customer's consent to disclosure of his (the customer's) account?

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[51] See Lord Nolan in Robertson, supra, at pp.1499-1500, who side-stepped the issue by holding that the disclosure, without the customer's consent, had not caused the customer loss. In Robertson, it was revealed that the customer's account was overdrawn.

[52] This is implicit in Robertson, supra, at p.1499H.

Whilst the English courts have not ruled out the possibility that, in appropriate circumstances, the bank may be under an obligation to obtain such consent[53], it is suggested that, as a general rule, this is impracticable, as a situation may arise in which the banker has been subpoenaed and attends court, having informed the customer of the subpoena and sought the customer's consent to disclosure, but where the customer has refused to give his consent to the disclosure of his bank records. In such a situation, the appropriate procedure would be for the court to make an order compelling the banker to give evidence relevant to the issues in dispute[54]; the banker would need to inform the court of the position concerning his customer. However, if the banker refused to give evidence in court, he would be in contempt of court.

(iii) Whether the normal immunity from legal action applying to witnesses in court cases would apply to a banker subpoenaed to give evidence?[55]

It is submitted that, under English law, the immunity would apply, as the banker has been compelled to give evidence and would be in contempt of court if he refused to do so. Hence, no action for breach

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[53] Robertson, supra, at pp.1495H-1496A, and 1500A-B, per Lord Nolan.

[54] A similar view is expressed by Obank, R., "Banker-Customer Confidentiality in the 90's" (1995) B.J.I.B.F.L. 113.

[55] Robertson, supra, at p.1500, per Lord Nolan, who said that the question was not necessary for the decision in this case, and should wait until an apposite case arose.

of confidence would lie. In Scotland, the general rule is that "information disclosed in open court is not confidential".[56] Thus, if a banker was cited as a witness, he would not be liable for breach of confidence, as the information disclosed in court would not be confidential - it would be a matter of public record.

(b) Discovery/Production of Documents in England

In England, it has been held that an order for discovery of documents, under the Rules of the Supreme Court[57], prior to a trial, is something that must be complied with, and a customer cannot seek to restrain a party to litigation - in that case, an intervener - from complying with an order for discovery.[58] Interestingly, in the case in

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[56] MacQueen, H.L., "Breach of Confidence", Stair Memorial Encyclopaedia, Vol. 18, at para.1474.

[57] R.S.C. Ord. 24. In Scotland, there is no equivalent of discovery in the English sense. There may, however, be a commission and diligence, for recovery of documents, under s.1 of the Administration of Justice (Scotland) Act 1972 and Rule 35.2 of Rules of the Court of Session 1994. See too: Rule 35.3 (Optional Procedure) and Rule 35.4 (Execution of commission and diligence for recovery of documents).

[58] Adham v. Bank of Credit and Commerce International S.A. (No 2) [1995] 2 B.C.L.C. 581, at p.583b, per Evans-Lombe J. This supports the view of Sir Donald Nicholls V.C. (as he then was) in an earlier interlocutory application in the same series of applications: see El Jawhary v. Bank of Credit and Commerce International S.A. [1993] B.C.L.C. 396, at p.400. The position is similar in France:

issue, the judge said there was no obligation on the party required to make disclosure to inform the customer that information had been passed to a third party;[59] this view is hard to support in the light of the dicta from Robertson's case[60], concerning disclosure to the customer.

(c) Commission and Diligence in Scotland

Unlike England, Scotland does not have a formal discovery process. If a party ("P") involved in litigation wishes to obtain a document, which it believes is relevant to proving a matter in dispute, then P may seek to recover the document by way of the procedure called commission and diligence.[61] P does this by way of a motion with specification of the document, or documents, sought. If the motion is granted, then a hearing takes place before a commissioner (who, in Court of Session proceedings, is an advocate), prior to the proof before answer being heard by the Lord Ordinary. The onus of persuasion lies on P to show that a commission and diligence should

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see the decision of the Cour de Cassation in Banque Nationale de Paris S.A. v. Guy Freehin 1990 European Commercial Cases 141.

59 [1995] 2 B.C.L.C. 581, at p.584, saying that this was not inconsistent with Robertson, supra, which, it was said, had left this question open.

60 [1994] 1 W.L.R. 1493, at p.1499.

61 See s.1 of the Administration of Justice (Scotland) Act 1972 and Rule 35.2 of the Rules of The Court of Session 1994.

be allowed.[62] If P's motion is refused, he has a right of appeal with the leave of the Lord Ordinary hearing the proof or proof before answer.[63] Where a party claims confidentiality in relation to the document being sought by P, the document is put in a separate packet, and the party disputing production can be heard on this issue.[64] It is unlikely, though, that a banker would not be required to disclose such documentation.[65]

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[62] Civil Service Building Society v. MacDougall 1988 S.C. 58, at pp.61-62, per Lord Justice-Clerk (Ross), delivering the opinion of the court.

[63] See Rule 35.3(5) of the Rules of the Court of Session 1994.

[64] See Rule 35.8 of the Rules of the Court of Session 1994. See too the optional procedure in Rule 35.3. For a discussion of this procedure: see vol.2 of the Parliament House Handbook, at paras.35.2.2.ff. Production of documents can also be ordered in the Sheriff Court: see the Ordinary Cause Rules 1993, made under the Sheriff Courts (Scotland) Act 1907, especially Rules 28.2 (commission and diligence), 28.3 (optional procedure) and 28.8 (confidentiality).

[65] See vol. 2 of the Parliament House Handbook, at paras.35.2.7 and 35.2.16.

(d) Drug Trafficking and Money Laundering Legislation

The recent legislation on drug trafficking and money laundering[66] has important implications for bankers, generally, as well as for their

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66 The legislation, for the purposes of the above discussion, comprises the following Acts of Parliament:

(i) Criminal Justice Act 1993 ("CJA'93") - this applies to both England and Scotland, and is concerned with money laundering not related to drug trafficking, but other crime, e.g., robbery. It amends the Criminal Justice Act 1988 ("CJA'88"), by inserting new ss.93A-93D; see also the new s.93E which applies ss.93A-93D in Scotland.

(ii) Drug Trafficking Act 1994 ("DTA") - this now applies to England only. It repeals the Drug Trafficking Act 1986, and introduces more comprehensive legislation regarding drug trafficking and the proceeds of drug trafficking. This Act no longer applies in Scotland.

(iii) Criminal Law (Consolidation) (Scotland) Act 1995 ("the 1995 Act") - this introduces similar provisions to the DTA for Scotland.

The above legislation, which was rather ad hoc in its implementation, was introduced pursuant to the EC Directive on Money Laundering: 91/308/EEC, O.J. 1991 L166/77. For a discussion of this directive: see Parlour, R., "Money Laundering in the New Europe" [1993] J.I.B.L. 435; and Cole, M., "Money Laundering" [1993] J.I.B.L. 129.

Other legislation affecting bankers, but which are not referred to in the discussion in the text, include: (i) Criminal Justice (International Co-

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obligation of confidentiality, because the legislation reverses the banker's obligation of confidentiality for offences concerning money laundering and drug-trafficking. A banker now faces criminal liability for non-disclosure to the authorities of the affairs of customers which are suspicious; but, the banker is excused civil liability for any disclosure made to the authorities[67]; in addition, this obligation of disclosure may be an on-going one[68], which does not stop after an initial disclosure by the banker to the "appropriate person".[69]

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operation) Act 1990 (as amended); and (ii) Northern Ireland (Emergency Provisions) Act 1991(as amended). NB Proceeds of Crime (Scotland) Act 1995, and Proceeds of Crime Act 1995.

[67] On the question of relief from civil liability for disclosure: see (i) 1995 Act ss.37(5)(a), 38(3)(a) and 39(4); (ii) DTA: ss.50(3)(a), 51(5)(a) and 52(4)(b); and (iii) CJA' 88: ss.93 (3)(a) and 93B(5)(a).

[68] Bosworth-Davies, R., "Current Problems For Practitioners In Money Laundering", paper delivered at Current Legal Issues in Banking, a seminar run by Hawkesmere plc, on 6th December, 1995, London ("Bosworth-Davies"), at p.6 of the seminar paper.

[69] This will normally be the Money Laundering Reporting Officer in the bank, who will then decide whether he should report the matter to the police, customs and excuse or National Criminal Intelligence Surveillance Unit: see The Money Laundering Regulations (S.I. 1933 of 1993), reg.14.

It is beyond the scope of this chapter to provide a detailed analysis of the legislation[70], which creates five types of money laundering offences: (i) "Own Funds" money laundering; (ii) assisting another to obtain the benefits of crime; (iii) failing to disclose knowledge or a suspicion of money laundering; (iv) acquiring or using or possessing property that represents the proceeds of crime; and (v) "tipping off"[71]. However, the aim of the legislation, amongst other things, is to prevent the proceeds of drug-trafficking and other criminal activity, such as, robbery[72], or extortion, or funds connected with terrorism, being filtered through the banking system, for the benefit of the criminal concerned. To counter-act this (as well as creating offences in relation to the prime culprits), a system of reporting has been introduced, which requires bankers to disclose their knowledge, or

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70 For a fuller discussion of the legislation: see (i) in Scotland: Brown, A.N., Proceeds of Crime: Money Laundering, Confisication and Forfeiture (1996); and (ii) in England: Bosworth-Davies; McCormack, G., "Money laundering and banking secrecy" (1995) 16 The Company Lawyer 5; Radman, G., Bhattachayya, G., and Laddie, M., "Money laundering prevention - effect of the new law on solicitors" (1995) 16 The Company Lawyer 155; Bosworth-Davies, R., "CJA 1993 - money laundering" (1994) 15 The Company Lawyer 56; and Haynes, A., "Recent Developments in Money Laundering Legislation in the United Kingdom" [1994] J.I.B.L. 58. The offences are basically the same in both jurisdictions.

71 Brown, A.N., Proceeds of Crime: Money Laundering, Confiscation and Forfeiture (1996), at p.14.

72 Bosworth-Davies, supra, at p.7.

their knowledge or suspicion[73], of drug-trafficking and/or money laundering to the authorities[74]. If the banker fails under the legislation to do so, or assists a suspicious customer, the banker commits an offence under the legislation.[75] For example, a banker, who takes a deposit from a suspicious customer, knowing he is dealing with drug money, could be liable for an offence of knowingly acquiring or possessing, directly or indirectly, the proceeds, either in whole or in part, of another's drug trafficking, or for knowingly using such proceeds, if the banker lent the money out to another customer[76]. Also, subject to the defence of paying adequate consideration[77], the purchasing of foreign currency by a banker from

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[73] This varies from offence to offence: see: (i) "knowledge": s.37 of the 1995 Act, s.51 of the DTA, and s.93B of CJA'88; and (ii) "know or suspect": ss.36, 38-40 of the 1995 Act, ss.49, 50, 52, 53, 58 of the DTA, and ss.93A, 93C, and 93D of the CJA'88.

[74] Where a banker has suspicions about a customer concerning money laundering, the appropriate authority will be the Money Laundering Reporting Officer in the bank, who will disclose those suspicions to the police, or customs and excise or the National Criminal Intelligence Surveillance Unit. The Money Laundering Reporting Officer is appointed under reg.14 of The Money Laundering Regulations 1993 (S.I. 1933 of 1993).

[75] S.39 of the 1995 Act and s.52 of the DTA.

[76] S.37(1) of the 1995 Act, and s.51(1) of the DTA. See also s.38 of the 1995 Act and S.50 of the DTA.

a customer, who is seeking to convert a foreign currency (representing the proceeds of drug trafficking) to pounds sterling, could constitute an offence, as amounting to an acquisition of such proceeds of crime[78]; a similar offence is created under the money laundering legislation.[79]

The drug trafficking legislation can also impose liability on a banker where he knows, or merely suspects, that another person ("A") is involved with, or has benefited (financially) from, drug trafficking, and the banker becomes involved with an arrangement whereby: (a)

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[77] Ss.37(2) and (3) of the 1995 Act, and ss.51(2) and (3) of the DTA, which apply regardless of knowledge. This is curious as the aim of the legislation is to ensure that drug traffickers are not able to launder drug money: not to ensure they receive adequate consideration for their illegal money, or for assets representing this money. Drug money does not change its character, regardless of whether adequate consideration is given. What the legislation, in this instance, does is put any such transaction on a normal commercial footing, and protects a purchaser who is well down the chain of ownership. For example, A is a drug trafficker, who sells his house, built with drug money, to B; B on sells the house to C; C on sells to D. In the circumstances, B, C and D will be protected, if they paid the market price, although B is closer to the criminal act than C and D. It will protect the *bona fide* purchaser for value, with or without notice. (I am grateful to members of my 1996/97 Commercial Law Honours Class for helping to clarify my thoughts on these sections.)

[78] Ibid.

[79] See s.93B of the CJA'88. This section applies in Scotland also.

A, either personally or via an agent, is able to retain, or control, the proceeds of his (A's) drug trafficking - this can be done by concealing the proceeds, removing them from the jurisdiction, or transferring them to nominees; or (b) the proceeds of A's drug trafficking are used either to: (i) secure funds that are put "at A's disposal", or (ii) acquire investment property for A.[80]

The penalties for committing offences range from a fine, not in excess of the statutory maximum[81], and/or six months imprisonment on summary conviction[82], to a fine and/or fourteen years imprisonment on indictment, depending on the nature of the offence.[83]

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[80] S.38(1) of the 1995 Act, and s.50(1) of the DTA. In the context of money laundering: see s.93A of the CJA'88.

[81] In Scotland, this is set out in the Criminal Procedure (Scotland) Act 1995, s.225(8), which sets a fine of £5,000. In England, the position is set out in s.32(9) of the Magistrates' Courts Act 1980 (as amended by s.17 of the Criminal Justice Act 1991). This section also sets a fine of £5,000.

[82] See: (i) 1995 Act: ss.36(5)(b), 37(9)(a), 38(6)(b), 39(11)(a), and 40(7); (ii) DTA: s.54(1)(a), relating to breaches of ss.49-51, and s.54(2)(a), relating to breaches of ss.52-53; and (iii) CJA'88: ss.93A(6)(a), 93B(9)(a), 93C(4)(a) and 93D(9)(a), and s.93E, applying ss.93A-93D to Scotland. The terms of imprisonment on summary conviction differ in the two jurisdictions under the CJA'88. In Scotland, the period is three months; whereas in England, it is six months.

[83] See: (i) 1995 Act: ss.37(9)(b), and 38(6); (ii) DTA: s.54(1)(a); and (iii) CJA'88: ss.93A(6)(b), 93B(9)(b), and 93C(4)(b).

Money Laundering Regulations

In addition to the statutory regime, there are "The Money Laundering Regulations 1993"[84], which apply to the financial sector and deal with, amongst other things: (i) identification of new customers, so that it can be established that they are who they claim to be[85]; (ii) the training of staff and the introduction of appropriate systems to prevent money laundering[86]; (iii) internal reporting

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The following provisions impose a five year sentence on indictment: (i) ss.36(5)(a), 39(11)(a), and 40(7)(b) of the 1995 Act, (ii) 54(2)(b) of the DTA, and (iii) 93D(9)(b) of the CJA'88.

84 S.I. 1933 of the 1993. These came into force on 1st April, 1994. Failure to comply may result in imprisonment and/or a fine: see reg.5.

85 Regs.7-11. There is a minimum of 15,000 ecus in "one off" transactions, or two or more "one off" transactions, under regs.7(4) and (5). "Reasonable measures" must be taken to establish a person's identity: see reg.9(2). Reg.7 talks in terms of establishing the identity of applicants for business, which suggests that this part of the legislation applies to new customers, not old established customers.

86 Reg.5. Included in the requirements under this regulation are, amongst other things, the maintenance of: (i) identification procedures, under regs.7 and 9; (ii) record keeping procedures, under reg.12; (iii) internal procedures, under reg.14; and (iv) such other internal controls and communication procedures as are appropriate to forestall or prevent money laundering. It is a defence to a breach of reg.5 that the person "took all reasonable steps and exercised all due diligence to avoid committing the offence": see reg.5(4). Also,

procedures, including appointing an "appropriate person" to whom information, concerning knowledge or a suspicion of money laundering, can be given[87]; (iv) procedures relating to record-keeping[88]; and (v) the duties of supervisory authorities to report money laundering[89].

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a court may take into account any guidance (superisory or regulatory) which is applicable to the individual concerned, or any guidence issued by a trade association or professional body: see reg.5(3). Where a breach of reg.5 is committeed by a body corporate (e.g., a bank), and it was done "with the consent or connivance of, or [is] . . . attributable to any neglect on the part of, any director, manager, secretary or other similar officer of the body corporate", that officer can be liable: reg.6(1). The penalties for breach of reg.5 are: (a) a maximum of two years imprisonment and/or a fine, on indictment, or (b) a fine not greater than the statutory maximum on summary conviction.

87 Reg.14.

88 Regs.12-13. The period is five years, under regs.12(2) and (3). A breach of reg.12 is regarded as a breach of reg.5(i) and (ii) (see above), and the same penalties apply: see regs.12(4) and (5), and includes an appointed representative's principal.

89 Regs.15-16. Interestingly, and suprisingly, a recent newspaper report indicates that, according to Mr. John Moscow, the assistant district attorney for New York County, who is that county's financial fraud specialist, City of London bankers are conveniently ignoring "possible money laundering activities out of fear of being rude to their customers". Two types of transaction were singled out: (i) the creation of "pass-through bank accounts",

Conflict Between Duty of Confidentiality and the Obligation to Make Disclosure Under the Money Laundering and Drug Trafficking Legislation

The inevitable conflict between: (i) the disclosure requirements under the money laundering and drug trafficking legislation, and (ii) the banker's Tournier obligations of confidence[90], is recognised by the legislation in three respects:

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and (ii) the arranging back-to-back loans. In the former situation, launderers in country A are able to manipulate accounts in countries B and C. And in the latter case, a company in country A places a large sum on deposit, e.g., £100m, with a bank in country B; an offshore shell company, which is assetless, arranges to borrow £100m from the bank which has the deposit, using the deposit as security. This claim has been denied by the head the City of London police's fraud office, Superintendent Terry Ohlson, who said that the United Kingdom's system of combating money laundering was "about as robust you can get." See Cohen, N., "Bankers 'ignoring' money laundering", *The Financial Times*, 18th April, 1997, p.18.

[90] There is also the possibility of liability, under English law, as a constructive trustee, for either dishonest assistance or knowing receipt, as defined in Barnes v. Addy (1874) 9 Ch. App. 244, and re-stated by the Privy Council in Royal Brunei Airline Sdn Bhd v. Tan [1995] 2 A.C. 378. See on this: Bosworth-Davies, at pp.1-4, and Radmore, Bhattacharyya and Laddie, supra, at p.157 (in the context of a solicitor, although the principle is the same for a banker); of these categories, only the second is relevant to Scots law: see, for example, Huisman v. Soepboer 1994 S.L.T. 682. For a discussion of Bank Liability as a

(a) it is an offence for a banker to "tip off" a customer about a possible investigation of the customer's affairs by the police, Customs and Excise or the National Criminal Intelligence Surveillance Unit;[91]

(b) there is an express exemption from liability, bringing the matter under the first Tournier exemption of compulsion of law[92], where disclosure involves breach of a statutory duty or otherwise; and[93]

(c) a banker can exempt himself from liability for drug trafficking or money laundering under the legislation in four situations.

(i) by showing he did not know or suspect that the arrangement he was involved with concerned another person's proceeds of drug trafficking[94] or other criminal conduct;[95]

(ii) by making disclosure to the appropriate authorities, where the banker has knowledge or a suspicion of drug trafficking or money laundering, prior to his (the banker's) involvement with the doing of

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Constructive Trustee: see Chapter 8 "Banks As Constructive Trustees Under English Law".

91 S.40 of the 1995 Act; s.53 of the DTA; and s.93D of the CJA'88.

92 It could also be argued that such a disclosure would come within the public duty exemption under Tournier, and the interests of the bank exception.

93 See: (i) 1995 Act: ss.37(5)(a), 38(3)(a), and 39(4); (ii) DTA: ss.50(3)(a), 51(5)(a), and 52(4), (6); and (iii) CJA'88: ss.93A(3)(a) and 93B(5)(a).

94 See: (i) s.38(4) of the 1995 Act; and (ii) ss.50(4)(a), (b) of the DTA.

95 Ss.93A(4)(a), (b) of the CJA '88.

an act, which would constitute an offence under the legislation; and to avoid being guilty of "tipping off", if the banker does such an act, he does so with the consent of the police, which is permitted[96]; or

(iii) by making disclosure after involvement with an act, which would constitute an offence under the legislation, provided the disclosure is done on the banker's own initiative, and as soon as it is reasonable for him to make disclosure[97]; or

(iv) where the banker intended to make a disclosure, but did not, and he "has a reasonable excuse for not doing so"[98].

The Money Laundering Reporting Officer

In making disclosure, the banker does not have to go straight to the police: he is able to report his knowledge, or suspicions, of money laundering - whether it, or they, be drug related or not - to "the appropriate person" in his organisation (the Money Laundering Reporting Officer), "in accordance with the procedure established by

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96 See: (i) s.37(5)(b)(i) of the 1995 Act; (ii) s.51(5)(b)(i) of the DTA; and (iii) s.93B(5)(b)(i) of the CJA'88.

97 See: (i) ss.37(7) and 38(4)(c) of the 1995 Act; (ii) ss.50(4)(c), 51(7) and 52(3) of the DTA; and (iii) s.93(A)(4)(c) of the CJA'88. Cf. s.39(3) of the 1995 Act and s.52(3) of the DTA, regarding the defence of "reasonable excuse".

98 See: (i) ss.37(5)(b) and 38(5)(b) of the 1995 Act; and (ii) ss.50(3)(b), 51(5)(b)(iii), and 93A(3)(C) of the CJA'88.

his employer for making such disclosures"[99]. This requirement of a Money Laundering Reporting Officer, was introduced after lobbying by the banks, as conduct at one branch of a bank by a customer may be suspicious, but explicable by a banker at another branch.[100] Similarly, conduct which a junior teller is unsure of, might make sense to a more experienced banker, such as the manager, in the same branch. In addition, to avoid the management problem of masses of tellers in the many different banking organisations in Britain making disclosures without the banks' management being aware of them, there was the need for a sound system for reporting disclosures to the appropriate authorities. Moreover, there was the fear that "blanket" reporting by tellers, without reference to a higher

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[99] See: (i) 1995 Act: ss.37(8), 38(5) and 39(5); (ii) DTA: ss.50(5), 51(8), and 52(5); and (iii) CJA'88: ss.93A(5) and 93B(8). These procedures are established pursuant to reg.14 of the Money Laundering Regulations 1993 (S.I. 1933 of 1993). However, a survey conducted by The Financial Times Financial Publishing of 260 Money Laundering Reporting Officers, in London, indicated that, amongst other things, "one in five officers in banks and other financial institutions who are responsible for reporting suspicious transactions have received inadequate training about their legal obligations": see Mason, J., "Banker's question US dirty money crackdown", *The Financial Times*, 29th April, 1997, p.9.

[100] See McCormack, G., "Money laundering and banking secrecy" (1995) 16 The Company Lawyer 6, at p.9, referring to the Memorandum submitted by the Committee of London and Scottish Bankers to the Home Affairs Committee, 7th Report, 1988-1989 Parliamentary Session, at para.6, on p.103.

authority in their bank, could lead to damages claims against the bank[101].

Continuous Disclosures

In dealing with this stringent legislation, a banker needs to be careful to remember that, whilst he may make a disclosure, or a defensive disclosure, to protect his position[102], his obligation may not end there, as the customer's activities may be on-going, and further evidence may be required to prove the case against the customer. Hence, the banker (via the Money Laundering Reporting Officer, in the case of money laundering), will need to make continuous disclosures to the police, or Customs and Excise, or the National Criminal Intelligence Surveillance Unit.[103] This makes the banker's relationship with his customer very difficult.[104] Whilst there may be a strong temptation for the banker to say that he will no longer deal with the customer, the banker must be careful not to breach the "tipping off" provisions of the drug trafficking and money laundering legislation, which a refusal to continue to act for a customer under investigation could constitute, as this is the sort of conduct likely to

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101 Ibid. These are likely to be claims for defamation, negligence and breach of contract.

102 Boswell-Davies, supra, at pp.6-8.

103 Boswell-Davies, supra, at p.6.

104 Boswell-Davies, supra, at p.9.

alert a criminal that he was being investigated.[105] Consequently, bankers need to be prepared for periods of continuous, statutorily authorised, breaches of their duty of confidentiality to their customers.

(2) Public Duty To Disclose

This second exception to the banker's duty of confidentiality is one that a lender should be very cautious about relying on, as it involves a balancing of: (i) the public interest in keeping confidences[106], and (ii) "some other countervailing public interest which favours disclosure"[107], that is "not limited to detecting or preventing wrong-doing"[108]. Hence, it is by no means clear when the second public interest will prevail, and, thus, it is the most difficult of the four exceptions to the duty of confidentiality to apply with certainty[109].

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105 Boswell-Davies, supra, at p.9.

106 See Lord Keith of Kinkel, at p.256, and Lord Goff of Chieveley, at p.282, in Spycatcher [1990] 1 A.C. 109.

107 Per Lord Goff of Chieveley in Spycatcher [1990] 1 A.C. 109, at p.282E-F.

108 Per Millett J. (as he then was) in Price Waterhouse v. B.C.C.I. Holdings (Luxembourg) S.A. [1992] B.C.L.C. 583, at p.596d, citing Lord Griffiths, at p.268, and Lord Goff, at p.282, in Spycatcher, supra.

109 A similar view is taken by Paget's Law of Banking (1996) 11th edn. (by M. Hapgood Q.C.), at p.122. See too Lord Nolan in Robertson, supra, at p.1499B. The Jack Committee was of the opinion that this category of exception should be

(a) Disclosure to Central Bank

The most likely occasion when the public interest exception will apply concerns the obligations owed by a bank to its central or supervisory bank - in Britain, at present, this is the Bank of England[110], and in the United States, it is the Federal Reserve Board - in which the public interest in the prudent supervision of the banking system will outweigh the public interest in keeping the customer's confidences.

An example of this arose in Price Waterhouse v. BCCI Holdings (Luxembourg) S.A.[111] The Bingham inquiry, which had been set up by the Bank of England under the chairmanship of Bingham L.J. (as he then was), to investigate the collapse of BCCI, did not have power to compel witnesses to attend before it or to compel the production of documents. PW had been asked to submit documentation it had in its possession, most of which was confidential to BCCI, with the majority of it being covered by the banker's duty of confidentiality to its customers.[112]

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abolished, as it had been eroded so much legislation: see Cmnd. 622, Feb, 1989, at paras.5.30 and 5.41. In view of recent case law, this view is now questionable.

110 The Government has proposed that the Bank of England lose its supervisory role, And that this be given to a revamped Securities and Investment Board, to be headed by the current Deputy Governer of the Bank of England: see *The Financial Times*, 21st May, 1997.

111 [1992] B.C.L.C. 583.

112 Some documentation was also covered by legal professional privilege.

Millett J. (as he then was) - after noting that where disclosure had been allowed in the public interest, it had been done so to: (i) detect or prevent wrongdoing, or (ii) prevent a miscarriage of justice, or (iii) maintain public safety[113] - observed that a duty of confidence, either contractual or equitable, is subject to the limitations that there is a "right, not merely a duty, to disclose information where there is a higher public interest in disclosure than in maintaining confidentiality"[114]. Consequently, his Lordship concluded that the public interest disclosure should prevail, as "[t]here is an important public interest in the effective regulation and supervision of authorised banking institutions and the protection of depositors".[115] This was so because, amongst other things, under s.39 of the Banking Act 1987, Parliament had given public interest greater weight than the duty of confidentiality, and, if it was in the public interest to permit confidential information to be disclosed to the Bank of England to allow it to perform its supervisory functions, then the public interest in disclosing confidential information to an inquiry set up to examine the Bank of England's performance of its statutory functions, must be as great.[116] To this there was added the proviso:

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[113] [1992] B.C.L.C. 583, at p.601b-c.

[114] [1992] B.C.L.C. 583, at p.601e-f.

[115] [1992] B.C.L.C. 583, at p.601f-g.

[116] [1992] B.C.L.C. 583, at p.601f-h. See too s.83 of the Banking Act 1987 (as amended). Nb Part V of the Banking Act 1987, restricting disclosure of information obtained in relation to the Banking Act 1987. See Bank of Credit

that as the disclosed information could be no wider in this second situation than in the first, disclosure by PW was limited to material relevant to the inquiry, and PW was to maintain confidentiality of the underlying banking transactions, except where the disclosure was specifically asked for by the inquiry in a particular instance.[117]

Similarly, in A v. B Bank (Bank of England Intervening)[118], the customers of B Bank had obtained an injunction, in England, preventing disclosure to third parties of details relating to their accounts. B Bank was being investigated by the United States Federal Reserve Board, and a subpoena had been issued in New York requiring it to produce certain documents; B Bank was also "a deposit-taking commercial trading bank in England". The Bank of England, which had issued a notice, under the Banking Act 1987, upon the customers, requiring them to produce documents pertaining to their accounts, sought to vary the customers' injunctions. It was held by Hirst J. (as he then was) that the injunction, preventing disclosure by B Bank to third parties, did not have effect with regard

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and Commerce International (Overseas) Ltd. (in Liquidation) v. Price Waterhouse [1998] Ch. 84, at p.97A-F, in which Laddie J. held that it was a criminal offence for any one (including the Bank of England) to disclose information about a person's business affairs, contrary to s.82 of the Banking Act 1987; this obligation could not be overriden by a party's obligation to give discovery.

117 [1992] B.C.L.C. 583, at p.602e.

118 [1993] Q.B. 311.

to a Bank of England notice[119], and, thus, B Bank had to produce the documentation. The Bank of England's public duty to supervise banks, which was "extremely wide"[120], overrode the injunction, which did not qualify as a "reasonable excuse" within s.39(11) of the Banking Act 1987 (as amended).[121] Also, the notice was not invalidated because the Bank of England was assisting the United States Federal Reserve Board, as this assistance did not stop the Bank of England from using the information obtained for its own supervisory purposes; the Bank of England had decided to look into matters of concern regarding B Bank and its customers, which had been brought to its attention by the Federal Reserve.[122]

A further example of the public duty exception arose in Libyan Arab Foreign Bank v. Bankers Trust Co.[123] In that case, Staughton J. (as he

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[119] [1993] Q.B. 311, at p.325F-G.

[120] At p.324C.

[121] [1993] Q.B. 311, at pp.324-325. The sorts of situations his lordship envisaged as constituting a "reasonable excuse" included; accidental destruction of documents and illness, i.e., "physical inability to comply with a requirement for information on documents": see Hirst J. (as he then was) supra, at p.323F-G, citing, with approval, Ralph Gibson L.J. in Bank of England v. Riley [1992] Ch. 475, at pp.485-486.

[122] [1993] Q.B. 311, at pp.325-328A.

[123] [1989] 1 Q.B. 728. The case was concerned with the question of the proper law of the banking contract.

then was), briefly, looked at the question of the banker's duty of confidentiality against the background of the freezing, pursuant to a Presidential Order, of Libyan assets that were in the possession or control of United States' banks in America or overseas. An issue of confidentiality arose because a branch of Bankers Trust, in New York, had discussed with the Federal Reserve Board, at the Federal Reserve Board's request, details of the LAFB's accounts with Bankers Trust. The reason for the discussion was that Bankers Trust, in New York, had received payment instructions from LAFB to pay a sum from the LAFB's New York account to its account in the London branch of Bankers Trust; Bankers Trust had refused to make the payment. LAFB's had a "call account" at the London branch of Banker's Trust, and a "demand account" at its New York branch. A so-called "peg balance" of US $500,000 was to be maintained at the New York branch. This meant that funds were either transferred to, or from, the London branch via the New York branch.

Staughton J. suggested, tentatively, that the public duty exception might be able to be invoked by a bank in disclosing customer information to its central bank[124]; however, as LAFB could show no loss had resulted from the breach by the bank,[125] his lordship did not pursue the point.

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[124] At p.771C.

[125] At p.771D-E. Cf. Kaufmann v. Credit Lyonnais Bank, *The Times*, 1st February, 1995, in which a bank, that had voluntarily disclosed confidential reports to the regulatory body, which it was a member of, was held, by Arden J., to be unable to rely on the public duty exception, concerning a claim for

(b) Prevention of "Fraud"/Misrepresentation

In Canada, it has been held, applying Tournier, that the public duty exception may be used to expose or prevent a "fraud" or misleading conduct by a customer. It is suggested that the position would be no different in Britain, as this is not the sort of conduct the courts will condone, especially in (large) commercial transactions. The situation arose in Canadian Imperial Bank of Commerce v. Sayani[126], where the S brothers had negotiated a large financing for a condominium development project with a trust company. As part of the negotiations, the Ss disclosed personal financial statements which failed to show that they were in default on a loan to CIBC for more than Can. $300,000. The documentation was sent to the trust company's lawyers, who also acted for CIBC; CIBC were considering taking proceedings against the Ss, who had not honoured settlement agreements to repay the loan. When the law firm received instructions, a lawyer from it telephoned the trust company to say the firm would be unable to act, as they acted for a financial institution in dispute with the Ss, which may lead to litigation. The lawyer added that the Ss had not proved reliable, and he suggested that a credit analysis might be in the trust company's interests.

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production of the reports by investment clients, on the basis that disclosure could only be prevented if a clearly demonstrated need to withhold the information from the investors was shown.

126 (1993) 83 B.C.L.R. (2d.) 167. See too, the English Court of Appeal in Finers (a firm) v. Miro [1991] 1 W.L.R. 35, in which it was held that fraud "unravelled all" - in this case, a firm of solicitors' duty of confidence to their client.

Enquiries by the trust company indicated that other creditors had had difficulties with the Ss. As a consequence, the terms of the trust company's financing were withdrawn and other finance offered on more stringent terms, with the result that the condominium project did not proceed. CIBC sued the Ss for its debt, and obtained judgement for nearly Can. $520,000. The Ss counterclaimed for damages for breach of confidence, on the basis of the disclosure by the bank's solicitors (who were acting as agents for the bank).

The British Columbian Court of Appeal dismissed the counterclaim, holding that: (i) the bank could rely on the second Tournier exception to prevent fraud or crime, and (ii) the disclosure by the solicitor revealed no "more than that which the trust company would have learned had the [Ss'] dealings with the bank been disclosed by them in the financial statements, as they should have been."[127]

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[127] Per Taylor J.A., giving the judgement of the Court, at p.175, para.33. Nonetheless, it can be argued that the solicitor (on behalf of the bank), by his statement that the Ss were unreliable and his suggestion that a credit analysis be undertaken, went very close to the boundary of what it was reasonable to disclose *vis-a-vis* the bank's duty of confidentiality to its customers (the Ss) and the exceptions to it. If a writ had been issued, then the dispute was in the public domain, and limited details could be disclosed (i.e., the details appearing on the writ), but this appeared not to be the situation here. Moreover, the solicitor, by his disclosure, was merely giving a "friendly" warning that there might be repayment difficulties, rather than seeking to prevent fraud or a crime.

It is the first point which is of interest here. Taylor J.A., who delivered the court's judgement, disagreed with the trial judge, who had said that the appropriate exception was the third Tournier exception (i.e., in the interests of the bank). His Honour noted the comments in Tournier of both: (i) Scrutton L.J.[128], who said that a bank may disclose a customer's account details "to prevent frauds or crimes", and (ii) Atkin L.J. (as he then was)[129], who, similarly, said there could be disclosure to protect "the bank or persons interested, or the public, against fraud or crime", and, based upon those views, Taylor J.A. opined that this exception - to prevent, rather than prosecute, fraud - came under the second Tournier category.[130] His Honour put the position, thus[131]:

> "It seems to me that such an exception would have to be part of the implied term of the contract between bank and customer defining the bank's duty of confidentiality. It seems to me inconceivable that an honest banker would ever be willing to do business on terms obliging the bank to remain silent in order to facilitate its customer in deceiving a third party. I think it equally unreasonable that any would-be customer could expect a bank to be willing to be silent in such circumstances. Implied terms must, of course, be such as reasonable people making such a contract would expect and accept."

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[128] [1924] 1 K.B. 461, at p.481.

[129] [1924] 1 K.B. 461, at p.486.

[130] (1993) 83 B.C.L.R. (2d.) 167, at p.173.

[131] At p.173, para.23.

Taylor J.A. concluded "that there must be an exception which meets that case of a misrepresentation, such as that involved here, whether or not it constitutes fraud or deceit in law".[132] Moreover, it would "be unreasonable for the law to imply a covenant on the part of the bank that it would resolve such a dilemma in such circumstances by remaining silent."[133]

This case may be contrasted with the decision of the Court of Appeal, in England, in Lipkin Gorman v. Karpnale Ltd.[134], where a solicitor was misappropriating moneys from his firm's client account to pay for his gambling habit. The bank, where the account was held, was aware of the solicitor's gambling habit, and of withdrawals by the solicitor from the client account with the bank, but it did not enquire about the withdrawals, nor did it inform the firm's senior partner. In addition, the solicitor had a personal account with the bank. It was stated by May L.J., applying Tournier, that the firm's bankers were under an obligation to the solicitor not to disclose information

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[132] At p.174, para.27.

[133] At p.175, para.31. The problem here, was that the solicitor, when making disclosure, appeared to be unaware of the position surrounding the Ss and the trust company.

[134] [1989] 1 W.L.R. 1340 (C.A.). This aspect of the case was not discussed on appeal to the House of Lords: see [1991] 2 A.C. 548. The main discussion in the case in the Court of Appeal concerned the liability of the bank for liability for dishonest assistance as a constructive trustee (a cause of action not known in Scotland).

to any person, including the firm, which the bank had obtained due to the solicitor having a personal account with the bank.[135] If the bank manager had told the firm's senior partner that, because of the way the solicitor was operating his own account, the solicitor was gambling, the manager would have been in breach of his duty of confidentiality to the solicitor.[136] However, this was not true of the way the client account was being operated, because the senior partner was one of the account holders. It can be argued, based on Tournier, that, as the withdrawals from the client account were not authorised, and the funds did not belong to the solicitor, the manager would have been justified in making disclosure to the senior partner to prevent a crime or fraud, if he had sufficient knowledge of the crime or fraud. In this case, it appears the manager did not.

(3) Disclosure In The Bank's Interest

There is little case law on this exception[137], and it remains an uncertain and unreliable, although an increasingly important, one[138].

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135 [1989] 1 W.L.R. 1340, at pp.1357-1358.

136 This is a straight application of Tournier principles, on not disimilar facts, *vis-a-vis* this aspect of the case.

137 See, for example, Sutherland v. Barclays Bank Limited (1938) 5 Legal Decisions Affecting Bankers 163, concerning a husband taking over from his wife, a telephone conversation between her and her bank manager, in which the reason for the bank manager refusing the wife an overdraft, owing to her gambling, was discussed, and was explained to the husband. A claim by the wife for breach of confidence failed under this exception and the fourth

However, in applying this exception, there is a balancing act between: (i) what might be in the bank's interest, and, thus, legitimate to disclose, and (ii) mere disclosure which will, directly or indirectly, benefit the bank financially, such as providing information to credit agencies or disclosure of information for marketing purposes. In these latter cases, the disclosure is not justified, because the exception is concerned with the bank making a disclosure to protect itself, i.e., to prevent a detriment to the bank, rather than the bank obtaining a benefit.

When Will A Disclosure Be In The Bank's Interests?

As to when a disclosure will be in a bank's legitimate interests, and, hence, permissible, it is difficult to say, but it would seem that the matter should relate to: (i) matters connected with legal proceedings, or (ii) the enforcement of legal rights, or (iii) the protection of the

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Tournier exception. The case has been criticised by Professor Ellinger, on the basis that the bank manager disclosed too much: see Modern Banking Law (1994) 2nd edn. (with E. Lomnicka), at p.142, who argue that the banker should have given "insufficient funds" as the reason for the dishonour, and not revealed why there were insufficient funds.

138 The Jack Committee recommended that the circumstances where there can be disclosure under this third exception should be defined by statute: see at para.5.3.1. This has not been done, and was rejected by H.M. Government in its response: see Cmnd. 1026, at paras.1.11, and 2.12.

bank's reputation[139]. In Canada[140], it has been held that a bank came within this exception when it gave notice of its security interests[141] over cattle and crops of its customer to purchasers, or potential purchasers, of the cattle or crops, so that moneys to be paid to the customer would be paid direct to the bank, under the security arrangements.[142] The customer argued that this was unjustified and involved divulging the state of the customer's account, which had a debit balance, to a third party. This argument was quickly rejected by MacKenzie J., who said the disclosure was justified under the third Tournier exception.[143]

(a) Customer's Details on a Document Pertaining to Legal Proceedings or Recovery of a Debt

The paradigm examples of this third exception relate to the bank being involved in litigation with one of its customers, such as where the bank issues a writ against the customer for repayment of an

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139 Such as in Sutherland v. Barclays Bank Limited, supra.

140 See Royal Bank of Canada v. Brattberg (1993) 143 A.R. 131.

141 The bank gave notice under s.178 of the Canadian Bank Act 1985, concerned with granting security to farmers and manufacturers, and the security's enforcement.

142 The customer had sold some cattle and deposited the proceeds of sale with another bank, which meant that the plaintiff bank could not use them to satisfy the debt owed to it by the customer.

143 At p.141, para.46.

overdraft and states the amount of the debt on the face of the writ.[144] Other similar examples include: (i) providing details to a guarantor of the amount of a customer's debt owed to the bank when the debtor has defaulted on a loan and the bank wishes to claim under the guarantee for repayment of its debt, or (ii) where a customer sues the bank for repayment of its credit balance, and the bank uses its books to defend the action.[145] These examples are not controversial.

(b) Compliance With Order of Foreign Court

Difficulties may arise where there is an international dimension to proceedings. For example, in XAG v. A. Bank[146], the issue was whether the London branch of a American bank should disclose confidential information about two corporate customers, under the third Tournier exception, in order to comply with the terms of a subpoena of a New York court, or face the possibility of being in contempt of court if it did not disclose it. The two customers sought an interlocutory injunction preventing disclosure, and were successful. Leggatt J. (as he then was) decided, on the balance of

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144 See Bankes L.J. in Tournier [1924] 1 K.B. 461, at p.473.

145 Fowler, W. (with Scottish noter up by I. Meiklejohn), "Great Britain": Ch.13 in International Bank Secrecy (1992) (D. Campbell, ed.), at para.13-029.

146 [1983] 2 All E.R. 464.

convenience[147], that the commercial detriment to the customer, in allowing disclosure, was greater than the detriment to the bank.[148] His Lordship felt that the exercise of power by the American courts was "excessive", and that, on the evidence presented, there was no real danger of contempt proceedings.[149]

Problem Areas Under The Third Tournier Exception

Two problem areas, concerning this exception, were recognised by the Jack Committee: (a) disclosure of confidential information within a banking group for marketing purposes, and (b) the receipt by banks of information from credit rating agencies, and the disclosure of information to these agencies by banks.

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147 Applying the principles relating to interlocutory injunctions, in England, under American Cyanamid Co. v. Ethicon Ltd. [1975] A.C. 396, at pp.407-408, per Lord Diplock. This case does not apply in Scotland. The test for an interim interdict in Scotland is set out by Lord Fraser of Tullybelton (obiter) in N W L Ltd. v. Woods [1977] 1 W.L.R. 1294, at p.1310. (H.L.(E.). See also the speech of Lord Diplock in the N W L case, supra, at p.1306, regarding the balance of convenience, under English law, which Leggatt J. (as he then was) referred to in XAG v. A. Bank, supra.

148 [1983] 2 All E.R. 464, at p.480b-c.

149 At p.480b and e.

(a) Disclosure Within the Bank's Group - Marketing

This was recognised as a problem by the Jack Committee[150], who noted the practice of disclosing confidential information about customers to other members of the same group without the customer's express consent, some of whom may be non-banking in nature, such as, travel agents, estate agents[151], or brokers. The banks have sought to justify this disclosure on the basis of the necessity to protect themselves (and the group) against the increasing problem of customers defaulting on loans.[152] It has also been argued that implied consent was given,[153] which is highly contentious, as it is unlikely that most customers will be aware of the practice or condone it.

Whilst disclosure of information within a group of companies serves a very useful marketing purpose for the bank, this practice has not only caused concern to private customers, it has caused "unease among corporate treasurers"[154]. This type of disclosure has two difficulties: (i) subsidiaries are separate legal entities from their parent company, and (ii) the requirements of the Data Protection Act

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150 Cmnd. 622, Feb, 1989, at paras.5.12-5.14.

151 For example, Lloyd's Bank plc has a real estate "arm", "Black Horse", although there is no suggestion that it engages in improper conduct.

152 Cmnd. 622, Feb, 1989, at para.5.12.

153 Ibid.

154 The Jack Report, Cmnd. 622, Feb, 1989, at para.5.13.

1984; this Act will be modified by the new E.C. Data Protection Directive[155], which is due for implementation in October, 1998, and which will cause concerns for the banks, as it will strengthen the provision of the 1984 Act.[156]

(i) Subsidiaries Separate From Parents

The decision of a very strong English Court of Appeal in Bank of Tokyo Ltd. v. Karoon[157] reinforces the point that a subsidiary of a bank is a separate legal entity from its parent[158], and that the

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155 Directive 95/46/EC, 20th October, 1995, O.J. No. L 281/31. For a discussion of the Directive: see Hogg, M., "Privacy and European Data Protection Rights" 1996 S.L.T. (News) 127, at p.134, and Rowe, H., "Virtual Banking and Electronic Payments - Privacy and Related Issues" (1997) B.J.I.B.F.L. 20, at pp.26-28; see also Taylor, P and Davis S, "Bankers Beware! Proposals for Council Directives on the Legal Protection of Databases and the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data" [1993] J.I.B.L. 468, which deals with an earlier version of the draft in a banking context, but which makes useful general comments. See too the discussion of the Directive in the next section of the text.

156 See the discussion of this later in the text.

157 [1987] 1 A.C. 45n (C.A.), comprising Ackner and Robert Goff L.JJ. (as they then were). See also Bhogal v. Punjab National Bank [1988] 2 All E.R. 296, at p.305, per Bingham L.J. (as he then was) (C.A.).

158 See at pp.53f-54c and p.55, per Ackner L.J., and at p.64f-g, per Robert Goff L.J. See too: R v. Grossman (1981) 73 Cr. App. Rep. 302, in which the Court of

provision of information by a subsidiary of a bank to its parent, in another jurisdiction, is disclosure, and, hence, a breach of the implied duty of confidentiality contained in the general banking contract between a bank and its customer.[159] With respect, this is sensible because, if a bank wants the protection and advantages of carrying on business through a subsidiary, then it has to take the disadvantages as well, such as restrictions on information sharing.

(ii) Data Protection Act 1984

The sharing, by a bank, of information, on its computers, about its personal customers,[160] may be a breach of the Data Protection Act 1984. Under that Act, a bank will be regarded as a "data user"[161] - being a person who controls the contents and use of personal data

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Appeal set aside an inspection order, regarding the head office of Barclays Bank Ltd. in London, which required the bank to let the Inland Revenue look at, and make copies of, an account that a Manx company had at the Isle of Man branch of Barclays Bank Ltd.

159 See too Paget's Law of Banking (1996) 11th edn. (by M. Hapgood Q.C.), at p.123.

160 Under the legislation, these would be categorised as "Data Subjects". A "Data Subject" is an "individual": see s.1(4). Thus, it does not include bodies corporate. Consequently, the 1984 Act will only apply to personal customers, rather than corporate customers.

161 See s.1(5) of the 1984 Act. A data user is required to be registered under the 1984 Act: see Part II of the 1984 Act, especially ss.4-6. A data user is "a person", which can include a body corporate, such as a bank: see s.1(5).

about its customers and, as such, is under obligations regarding the information's accuracy[162], security[163] and the customer's rights of access to it[164]. Data can be regarded as "information recorded in computer readable form"[165].

The bank is also under a further obligation[166] to comply with the standards set out in the 1984 Act, which the Data Protection Registrar may enforce[167]. Moreover, under the code of banking practice, The Banking Code, banks are required to explain to

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162 S.22 (Compensation for inaccurate data).

163 S.23 (Compensation for inaccurate disclosure leading to loss).

164 S.21 (Right to access to data).

165 See s.1(5) of the 1984 Act, and Lord Goff of Chieveley in R v. Brown [1997] European Commercial Cases 105, at p.108, para.6.

166 S.2(2) and Schedule 1.

167 S.10. The matter is discussed in an article by Ms Rosemary Jay, Legal Adviser to the U.K. Data Registrar, on which the above discussion draws heavily: see "The Impact of the 1984 Data Protection on Marketing by Banks and Financial Institutions" (1995) B.J.I.B.F.L. 109. For a general discussion of the Data Protection Principles: see MacQueen, H.L., "Data Protection", Stair Memorial Encyclopaedia, Vol. 18, at paras.1501ff. See also Rowe, H., "Virtual Banking and Electronic Payments - Privacy and Related Issues" (1997) B.J.I.B.F.L. 20, at pp.22-25.

customers that, pursuant to the 1984 Act, the customer has a right of access to their personal records held on the bank's computer files.[168]

Under the 1984 Act, there is a dual regime[169] of: (i) compliance with the registration provisions of the Act and a declaration of data uses and purposes on the register, which is public[170], and (ii) compliance with the Data Protection Principles, imposing standards of "good information handling"[171].

Where a bank seeks to use personal data for marketing purposes, this "will require registration under the Registrar's purpose P004"[172], relating to marketing and selling, and a further registration will be required under P018, concerning trading in personal information, or

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168 (1997) 3rd edn., at para.4.4.

169 Jay, supra, at p.109.

170 S.5 of the 1984 Act. Use of data has been held not to be retrieval of it; retrieval is merely a prerequisite to use: see Lord Goff of Chieveley in R v. Brown [1997] E.C.C. 105, at p.110, para.11, and see too Lord Hoffman, supra, at pp.1122-124, paras.66-70, who said retrieving data from a computer was a use of a computer rather than the use of data.

171 Jay, supra, at p.109. See Schedule 1 of the 1984 Act, which is made pursuant to s.2(1), and the statutory guidance to interpretation of the Principles in Part II of Schedule 1. A bank may also have to apply for registration under P023-P035, especially P026 (Personal Banking) and P027 (Corporate Banking).

172 Jay, supra, at p.110.

"an appropriate Method 2 will be required"[173] if the bank wishes to allow other persons (either associated or non-associated companies) to use the data.[174] The bank will also be obliged to comply with Principle 1 of the Data Protection Principles, which states that personal data must be obtained and processed both fairly and lawfully. In looking at whether the "information was obtained fairly", it is appropriate to look at "the method by which the [information] was obtained", such as whether a person from whom the information was obtained was deceived or misled as to the purpose for which [the information] was to be held, used or disclosed."[175] In this context, "fairly" has been defined to mean that

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[173] Jay, supra, at p.110. A Method 2 is "a free text description" of a purpose that a data user wishes to use data for. The Data Protection Registrar permits "a purpose to be described either by a standard purpose description or by a free text description": see letter from Ms Rosemary Jay, Legal Adviser to The Data Protection Registrar, date 3rd April, 1997, to the author in the Appendix to this thesis.

[174] Jay, supra, at p.110.

[175] Principle 1.1 of the Data Protection Act 1984. "Disclosure" (or "disclose") is not defined in the 1984 Act. For data to be disclosed, it must have been retrieved from its database and changed into a communicable form: per Lord Goff of Chieveley in R. v. Brown [1997] E.C.C. 105, at pp.110-111, para.12, who said the word should be given its natural and ordinary meaning. There is a definition of "Disclosing" in s.1(9), but this "is concerned with the particular case of disclosing information extracted from data . . . and with the particular situation which arises where such an extract does not of itself reveal the

the interests of the individual, whilst not prevailing over all other interests, are to be the paramount interests.[176]

Consent Under The Data Protection Act

Assuming that the appropriate consent from a customer has been obtained by a bank, the Registrar for Data Protection will permit that customer's bank to use data relating to the customer, with regard to personal banking, to sell the bank's products "within the range of acceptable uses anticipated by the customer".[177] The reason is that "this is the same type of use and the bank may assume the authority of the customer extends to being sent information about the bank's own products."[178] However, the use of a customer's data for the purposes of so-called "host mailing" - such as, where the bank, on behalf of a third party, chooses a select group of customers and sends mail to them, regarding other products or services which have nothing to do with the provision of banking services, or where in bank mail to a customer, the bank includes brochures of a third

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identity of the person who is the subject of the data", per Lord Goff, supra, at p.110, para.11.

176 See the decisions of the Data Protection Tribunal in CCN Systems Limited v. Data Protection Registrar, February, 1991, and Infolink Limited v. The Data Protection Registrar, June, 1991, referred to in Jay, supra, at p.110.

177 Jay, supra, at p.112.

178 Ibid.

party[179] - is not permitted. This is because the customer is unlikely to have anticipated or assumed such mail, and the "extracting [of] personal data to market non-bank products involves a use of personal data which breaches the obligation of confidence and therefore requires the consent of the customer."[180]

Penalties If Data Protection Act 1984 Is Breached : Criminal and Civil

Criminal: Fine and Forfeiture

Where there has been a breach of the Data Protection Act 1984, the Registrar may issue an enforcement notice which can require the data user to do something or refrain from doing it.[181] Breach of such a notice is a criminal offence.[182] Other offences include a wilful or reckless failure to conform with a register entry's scope.[183] The

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179 Ibid.

180 Ibid.

181 S.10(1) of the 1984 Act.

182 S.10(9) of the 1984 Act.

183 Ss.5(2), (3) (servants and agents) and (5) of the 1984 Act. See also s.5(6) (inserted by the Criminal Justice and Public Order Act 1994), which provides that a person who procures the disclosure of personal data to himself, where he knew, or ought to have known, that this was in contravention of ss.5(2) or (3), is guilty of an offence. Under ss.5(7) and (8), it is an offence for such a person to sell, or offer to sell, personal data he has procured, or which he subsequently procures, contrary to s.5(6).

penalty for a breach of the 1984 Act is a fine on indictment, or a fine up to the statutory maximum on a summary offence.[184] In addition to the fine, a court has power to order forfeiture and destruction of personal data, where the data "is connected with the commission of" an offence under the Act.[185] In the case of a company, (i.e., a bank), if the breach is "committed with the consent or connivance of or is attributable to any neglect on the part of any director . . or other officer", then the relevant company officer can be fined, as well as the company.[186] This is not something that the chief executive officer of a bank would be pleased about, either financially (if an unlimited fine on indictment) or in terms of the bad publicity associated with such a breach.

Civil Compensation

Furthermore, a personal customer (but not a corporate customer)[187] can claim compensation for any loss suffered where there has been unauthorised disclosure of personal data by the bank.[188]

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184 See s.19 of the 1984 Act. Currently, this is £5,000: see s.225(8) of the Criminal Procedure (Scotland) Act 1995, for Scotland; and s.32(9) of the Magistrates Courts Act 1980, for England.

185 S.19(4) of the 1984 Act.

186 S.20 of the 1984 Act.

187 The "Data Subject" has to be "an individual", under s.1(4); whereas the "data user" is "a person", which can include a company: see s.1(5) of the 1984 Act.

188 S.23(1)(c) of the 1984 Act.

(iii) The New EC Data Protection Directive

It is beyond the scope of this thesis to describe, in detail, the provisions of the new E.C. Data Protection Directive[189], dealing with the processing of personal data[190].

This Directive is due to be implemented by October, 1998[191], although older data, as opposed to new data, is required to conform to the requirements of the Directive within twelve years[192]. The emphasis in this section will be on the features of the Directive which will affect a bank's obligation of confidentiality. It is not unfair to state, at the outset, that the Directive is poorly drafted, and lacks clarity on several matters, as well as being, seemingly, contradictory, at times, such as having the conflicting aims of: (i) protecting "the

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189 Article 2 defines "personal data" as "any information relating to an identified or identifiable natural person (data subject)". An "identifiable person" is someone "who can be identified, directly or indirectly, in particular by reference to an identification number or to one or more factors specific to physical, psychological, mental, economic, cultural or social identity". Processing of personal data is also defined in Article 2: see the text above.

190 Directive 95/46/EC, 24th October, 1995, O.J. No. L 281/31. For a fuller treatment: see Hogg M. "Privacy and European Data Protection Rights" 1996 S.L.T. (News) 127; and Rowe, H., "Virtual Banking and Electronic payments - Privacy and Related Issues" (1997) B.J.I.B.F.L. 20.

191 Art. 32, para.1.

192 Art. 32, para.2.

fundamental rights and freedom of natural persons, and in particular their right to privacy with respect to the processing of personal data"[193], but (ii) not restricting or prohibiting "the free flow of personal data between members states for reasons connected with the protection afforded under paragraph 1"[194]. The Directive is also not helped by having 72 recitals, covering seven and a half pages, which is nearly forty percent of the length of the Directive.[195]

The key features of the Directive are as follows:

(a) Personal data includes both manually and electronically processed data[196]; manually processed data must be part of a filing system[197]. This would include manuscript notes made by a banker at an interview with a customer, e.g., for a loan, which, are part of the customer's file.

(b) The Data Protection Principles of the Data Protection Act 1984 are covered by Article 6 of the Directive. Principle 1 is equivalent to

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193 Art. 1, para.1.

194 Art. 1, para.2.

195 The Directive is only nineteen pages long (including recitals).

196 Art. 2.

197 Art. 3(i). "A personal data filing system" is defined, in Art. 2, as being "any structured set of personal data which are accessible according to specific criteria, whether centralized, decentralized or dispersed on a functional or geographical basis".

Art. 6(a)[198]; Principle 2 is equivalent to Art. 6(b)[199]; Principle 4 is equivalent to Art. 6(c)[200]; Principle 5 is equivalent to Art. 6(d)[201]; and Principle 6 is equivalent to Art. 6(e)[202].

(c) The "processing of personal data" is defined to mean "any operation or set of operations which is performed upon personal data, whether or not by automatic means, such as collection, recording, organization, storage, adaptation or alteration, retrieval, consultation, use disclosure by transmission, dissenumeration or otherwise making available or combination, blocking, erasure or destruction."[203] As banks have their records on computer, they will subject to this Article.

(d) Personal data, however, may only be processed where:[204]

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198 Concerned with fair and lawful processing.

199 Concerned with processing for "specified, explicit and legitimate purposes".

200 Deeming the personal data to be "adequate, relevant and not excessive", concerning the purposes for which data is processed or collected.

201 The data is to be accurate and up to date.

202 The data is to be kept "for no longer than is necessary for the purposes for which the data were collected or for which they are further processed".

203 Art. 2.

204 Art. 7.

(i) the data subject has given unambiguous consent - such that there is no coercion;[205]

(ii) the "processing is necessary for the performance of a contract" which the data subject is a party to, or to "take steps at the" data subject's request, before "entering into a contract".[206]

(iii) it is necessary to comply with a legal obligation which the controller is subject to - this would cover the first and second Tournier exceptions, such as disclosure to a central bank.[207]

(iv) the processing is required to protect the data subject's "vital interests". [208]

(v) The processing is needed for the "legitimate interests pursued by the controller or by the third party or parties to whom the data are disclosed, except where such interests are overridden by the interests for fundamental rights and freedoms of the data subject which require protection under Article 1(1)".[209]

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205 Art. 7(a).

206 Art. 7(b).

207 Art. 7(c).

208 Art. 7(d).

209 Art. 7(f).

As to what this last provision means is unclear. What are the "legitimate interests" pursued by a bank (i.e., data controller) or a third party it has disclosed data to, e.g., a credit reference company, or a third party seeking a reference about a customer[210]? It is apparent, from Art. 14, that this would not include disclosure for the purposes of "direct marketing"[211]. If this was not opaque enough, the exception introduced, referring back to Art. 1, is even more unclear, as there is a tension between the two paragraphs of Article 1: the first protecting the data subject, and the second preventing the flow of information being restricted or prohibited. It would be a brave bank that would seek to rely on this provision, which, it is suggested, will be construed in favour of the data subject.

(vi) The processing is, amongst other things, needed for "the performance of a task carried out in the public interest or in the exercise of official authority by the controller or a third party to whom the data are disclosed".[212]
Again, the precise ambit is unclear, but the reference to public interest will be qualified by the other part of the

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210 These matters would be governed by the code on banking practice, The Banking Code (1997) 3rd edn., which requires customer consent: see paras.2.15 and 4.1.

211 Art. 14(b).

212 Art. 7(e).

Article, referring to exercising official authority. This would permit the processing of data relating to drug traffickers or money launderers by lenders, but this would also be covered by Art. 7(c).

(e) Article 10 requires that where data has been collected from the data subject, that subject is to be provided with information concerning: (a) the controller or his agent's identity, (b) the purpose for processing the data[213], and (c) further information regarding data collected to ensure fair processing of the data about the data subject.

This further information includes the recipients of the data, whether it is obligatory to reply to questions, and the consequences of not replying, and "the existence of the right of access to and the right to rectify data concerning" the data subject.

In the case of a bank, a customer will know (a), and should have (b) explained to them. Category (c) is important - especially in relation to disclosures to credit reference agencies (which goes on now). It means that banks will now have to inform customers, if they disclose information to third parties. If the customer (data subject) is not happy with this, he can object under Section VII of the Directive.[214]

(f) Under Article 11, when personal data about a data subject (customer) has not been obtained from the customer, the controller (bank) must provide the same information as in Article. 10 "at the

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213 Art. 10(a) and (b).

214 Art. 14 and 15.

time of undertaking the recording of personal data or if a disclosure to third party is envisaged, no later than the time when the data are first disclosed." The requirement concerning third parties is curious, as it is open to potential abuse, but also it does not give the data subject a great deal of time to object. This would include information obtained from credit rating agencies.

(g) An Article that will have a critical effect on banks is Article 12. This provides that the data subject is to have an unrestricted right "at reasonable intervals and without excessive delay or expense" to know, whether personal data concerning him is being processed, the purpose of the processing, the categories of data and the recipients of the data[215]. The data subject is also entitled to: (i) know "in an intelligible form", the data that is being processed, and (ii) "knowledge of the logic involved in any automatic processing of data concerning" the data subject, at least regarding automated decisions under Article 15[216].

Also, under this Article, there is a right of "rectification, erasure or blocking of data the processing of which does not" conform with the Directive, especially where the data is not correct or not complete[217]; and a right to have this "rectification, erasure or blocking" notified to

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215 Art. 12(a).

216 Art. 12(a).

217 Art. 12(b).

third parties to whom the data has been disclosed, unless this proves "impossible or involves a disproportionate effort"[218].

(h) The obligations in Articles 6(1), 10, 11, 12 and 21, can be restricted where, amongst other things, they affect: (a) national security; (b) defence; (c) public security; (d) "the prevention, investigation, detection and prosecution of criminal offences"; and (e) a monitoring inspection or regulatory function concerned, even sometimes, with exercising official authority in (c), and (d).

As far as a bank is concerned, in relation to confidentiality, (d) is similar to the second (and, possibly, the third) Tournier exception, and would protect any data on a customer who was involved in crime, especially drug-trafficking and money laundering, as will (f). There is also an exemption where it is needed to protect the data subject or others "rights and freedom"[219].

(i) The two provisions which will affect banks are Arts. 14 and 15. Under Art. 14(a), a data subject, amongst other things, "can object at any time on compelling legitimate grounds relating to his particular situation to the processing of data" about him, except where it is justified by national legislation, such as the Banking Act 1987 (as amended). Also, under Art. 14(b), the data subject can object to data about him being processed which the controller anticipates will be used for "direct marketing"; this is a right that the data subject is also entitled to be informed about before the data is "disclosed for the

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218 Art. 12(c).

219 Art. 13(g).

first time to third parties or used on their behalf" for direct marketing, and he can object "free of charge to such disclosures or uses".

This provision (Art. 14(b)) will prevent disclosures by banks to subsidiaries for marketing purposes, but it remains unclear what "compelling legitimate grounds" are under Art. 14(a); this is unlikely to include disclosures by lenders to credit rating agencies.

(j) Art. 15 relates to "automated individual decisions," and it allows "every person not to be subject to a decision which produces legal effects concerning him or significantly affects him and which is based solely on automated processing of data intended to evaluate certain personal aspects relating to him, such as his . . . creditworthiness, reliability, conduct etc"[220].

This right to "opt out" is subject to two exceptions:[221]

(i) where the decision is taken in relation to the formation or performance of a contract and the data subject's "request for the entering into or performance of the contract . . . has been satisfied", or there exist "suitable measures to safeguard" the data subject's "legitimate interests", such as permitting him to give his view, (i.e., natural justice), and

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220 Art. 15, para.1.

221 Art. 15, paras.2(a) and (b).

(ii) where the decision "is authorised by a law", which has measures to protect the data subject's "legitimate interests".

Article 15 will have a significant effect on banks if an individual does not want information concerning his creditworthiness processed, as it will limit the bank's scope for making decisions. It is understood that some banks now use computers to determine loan applications for individuals; these machines are considered more effective and accurate at determining bad credit risks than the average high street bank manager.

The result for a customer, though, is that they are unlikely to be granted a loan, if they exercise their rights under Article 15.

With regard to exception (i) above, this is likely to apply in relation to the formation of a loan contract, as the bank will require this information.

(k) Where a processing operation is "likely to present specific risks" to a data subject's "rights and freedoms", this must be examined before the commencement of the processing operations.[222]

(l) Other provisions relate to: (i) the notification to a supervisory authority (the Data Protection Register)[223]; (ii) a judicial remedy for

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[222] Art. 20.

[223] Arts. 18 and 19. This concerns only automated data.

breach of any rights guaranteed to the data subject under any national law relating to the processing[224]; and (iii) compensation[225].

How far the Directive will involve modification of the Data Protection Act 1984 is a matter of interpretation and intention. For a lender, the Directive will mean greater care will need to be taken to ensure there is no disclosure without consent - disclosures to third parties, such as credit rating agencies, are clearly in breach of the Directive. The main burden will be the right of the customer to regular updatings on data held by the lender. The Directive imposes greater controls on the data users conduct, and requires greater co-operation and transparency with the data subject - secretive disclosures of personal data (to the extent they may have been undertaken) are to be greatly reduced. The position in the United Kingdom has been strengthened by the Criminal Justice and Public Order Act 1994, relating to the disclosing personal data or selling or offering it for sale, which will affect the transmission of information to credit rating agencies.

(iv) When Group Disclosure is Permitted

The Jack Committee acknowledged that there could be valid situations in which a bank would need to disclose information to other members of its banking group, such as, to comply with the reporting requirements under the Banking Act 1987 (as

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224 Art. 22.

225 Art. 23.

amended)[226], or if there is to be a sale of the bank, in which case, a prospective purchaser would need to know the level of bad debts in the vendor's loan book.[227] However, it, rightly, condemned the disclosure of customer information to non-banking subsidiaries, without the customer's consent[228]. To have a customer's details "circulating around" a banking conglomerate, with many people looking at them for purposes not necessarily related to the original general banking contract, makes a mockery of that contract and its implied duty of confidentiality. This is now prohibited, for personal customers, by The Banking Code, which is voluntary.[229]

(v) Marketing Under The Lenders' Code Of Practice

Under The Banking Code, a bank is not to disclose anything about a customer's account, name and addresses to anyone, including other companies in the bank's group for marketing purposes, except when customer consents to this or requests the bank to do so.[230]

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226 See ss.36-39.

227 Cmnd. 622, Feb, 1989, at para.5.31.

228 Cmnd. 622, Feb, 1989, at para.5.32.

229 (1997) 3rd edn., at paras.2.15 and 4.1.

230 Paras.2.15 and 4.1. This voluntary Code (now in its third edition) was a result of the Government response to the Jack Report: see Cmnd. 1026, at paras.1.11 and 1.12, where disclosure of "white" information and use of such information for marketing purposes was criticised. This applies to personal

Moreover, the provision of "basic banking services", such as opening and maintaining a current account for the transmission of money by cheques, or "other debit instruments", is not to be dependant on the customer giving his consent. Likewise, a bank is not to use the third Tournier exception as a basis for disclosing information about a customer (including his name and address) or his accounts to anyone, which includes other companies in the bank's group for the purposes of marketing.[231]

(b) Credit Reference Agencies

A second area of concern in the Jack Report[232], is the disclosure of confidential information by credit reference agencies[233] to banks who are proposing to do business with a particular customer.[234] This subject was referred to in the discussion of the new Data Protection Directive and will be more difficult for banks when the new Data

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customers, but there is no good reason why it should not apply to corporate customers.

231 See para.4.1 of The Banking Code. The four Tournier exceptions are set out in para.4.1 of The Banking Code.

232 Cmnd. 622, Feb, 1989, at paras.5.15 - 5.20.

233 See the definition in s.145(8) of the Consumer Credit Act 1974 ("CCA"). These must be licensed by the Director-General of Fair Trading, under s.25 of the CCA.

234 Fowler, W. (with Scots law noter up by I. Meiklejohn), "Great Britain" : Ch.13 in International Banking Services (D. Campbell ed.), at para.13-031.

Protection Directive is implemented. The credit rating agencies obtain the information "from public sources and from providers of credit who are prepared to contribute"[235]. Of more concern, though, is the situation that banks are disclosing such information to the credit reference agencies: the banks are now providers, as well as receivers, of confidential customer information. Information disclosed to, and by, banks falls into two categories: (i) "black" information, relating to borrowers who are in default for at least three months, and who have been told by the lender that their details will be given to an agency if the situation is not remedied[236]; and (ii) "white" information, concerning the details of borrowers who are not in default, which is more controversial. The reason for disclosure of this information, is to seek to reduce defaults by borrowers by not lending to those with a poor repayment record.

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235 Ibid.

236 Reported in the article by Dolan, E., "The banks that won't keep your secrets safe", Weekend Money Section, *The Times*, 26th March, 1994, at p.33. See too the Jack Report, Cmnd. 622, Feb, 1989, at para.5.18. Para.4.2 of The Banking Code says banks are to give a customer twenty-eight days notice if the bank intends to disclose details of a customer's undisputed personal debts to credit reference agencies, where the customer is in default and no satisfactory proposals for repayment have been received by the bank after a formal demand; otherwise, customer consent must be sought by the lender. Under para.4.3, the bank will not disclose any other information concerning the customer to such agencies without the consent of the customer.

Views between banks vary on the disclosure of "white" information. National Westminster Bank plc and the Midland Bank plc have indicated they would not disclose "white" information, as this would be a breach of confidentiality.[237] Whereas Barclays Bank plc state that, whilst a borrower may not have defaulted under a loan, the borrower may be at the limit of his repayment ability, and, hence, it is sensible to find out what is owed to whom.[238] That bank was of the view that "what we know at present is what you tell us. With 'white data', we discover the true nature of the situation"[239]. Similarly, Girobank, a subsidiary of the Alliance and Leicester Building Society, felt that the information resulted in a reduction in fraud and a faster granting of credit.[240] Curiously, the bank "did not see customer confidentiality as a problem".

The second set of banks' opinions, whilst, perhaps, commercially valid, are wrong in law, and fail to give sufficient weight to the obligation of confidentiality they owe to their customers. Consequently, these lenders risk exposing themselves to an action, by a customer, for breach of confidence; it is unlikely that disclosure will be condoned as being in the (legal rather than financial) interests of the bank. A customer expects that details of his account(s) will

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237 Reported in the article by Dolan E., The banks that won't keep your secrets safe", Weekend Money Section, *The Times*, 26th March, 1994, at p.33.

238 Reported in the above article by Dolan, supra.

239 Ibid.

240 Ibid.

remain confidential, and that the only persons who should know about the account(s) are: (i) the customer, (ii) the bank and (iii) any other party whom the customer has given, or authorised the giving of, details about his account to. If a bank wants details of someone's financial affairs, then they should ask that person, or, if it is a company, an appropriate officer of the company, who may need to get board approval. In the case of personal customers, The Banking Code makes it clear that the customer's consent should be sought[241].

The disclosure of "white" information may be harmful to a customer (either a personal or corporate one) which has a credit balance on its account.[242] For example, the balance may be higher or lower than expected, which may have commercial consequences that the customer has no control over or considers undesirable, e.g., in the case of a company, a fall in its share price or a hostile takeover bid.[243] It could also lead, in extreme and remote situations, to criminal consequences, such as, blackmail.

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[241] At paras.4.2 and 4.3.

[242] Cf. the recent matter in which employees of a bank, allegedly, disclosed the identity of a lottery winner, who was a customer of the bank, to a local newspaper, after recognising a cheque for the winning amount passing through the customer's account: see *The Times*, 19th January, 1996.

[243] Companies will be required under Chapter I of Part VII (especially ss.221 and 227) of the Companies Act 1985 (as amended) to keep accounting records and produce annual accounts; these will often be out of date by the time they

The Jack Committee was also opposed to any disclosure of "white" information[244] Although "understand[ing] and sympathis[ing] with the arguments of public policy that, taken on their own, may point in [the] direction [of disclosure]"[245], they "view[ed] with real concern and dismay"[246] any further erosion of confidentiality. The committee stated that "this sizeable bale of straw could break 'the camel's back"[247] in terms of its effect on banker - customer confidentiality.[248] With this opinion it is agreed.

The Jack Committee went on to observe that[249]:

> "If . . . information to be provided relates to whether or not the customer is 'white', in the sense that he has performed, or is duly performing, his repayment obligations to the bank, then the difficulty for the bank becomes even more acute. For the banker with his continuing customer relationship conducted on a comparatively informal basis, there must be all sorts of shades of 'white' merging into grey. If the intention is

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are published - hence, the keeping of management accounts. Companies listed on the Stock Exchange will normally give interim profit figures.

[244] Cmnd. 622, Feb, 1989, at para.5.34.

[245] Ibid.

[246] Ibid.

[247] Ibid.

[248] Ibid.

[249] Cmnd. 622, Feb, 1989, at para.6.36.

that 'white' information should extend to non-factual information of this kind, with the considerable judgmental element which will be involved, then it adds weight to our view that it would be wrong for the customer to be exposed, without his informed consent, to the potentially dangerous consequences of that judgement, however carefully and conscientiously it may be arrived at."

The former Data Protection Registrar, Mr. Eric Howe, had said that whilst customer consent to disclosure may now be sought, a refusal to give consent could result in a customer being denied credit facilities.[250] Mr Howe had previously warned banks in January, 1994, that they should not pass on "white" information without the customer's unconditional consent. He also wanted customers to be given notice before details of their poor repayment record were given to credit reference agencies.[251]

"Black" information is more problematic in that a lot of information is already in the public domain, such as, Sheriff Court decrees, in Scotland, County Court judgements, in England, and bankruptcies - (the latter two of which are, in England, put on computer and

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[250] Dolan, supra, at p.33. Nb. the position under The Banking Code, regarding marketing: see paras.2.15 and 4.2.

[251] Quoted in "Warning to banks on data protection", an article in *The Times*, dated 7th January, 1994, by P. Tehan.

updated weekly[252]), and disqualified directors[253]. In May, 1988, the main clearing banks and credit agencies reached an agreement with the Data Protection Registrar, whereby, for a period of a year, the banks would make "black" information available to the credit reference agencies,[254] with a year's notice being given to customers.[255] It is understood that this was "an interim arrangement", and that "now credit grantors and banks clearly notify at the onset of a relationship that information will be filed with credit reference agencies"[256].

The Jack Committee was a little more sympathetic and understanding to banks, who had been urged by the Government to contribute to

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252 Ibid.

253 Ibid, and Data Protection Guidance on Credit Referencing, March 1996, produced by The Data Protection Registrar, at para.36, on p.11.

254 Cmnd. 622, Feb, 1989, at para.5.18. The Data Protection Register has "accepted that it may be a condition of an agreement [between banker and customer] that 'black' data be given to credit reference agencies": quoted in "Warning to banks on data protection", an article in *The Times*, dated 7th January, 1994, by P. Tehan.

255 Cmnd. 622, Feb, 1989, at para.5.18.

256 See the copy of the letter in the Appendix hereto, from Ms Rosemary Jay, Legal Adviser to the Data Protection Registrar, date 3rd April, 1997, to this writer. See too para.4.2 of The Banking Code (1997) 3rd edn.

"black" information lists.[257] The Committee proposed that the obligation of confidentiality should be relaxed in relation to "black" information.[258] This would be achieved by a further exception to the banker's duty of confidentiality being added by statute, allowing a bank to disclose "black" information to a credit reference agency "when there has been a breakdown in the bank - customer relationship arising through customer default".[259] "Default", the Jack Committee said, would be the situation "where no security has been given, and no satisfactory response has been received from the customer within twenty eight days of formal demand for repayment".[260] However, it recommended that the disclosure should only be "to approved credit reference agencies" and disclosure should be limited to "information about debts".[261] The twenty eight day notice period and the disclosure being restricted to information concerning debts have been included in The Banking Code[262].

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257 Cmnd. 622, Feb, 1989, at paras.5.18, 5.34 and 5.37. This, however, has no legal force.

258 Cmnd. 622, Feb, 1989, at para.5.37.

259 Ibid. No such provision has been added. The Jack Committee had proposed giving statutory form and force to the Tournier exceptions, except for the second one (public duty): see Cmnd. 622, Feb, 1989, at paras.5.29-5.39.

260 Cmnd. 622, Feb, 1989, at para.5.45.

261 Ibid.

262 At para.4.2.

There is merit in this view in that it reduces the likelihood of defaults on loans by stopping bad debtors from obtaining finance in the first place, which, theoretically, should mean that finance is more readily available and at cheaper interest rates for reliable borrowers.

Nonetheless, very great care will need to be taken, with appropriate safeguards and redress if errors are made. Tight controls will have to be kept on the accuracy of this information and the persons to whom it is made available, as a "one-off", non-performing loan may be a source of much embarrassment to a customer, and may not be indicative of that customer's financial record[263]. There will also be a need to make sure that customers are made aware that there may be disclosure to such agencies. The position will be affected, in the case of individuals, by the new E.C. Data Protection Directive.[264]

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263 An individual may, upon payment of £1, make an application to a credit reference agency, under s.158 of the CCA, for financial information it holds about him. An application can also be made under the Data Protection Act 1984, which costs £10.

264 See, for example, Article 15 of the Data Protection Directive 95/46/EC, 24th October, 1995, O.J. No. L 281/31. This Article allows an 'individual' "not to be subject to a discussion which produces legal effects concerning him or significantly affects him and which is based solely on automated processing of data intended to evaluate . . . creditworthiness . . ."

(c) Conflicts of Interest[265]

A problem of confidentiality may also arise where a bank has a conflict of interests, such as where a bank is the lead bank in a syndicate, but is also a banker to the borrower, and the bank obtains confidential information about its customer in a capacity other than as the lead bank. In such a situation, the lender has a conflict of interests: as it has a duty to preserve the customer's confidentiality, but also has a duty of disclosure to the other syndicate members. The bank may be excused from making disclosure due to a provision in the information memorandum sent to the syndicate members.[266] Where such a provision is absent, the bank should seek consent for disclosure. If that is refused, the bank would need to rely on the third Tournier exception, if it deemed disclosure necessary. For example, a company may be involved in a complicated asset sale with bank A, to reduce its indebtedness to that bank, and the company may also be in the beginning of negotiating a rescue package with a syndicate of banks, of which bank A is lead manager. The sale of the asset by the company may reduce the company's capacity to produce income and service future debt, and the negotiations surrounding the asset sale may be sensitive. If the sale does not go ahead, bank A will withdraw from the rescue syndicate;

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265 This issue is discussed more fully in the chapter on Banks as Fiduciaries.

266 See Tennekoon, R., The Law and Regulation of International Finance (1991) (2nd edn.), at p.64 and fn.20 thereof, citing J.R.F. Lehane, "Role of Managing and Agent Banks: Duties, Liabilities, Disclaimer Clauses in Current Issues in International Financial Law (1985).

but information concerning the sale is information that the other syndicate members would like.

This problem of conflicts of interest is also acknowledged by Walter and Ehrlich[267], who refer to the position of a banker who is also a director of a company, which is a customer of his bank, and who obtains confidential information as a banker, that will harm the company he is a director of.[268] The question there, though, is does the banker, as a fiduciary (i.e., director of the company), have a duty of disclosure to the company of the bank's confidential information, bearing in mind that the banker may also be a director of the bank, and have conflicting fiduciary duties? Even if the banker was an employee of the bank, and not an officer, he is still under a contractual and/or fiduciary obligation to the bank not to disclose confidential information.

(d) Fraud Proceedings: Interdict/Injunction to Prevent Bank Giving Customer Details: Bank Seeking Disclosure In Own Interests

Where a bank's customer is the subject of a fraud action for misappropriated moneys, the real owner of the moneys, in seeking to trace the proceeds of the fraud, may seek: (i) under Scots law, a commission and diligence against the bank, or, (ii) under English law,

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267 (1989) 63 A.L.J. 404, at p.417. See too the recent decision of the Israeli Supreme Court on confidentiality and conflicts: Tephahot Mortgage Bank of Israel v. Tavah, decision delivered 11th April, 1994, noted [1997] J.I.B.L. N-9.

268 This area is dealt with more fully in the chapter on Fiduciaries.

to subpoena the bank, to obtain documentary information about the missing moneys. However, the customer may then apply for an interdict or injunction restraining the bank from disclosing the customer's affairs to a third party. Such a predicament occurred, in England, in El Jawhary v. Bank of Credit and Common International S.A.[269], where, prior to BCCI's compulsory liquidation, some customers of BCCI had obtained injunctions preventing disclosure by BCCI of the customers' details, as, allegedly, there had been breaches of confidentiality by the bank; subsequently, the liquidators of the bank sought to vary the injunctions to permit disclosure by the bank (which was under the control of the liquidator) using the third exception in Tournier. The concern of the customers was that the liquidators, erroneously, thought that they were allowed to exercise their powers to disclose confidential information to third parties, in breach of the bank's duty of confidentiality, and that, as a consequence, confidential information held by BCCI about the customers would be revealed by the liquidators.

The application of the liquidator to vary the injunction was upheld by Sir Donald Nicholls V.C. (as he then was), who said that the customers would need to establish that a "real risk" existed that BCCI, acting through the liquidators, might breach the banker's implied duty of confidentiality, and this they failed to do.[270] Nonetheless, the liquidators, before making disclosure in a particular instance, not the

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269 [1993] B.C.L.C. 396. See the discussion of this case by Obank, R., "Banker-Customer Confidentiality in the 1990's" (1995) B.J.I.B.F.L. 113.

270 [1993] B.C.L.C. 396, at p.397i-398a.

subject of the injunctions, would still have to look at the questions of: (i) the nature of the information sought, (ii) the person to whom the information would be revealed, and (iii) the purpose for which the information was sought. Hence, the variation of the injunction did not mean the liquidators were free to disclose information about BCCI's customers.[271] The liquidators were to "err, if at all, on the side of caution", and either seek the customers' consent or seek directions from the court before disclosing information, if they had a "serious doubt"[272]. In contrast to the approach of the Privy Council in Robertson v. Canadian Imperial Bank of Commerce[273], Sir Donald Nicholls V.C. said that the liquidators were not obliged to tell the customers of any disclosures of confidential information about the customers, and that where a case fell within one of the exceptions in Tournier, no additional obligation existed[274]. It is suggested that such matter would be decided the same way under Scots law, as the principles of confidentiality involved are the same in both

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271 [1993] B.C.L.C. 396, at p.399i; see too Obank, R., "Banker-Customer Confidentiality in the 1990's" (1995) B.J.I.B.F.L. 113.

272 [1993] B.C.L.C. 396, at p.399c-d.

273 [1994] 1 W.L.R. 1493 (P.C.).

274 [1993] B.C.L.C. 396, at p.400a-c. Cf. Evans-Lombe J. in Adham v. Bank of Credit and Commerce International S.A. (No 2) [1995] 2 B.C.L.C. 581, a continuation of this saga, who took the view that the opinions of Lord Nolan in Robertson, supra, and Sir Donald Nicholls in El Jawhary were not inconsistent: see at p.584c; with respect, this is not correct.

jurisdictions, although there are procedural differences, regarding: (i) compelling witnesses to give evidence, (ii) the disclosure of documents, and (iii) restraining actions.[275]

(4) Express or Implied Consent of Customer

(a) Banker's References

Traditionally, the area of most contention has been the fourth category, under which banks have sought to justify the giving of credit references to third parties about the bank's customer, on the basis of the customer's implied consent. However, this assumption by the banks has not been tested judicially[276], and it is doubtful

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275 See: (i) s.1 of the Administration of Justice (Scotland) Act 1972 and Rule 35 of the Court of Session Rules 1994 for Commission and Diligence, and (ii) Rule 60 of the Court of Session Rules and s.47(1) of the Court of Session Act 1988 for Interdicts.

276 The third party recipient has a cause of action in negligence against the lender for a negligent reference which results in the recipient suffering pure economic loss: see Hedley Byrne & Partners Ltd. v. Heller & Partners Ltd. [1964] A.C. 465 (H.L.(E.)). Any disclaimer of liability, such as the one successfully used by the bank in Hedley Byrne, would now subject to the test of "reasonableness" under the Unfair Contract Terms Act 1977; in certain circumstances, a disclaimer may be subject to the Unfair Terms in Consumer Contracts Regulations 1995 (S.I. 1994 No.3159), in the case of a non-corporate customer. See the fuller discussion of this topic in the chapter in this thesis on Negligence.

whether it is a valid one.[277] The better view is that there is no implied consent, as a customer may not be aware of the practice, but, even if he is, awareness on a general level does not constitute consent to disclosure on a specific occasion - it may be that the person to whom disclosure was made is not someone a customer wants their financial affairs revealed to. Moreover, the Younger Report on Privacy, in 1972, doubted whether the practice was "well-known and accepted among customers, particularly individuals, as the banks' assert."[278] The Committee went on to say that banks should make it clear to customers what the position is concerning the reference system and give customers the chance "to grant a standing authority for the provision of references or to require the bank to

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[277] Cf. Professor Ellinger believes that there is implied consent for such disclosure: see Modern Banking Law (1994) 2nd edn. (with E. Lomnicka), at p.143. The learned authors of Paget's Law of Banking appear to have changed their minds. In the 9th edition, different authors thought that there was not consent: see at p.182; but, in the 10th edition, at p.592, it expressed is accepted that there is implied consent; now, in the latest edition (11th edn.), the view of a third author appears to be that there is no implied consent: see Ch. 35 by K. Sharma, at pp.627-628, advising that banks should seek the customer's express consent to disclosure of its (the customers) financial details to a guarantor to avoid confidentiality problems, but noting, in fn.10 on p.628, that "[i]n many situations, it would be expected that the customer had impliedly given such authority". The learned author also says that "the bank has the option of declining to answer": see at p.628.

[278] Report of the Committee on Privacy, 1972, Cmnd. 5012, Ch.10, at para.3.2.

seek their consent on every occasion."[279] A credit reference, given by a bank without express consent, especially if incorrect, can have serious repercussions for a customer. For example, an indication that a customer is not in a financial position to enter into a particular transaction may have a follow on effect for the customer's business if rumours start about its solvency. As a consequence of the problems that may arise, the Jack Committee[280] recommended that the giving of banker's references, under this fourth exception, should only be allowed if the express consent of the customer is obtained. This view has been endorsed in The Banking Code[281], which says that before there is disclosure of a personal customer's details by a banker, the customer's consent should be obtained. This policy should reduce the scope of lender liability for breach of this exception; moreover, there is no good reason why the policy of consent should not apply to corporate customers as well.

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279 At para.3.2. See too H.M's Government's response to the Jack Report: Cmnd. 1026, at para.1.16, and that of the Scottish Law Commission, in their report on "Breach of Confidence", 1984 (S.L.C. No. 90), at para.4.74. The Government thought that, although the present system was not working against customers interests, "[t]he customer should be better informed" about bankers' references.

280 See Cmnd. 622, Feb, 1989, paras.5.33, 5.43 and 5.44.

281 Third Edition, March, 1997, at para.4.5, "Banker's References", and the meaning of "Banker's references" in the "Useful Definitions" part of Section 6 Help Section.

(b) Guarantees[282]

One last matter of importance is that, where a loan to a customer is being guaranteed, the banker must be careful about disclosing details of the customer's bank account to the guarantor, (even if the guarantor is also a customer of the bank), as this may amount to a breach of the bank's duty of confidentiality to the debtor customer.[283]

It is well settled that the details of a debtor's bank account is a matter for the guarantor to discover for himself, and the bank is under no obligation to disclose them to the guarantor[284]. This is

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[282] In Scotland, the term "cautionary obligation" is also used - especially in older cases and text books. However, in modern practice, the term "guarantee" is more commonly used, and is to be preferred for this reason.

[283] In England, the Court of Appeal, reluctantly, declined to strike out, under R.S.C. Ord. 18 r.19, a claim for breach of confidence against a bank by a guarantor, who was not a customer of the bank, on the basis that there was an arguable contractual duty of confidence and a duty of confidence arising in equity: see Farquharson L.J. in Taylor v. Co-Operative Bank plc, unreported decision of the Court of Appeal, delivered on 18th May, 1994; Simon Brown L.J., agreeing. Para.3.14 of The Banking Code (1997) 3rd edn. says that a bank may request customer consent to the disclosure of information about the customer to a guarantor of the customer, or that person's legal adviser.

[284] Hamilton v. Watson (1845) 4 Bell App. 67 H.L., 12 Cl. & Fin. 109 H.L.; Young v. Clydesdale Bank (1889) 17 R. 231; Royal Bank of Scotland v. Greenshields 1914 S.C. 259, at pp.266-267, per Lord President Strathclyde, and, at pp.271-272, per

because "there is in guarantee no universal obligation on the creditor to make disclosure of the whole state of matters to the proposed [guarantor]".[285] Nonetheless, "[t]he guarantor is entitled to particulars of the debtor customer's indebtedness whilst the guarantee is operative"[286], that is, up to the guarantee's limit. However, disclosing more than that "may require the [debtor] customer's consent (because of the duty of secrecy)".[287] Where there are unusual features concerning the dealings or the transaction between the banker and the debtor customer, which would affect the guarantee being given, and the guarantor would not normally expect these features, i.e., the position of the debtor is different from that which the guarantor would expect because of a "special arrangement between the bank and the customer"[288], the banker is required to

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Lord Mackenzie. See too Finlayson, R., Law Lectures To Bankers (1939), at pp.270-272. In England, see: National Provincial Bank of England Ltd. v. Glanusk [1913] 3 K.B. 335.

285 Gloag, W.M., and Irvine, J.M., Law of Rights in Security and Cautionary Obligations (1897), at p.706.

286 Cresswell, Blair, Hill, Wood, Encyclopaedia of Banking Law, at E.2010.1.

287 Cresswell, Blair, Hill, Wood, Encyclopaedia of Banking Law, at E.2010.1, fn 6. See also Gibbs C.J. in Commercial Bank of Australia Ltd. v. Amadio (1983) 151 C.L.R. 447, at p.456.

288 See Gibbs C.J. in Amadio, supra, at pp.456-457.

disclose such features to the guarantor[289]; but simply because the transaction is out of the ordinary is not enough to impose an obligation on the bank to disclose all the facts it has about the transaction and its customer - to suggest otherwise would be "commercially unreal"[290]. Thus, the banker is not required to inform the guarantor of a change in the customer's circumstances[291], as this may be a breach of the banker's duty of confidentiality[292]. Nor is the banker required to disclose any suspicions it has about the customer's honesty to the guarantor.[293] If the guarantor asks the

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289 Hamilton v. Watson (1845) 4 Bell App. 67, at p.103, per Lord Campbell H.L., 12 Cl. & Fin. 109, at p.119 H.L. This case was cited with approval by: (i) the High Court of Australia in Goodwin v. National Bank of Australasia Ltd. (1968) 117 C.L.R. 173, and Commercial Bank of Australia Ltd. v. Amadio (1983) 151 C.L.R. 447, and (ii) Michael Burton Q.C. (sitting as a Deputy High Court Judge) in Levett v. Barclays Bank plc [1995] 1 W.L.R. 1260. See too Gibbs C.J. in Commercial Bank of Australia Ltd. v. Amadio (1931) 151 C.L.R. 447, at p.457, cited with approval by Michael Burton Q.C. in Levitt's case, at p.1273. And see further: Gibbs C.J., at p.455, and Mason J. (as he then was), at p.463 in the Amadio case. Cf. Stair Memorial Encyclopaedia, "Cautionary Obligations", Vol. 3, at paras.897-899.

290 Gibbs C.J. in Amadio, supra, at p.457.

291 Cresswell, Blair, Hill, Wood, Encyclopaedia of Banking Law, at E.2010.1, citing National Provincial Bank Ltd. v. Glanusk [1913] 3 K.B. 355.

292 Cresswell, Blair, Hill, Wood, Encyclopaedia of Banking Law, at E.2010.1.

banker a question about the debtor customer's account, prior to signing the guarantee, the position is not clear, as to the banker's requirement to answer.

It has been suggested that there is implied consent to answer the question[294], but, the better view is that there is no such implied

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[293] National Provincial Bank Ltd v. Glanusk, supra, and Bank of Scotland v. Morrison 1911 S.C. 593, at p.602, per the Lord Justice-Clerk, and at pp.605-606, per Lord Salvesen.

[294] See Hamilton v. Watson, supra. However, whilst there are obiter remarks in Hamilton v. Watson, supra, suggesting that the bank has to answer questions concerning the debtor's account and business affairs, "the issue of whether the duty of confidence imposes a qualification on such obligations is not specifically addressed.": see O'Donovan, J., and Phillips, J., The Modern Contract of Guarantee (1992) 2nd edn., at p.118.

In France, the position appears to be that the banker cannot disclose information to a guarantor: his obligation of secrecy remains: see Lajoix, O., and Billiau, M., "France": Ch. 13 in International Bank Secrecy (1992) (D. Campbell, ed.), at para.10-0006. It is for the guarantor to contact the customer and ask the relevant questions: see Lajoix and Billiau, ibid.

In Australia, Harvey C.J. in Ross v. Bank of New South Wales (1928) S.R. (N.S.W.) 539, said, at pp.541-542, that whilst a bank is not allowed to disclose a customer's account to a guarantor of the customer, the guarantor "is entitled" to ask for information concerning any balance owing on the debtor customer's account, the interest rate charged and the amount the bank has realised from any collateral securities it holds.

consent, and that the bank should decline to answer the question and refer the guarantor to the debtor.[295] From a practical perspective, the best solution is for the bank to arrange a meeting between itself, the guarantor and the customer, at which questions on the customer's affairs can be answered.[296] To seek to prevent confidentiality problems arising, The Banking Code[297] provides that the customer may be asked to consent to the bank disclosing to the

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295 A similar view is taken by Paget's Law of Banking (1996) 11th edn., (by M. Hapgood Q.C.), at p.628 (Chapter 35 by K. Sharma). Cf. the 10th edn. of Paget, at p.592, by a different author.

296 See Walter and Erlich, supra, at p.418, approving the approach advised by J. Milnes Holden, The Law and Practice of Banking (1986) Vol. 1, 7th edn., at p.211. See also the approach advocated by the House of Lords for England in Barclays Bank plc v O'Brien [1994] 1 A.C. 180, at p.196 of having a separate meeting with guarantors, who may be the subject of undue influence, or misrepresentation, in the absence of the debtor; explained the extent of his/her liability; the risk involved; and requested to obtain independent legal advice. A similar approach is advocated in The Banking Code (1997) 3rd edn, at para.4.1. It would appear that disclosing the extent of the customer's liability would not constitute a breach of the duty of confidentiality, under English law. For Scot's law: see Smith v. Bank of Scotland 1977 S.C. (H.L.) 111, where it was held that informing the guarantor of the risk and requiring them to take independent advice is sufficient. A guarantor is still under a duty to make a full and honest disclosure, should one be required.

297 (1997) 3rd edn., at para.3.14.

guarantor or other security provider or their lawyers "confidential financial information" about the customer.

CONCLUSION

If a banker adopts a prudent and commonsense approach to its dealings with its customer, and to the questions of confidentiality and disclosures about a customer, by seeking customer consent, when there is doubt, just as a solicitor seeks instructions from his client, the banker should have little difficulty. The biggest problem for bankers comes not from the customers, but from the burgeoning amount of legislation requiring disclosure, such as the legislation on drug trafficking and money laundering. This legislation makes it hard for a banker to develop a proper relationship with his customer, as the former will always have to observe the customer's conduct in order to protect himself, thus, placing the bank in a situation where it has a conflict of interest. Whilst the curtailing of money laundering and drug trafficking are extremely desirable, the onus placed on a banker is a heavy one. The key to confidentiality, as well as to the general banking contract, is to keep the customer informed of what is happening - transparency will reduce misunderstandings and mean that if there is a problem, the customer can quickly inform the bank, which in turn, can react promptly to prevent, or reduce, financial loss to the customer.

CHAPTER 4.

LENDERS AS FIDUCIARIES

Ordinarily, a banker, when dealing with a customer, is required to be honest, reasonably careful, and discreet (in relation to the details of the customer's account); but he does not consider that he has to subordinate his interests to those of his customer. However, the changing nature of banking and the increasing sophistication of finance (both domestic and international) means that customers are looking to banks to provide more services than the traditional ones of operating cheque accounts and granting loans. This has meant that there is a greater dependence on banks, and greater expectations of them; the banks though have also sought to encourage this through advertising.[1] The consequence is that the traditional debtor/creditor relationship, characterised by being conducted at "arm's length", has altered on occasions. The arm has become considerably shorter, and, in a limited number of situations, the bank has come under a fiduciary obligation to its customer,[2] so that what was permissible

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[1] Similar views are expressed Finn, P.D., "Contract and the Fiduciary Principle" (1986) Vol.12 University of New South Wales Law Journal, 76, at p.95, fn.21, and "The Fiduciary Principle": Ch.1 in Equity, Fiduciaries and Trusts (1989) (T.G. Youdan, ed.) ("The Fiduciary Principle"), at pp.52-53.

[2] A bank is not, normally, under a fiduciary duty to its customer: Burmah Oil Ltd. v. Governor of the Bank of England [1981] 125 Sol. Jo.528, *The Times*, 4th July, 19881; and see also Morrision v. Bank of New Zealand [1991] 3 N.Z.L.R. 291, at 295, per Hillyer J; Elders Pastolral Ltd. v. Bank of New Zealand [1991] 1 N.Z.L.R. 180, at p.192, per Somers J.; James v. Australia and New Zealand

when the parties were at "arm's length" is "forbidden to those bound by fiduciary ties"[3].

In this chapter, the circumstances in which a bank will cease to be a debtor or creditor of its customer, and will stand in a fiduciary relationship towards that customer will be looked at. The chapter begins by looking at what a fiduciary relationship is, and seeks to "demystify . . . the fiduciary mystique".[4] Secondly, it examines the difficulties of terminology, and seeks to define who, or what, a fiduciary is. Thirdly, it looks at the duties imposed upon a fiduciary as a consequence - such as, the duties regarding conflicts of interest and secret profits[5] - and why the courts have been reluctant to impose fiduciary obligations when the parties are in an "arm's length" contractual or commercial relationship. Finally, the sort of conduct by banks which will invoke the fiduciary principle, plus the remedies of compensation in equity (under English law) and damages (under Scots law), which are available to a customer/beneficiary, will

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Banking Group Ltd. (1986) 64 A.L.R. 347; and Waryk v. Bank of Montreal (1991) 85 D.L.R. (4th) 514.

[3]Curtis, K., "The Fiduciary Controversy: Injection of Fiduciary Principles Into The Banker-Depositor and Banker-Borrower Relationship" (1987) Loyola L.A. Law Review 795, at p.796.

[4] Gautreau, The Hon. Mr Justice J.R.M., "Demystifying The Fiduciary Mystique" (1989) Canadian Bar Review 1.

[5]Which are really part of the same rule: see Deane J. in Chan v. Zacharia (1984) 154 C.L.R. 178.

be discussed, as will the effect of any "contributory negligence" by the customer/beneficiary.

(1) Who Is A Fiduciary?

The term "fiduciary" has been described as "one of the most ill-defined if not altogether misleading terms in our law".[6] The difficulty with it is that the courts say what a fiduciary can or can not do, such as not allowing his duty and interest to conflict, but do not tell us who or what a fiduciary is[7]. For example, in a well-known passage, Lord Cranworth L.C., in the Scottish case of Aberdeen Railways Ltd. v. Blaikie Bros[8], says:

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[6]Finn, P.D., Fiduciary Obligations (1977), at p.1, cited with approval by La Forrest J in L.A.C. Minerals Ltd. v. International Corona Resources Ltd (1989) 61 D.L.R. (4th) 14, at p.26. For a discussion of this case: see Waters, D.W.M., "LAC Minerals Ltd. v. International Corona Resources Ltd." [1990] Canadian Bar Review 455; Hammond, G., "Equity and Abortive Commercial Transactions." (1990) 106 L.Q.R. 207.

[7]A similar view is expressed by Gibbs C.J. in Hospital Products Ltd. v. United States Surgical Corporation (1984) 156 C.L.R. 41, at p.68. Cf. Goff, The Hon. Lord of Chieveley and Jones, G.H., The Law of Restitution (1993) 4th edn. (by G. Jones), at p.643, who state that "English judges have wisely never attempted to formulate a comprehensive definition of who is a fiduciary." But greater guidance than they have provided would have been helpful.

[8] (1854) 1 Macq. 461, at p.471 (H.L(Sc.)). See also McBryde, W.M., The Law of Contract in Scotland (1987), at para.8-78, on p.155.

" . . . it is a rule of universal application that no one, having [fiduciary] duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect."

However, it is not clear to whom this "rule of universal application" applies. Part of the problem is that the terminology used to define a fiduciary is vague and imprecise. Terms like "trust", "confidence", "vulnerability", "loyalty", "power", "ascendancy" are used to describe the concept, without saying how they differ from contractual obligations, for example. These are "characteristics"[9], rather than explanations of what is involved in a fiduciary obligation and what sets it apart from other obligations, such as delict/tort and contract.

Originally a concept from the English Courts of Chancery, the fiduciary obligation is one which has been traditionally enforced with great severity. As Lord Cranworth L.C. makes clear[10]:

"So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into." (i.e., in breach of fiduciary duty.)

His Lordship went onto discuss trustee situations - the trustee/beneficiary situation being the paradigm fiduciary relationship - and described the rule as "inflexible". In support of

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[9]Gautreau, J., "Demystifying The Fiduciary Mystique", supra, at p.5.

[10](1854) 1 Macq. 461, at p.471 (H.L.(Sc.).

this, his Lordship referred to the leading case of Keech v. Sandford[11], where a trustee, who could not obtain a renewal of a lease for an infant beneficiary, but, who subsequently took a renewal for himself, was required to assign the benefit of the lease to the infant, even though it had been impossible to obtain the lease for the infant.[12]

The trust, however, is different from other fiduciary relationships - such as principal and agent, or company and director - as the trustee owns the trust property[13] for the beneficial use of the beneficiary. Nonetheless, it is from this concept that the fiduciary obligation developed;[14] the word "fiduciary" comes from the Latin word

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[11](1726) Sel. Cas. t. King 61, 25 E.R. 223. See too the similar Scottish cases of Wilsons v. Wilson (1789) Mor. 16376, and McNiven v. Peffers (1868) 7 M. 181.

[12]Similar examples are found in the well known House of Lords' cases of Regal (Hastings) Ltd v. Gulliver [1942] 1 All ER 378, [1967] 2 A.C. 134n; and Boardman v. Phipps [1967] 2 A.C. 46 (H.L.(E.)).

[13]See the discussion of this by Waters, D.W.M., in "Banks, Fiduciary Obligations and Unconscionable Transactions" [1986] 65 Canadian Bar Review 37, at p.54. See also Waters, "LAC Minerals", supra, at p.468. Mason J (as he then was) in Hospital Products Ltd. v. United States Surgical Corporation (1984) 156 C.L.R. 41, at p.102, states that the rigorous standards applied to a trustee do not apply to a fiduciary, who can pursue his own interests under a contract.

[14]Ibid. Cf. Dickson J. in Guertin v. The Queen (1984) 13 D.L.R. (4th) 321, at p.339, who regarded the fiduciary obligation as having its origins in breach of confidence. This view was cited with approval in LAC Minerals, supra, at p.27.

"fiducia" meaning trust.[15] Whilst there is a strong parallel with the trustee, a fiduciary relationship is a basis for imposing liability upon a fiduciary who breaches his duties; and, in this respect, it is like contract, delict and unjustified enrichment[16].

One of the difficulties in the defining who is a "fiduciary" is the reluctance of the judiciary to provide a concrete definition[17]. Rather, the courts have spoken in generalisations regarding the categories of fiduciaries, which - like negligence - are never closed[18]. They have

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[15]See Southin J. in the Canadian case of Giradet v. Crease & Co. (1987) 11 B.C.L.R. (2d) 361, at p.362, where her Honour also says: "The word fiduciary is flung around now as if it applied to all breaches of duty by solicitors, directors of companies and so forth . . . But to say that simple carelessness in giving advice is such a breach is a perversion of words." See also Tipping J. in Estate Realties Ltd. v. Wignall [1991] 3 N.Z.L.R. 482, at p.492.

[16]Waters, "LAC Minerals", supra, at p.468 and fn.41 thereof.

[17]See Gibbs C.J. in Hospital Products Ltd v. United States Surgical Corp. (1984) 156 C.L.R. 41, at p.69. And see Tipping J in Estate Realties Ltd. v. Wignall, supra, at at p.491, who said:

> "The Courts have consistently set their face against giving any exclusive categorisation of such relationships or indeed any universal touchstone as to when fiduciary obligations will arise outside these conventional areas."

[18] See Dickson J in Guertin v. The Queen, (1984) 13 D.L.R. (4th) 321, at p.341, cited with approval in LAC Minerals, supra, at pp.27 and 61, who notes that "[i]t is the nature of the relationship, not the specific category of actor involved that gives rise to the fiduciary duty."

adopted a "rigid" approach, which is acceptable *vis-a-vis* the established categories of fiduciary, like an agent and a company director, but which may cause difficulty outside of these, such as where the relationship is creditor and debtor (i.e., contractual or commercial).

As a consequence, vague terms like "trust" and "confidence", or "vulnerability" have been used, as stated above, without necessarily relating them to the principle involved. Indeed, it has been said by one judge that the fiduciary obligation is "a concept in search of a principle"[19].

The Standard of Conduct: Loyalty

What one is looking at in a fiduciary relationship is a particular standard of conduct - being loyalty - from the fiduciary to the beneficiary.[20] It is a situation in which one party (the beneficiary)

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[19] Mason, Sir A.F., "Themes and Prospects" in Essays In Equity (1985) (P.D. Finn, ed.), at p.216.

[20] See Finn, P.D., "Contract and the Fiduciary Principle", supra, at p.83; and "The Fiduciary Principle", supra, at pp.27-28, and 31. In Bristol and West Building Society v. Mothew [1997] 2 W.L.R. 436, at p.449G, Millett L.J. (who delivered the leading judgement), speaks of a fiduciary having an "obligation of loyalty", and the beneficiary being "entitled to single minded loyalty". See also Finn, P.D., "Commerce, The Common Law and Morality" (1989) Vol. 17 M.U.L.R. 87, at p.91. It is not based on morality: see Lord Herschell in Bray v. Ford (1896) A.C. 44, at p.51 (H.L.(E.)), referring to the conflict rule. Cf. La Forrest J. in LAC Minerals, supra, at p.44, who argues that "it is simply not the case that business and accepted morality are mutually exclusive domains . . . ",

has a reasonable expectation that the other (the fiduciary), either expressly or impliedly, will act in the interests of the beneficiary and not its own[21], although it is not inconsistent for a fiduciary to have regard to its own interests, whilst retaining its fiduciary character[22]. Moreover, part of a fiduciary's activities may be fiduciary in character, and other parts may not be[23], which can sometimes be the situation with banks. However, a fiduciary will

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and that "[t]he essence of the imposition of fiduciary obligations is its utility in the promotion and preservation of desired social behaviour and institutions." See too Gautreau J., "Demystifying the Fiduciary Mystique", supra, at pp.10 and 14; and Austin, R.P., in "Commerce and Equity - Fiduciary Duty and Constructive Trust" (1986) O.J.L.S. 444, at p.452.

[21]Finn, P.D., "The Fiduciary Principle", supra, at p.46; by La Forrest J. in L A C Minerals, supra, at p.40; and the New Zealand Court of Appeal in D H L International (N.Z.) Ltd. v. Richmond Ltd. [1993] 3 N.Z.L.R. 10, at p.23, lines 5-19, per Richardson J. (delivering the leading judgement); see a note of this last case by Hood, P., "Fiduciary Obligation in a Contractual/Commercial Context: *DHL Internationl (N.Z.) Ltd. v. Richmond Ltd.* [1993] J.B.L. 285. See also Mason J. in Hospital Products, supra, at p.99, who says that the "obligation to act in the interests of another . . . is the foundation of the fiduciary relationship . . .", and also at pp.96-97.

[22]Gibbs C.J. in Hospital Products, supra, at p.69. See also Mason J., in the same case, at p.99, where his Honour notes that the fiduciary obligation can be subject to qualifications, including the qualification that "the fiduciary is entitled to act in his own interests."

[23]N.Z. Netherlands Society "Oranje" Inc. v. Kuys [1973] 1 W.L.R. 1126, at p.1130, per Lord Wilberforce. (P.C.)

not have breached his fiduciary obligation where he has been careless or negligent, rather than disloyal,[24] i.e., negligence (which involves a different standard of conduct - reasonable care) is not enough.

Reasonable Expectations

Nonetheless, although fiduciary obligations are normally imposed by the law[25], it is important that the expectation is reasonable. Where the potential fiduciary has indicated that he does not wish to undertake such responsibility, then he is not under such a duty, generally. For example, to take an extreme case, in the New Zealand decision of Bowkett v. Action Finance Ltd.[26], an elderly couple executed security documentation for an advance in the presence of a legal executive acting for the finance company which made the loan. The legal executive made it perfectly clear to the couple that she was not acting for them, and obtained an oral and written acknowledgement from them to this effect; she also told them to obtain independent advice, but they declined to do so. In an action against the lender for breach of fiduciary duty, amongst other things, it was held, first, that no fiduciary duty was owed, as there had been no undertaking of responsibility, either express or implied, by the lender; and, secondly, it was not reasonable for the Bowketts

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[24] Giradet v. Crease & Co. (1987) 11 B.C.L.R. (2d) 3G1, at p.362, per Southin J.; L.J. in Bristol and West Building Society v. Mothew [1997] 2 W.L.R. 436, at p.450B-C.

[25] Finn, P.D., "The Fiduciary Principle", supra, at p.54; and Gautreau J., "Demystifying the Fiduciary Mystique", supra, at p.13.

[26] [1992] 1 N.Z.L.R. 449.

to repose trust and confidence in the finance company in the circumstances, either directly or through the legal executive; and neither did they do so. Similarly, in the American case of Committee on Children's Television Inc. v. General Foods Corp.[27], the court said that "before a person can be charged with a fiduciary obligation, he must either knowingly undertake to act on behalf and for the benefit of another, or must enter into a relationship which imposes that undertaking as a matter of law."[28]

(2) Factors Giving Rise To A Fiduciary Duty

This leads to the question: what are the factors which will give rise to this duty of selflessness or "loyalty"[29]? As stated above, various judges and commentators have used many descriptions. The most

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[27] (1983) 673 P. 2d. 660.

[28] At p.675.

[29] Ogilvie argues that it is loyalty which is the "super added duty" which takes a fiduciary duty over and above the delictual duty of reasonable skill and care: see "Banks, Advice-Giving And Fiduciary Obligations" (1985) 17 Ottawa Law Review 263, at p.282. See also Gill, J., "A Man Cannot Serve Two Masters: The Nature, Existence and Scope of Fiduciary Duties" Vol. 2, 1989-90, Journal of Contract Law 115, at p.122, who refers to the protection of the duty of loyalty as the fiduciary relationship's "raison d'etre"; Shepherd, J.C., The Law of Fiduciaries (1981), at pp.47-48; and Waters, "LAC Minerals", supra, at p.468.

common is "vulnerability"[30]. However, whilst it may be present in such a relationship, it is not an essential ingredient in the fiduciary equation[31]: as it is not at the heart of the duty.

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[30] See, for example, Cooke P. in Watson v. Dolmark Industries Ltd. [1992] 3 N.Z.L.R. 311, at p.315, lines 50-56, who regards vulnerability as "an important, indeed cardinal, feature of a fiduciary relationship".

[31] Cf. Sopinka J in LAC Minerals, supra, at p.63, who regarded it as critical, and cited the view of Dr. Ong in "Fiduciaries: Identification and Remedies" (1986) 8 Uni of Tas L.R. 311, that the essential feature of a fiduciary relationship as "implicit dependency". See also the views of Wilson J. in Smith v. Frame (1987) 42 D.L.R. (4th) 81, at pp.98-100, where her Honour lists three characteristics of a fiduciary obligation:

(1) a discretion or power in the fiduciary;

(2) the fiduciary affecting the beneficiary's interests unilaterally; and

(3) the beneficiary being vulnerable, or at the fiduciary's mercy.

This vulnerability arises from the beneficiary's inability to stop the exercise of the power or discretion, plus "the grave inadequacy" of other legislation or practical remedies to redress this wrongful exercise of power or discretion. (Although Wilson J. was dissenting in that case, the principles have been approved by the Canadian Supreme Court in LAC Minerals, supra and subsequent cases).

(i) Vulnerability

"Vulnerability" is a characteristic[32], but is also present in a contractual relationship, where the standard of conduct expected is lower[33]. For example, if X supplies goods to Y on credit, particularly without a retention of title clause, then X is vulnerable until Y pays him. Alternatively, a bank is vulnerable when it lends money to a customer - particularly if the loan is unsecured, or the value of the borrower's security declines. Moreover, even when the parties are in a fiduciary relationship, such as a partnership, it is difficult to say that partners in a law or accountancy firm[34] are vulnerable in relation to each other, except to the extent of misconduct or fraud by a partner, which does not depend on there being a fiduciary obligation: such things can happen when the parties are in an arm's length contractual relationship.

(ii) Reliance/Dependency

Another factor is "reliance", namely that the beneficiary is relying upon the fiduciary. However, with nothing more, this is no different from a duty of care in negligence[35]. Again, in a contractual context,

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[32] Gautreau J., "Demystifying The Fiduciary Mystique", supra, at p.5.

[33] A similar view is expressed by Finn, "The Fiduciary Principle", supra, at pp.32 and 46.

[34] Similar views have been expressed by Finn, "The Fiduciary Principle", supra; and Gautreau J. "Demystifying The Fiduciary Mystique", supra, at p.5.

[35] Ironically "borrowed" from fiduciary law (see Nocton v. Lord Ashburton [1914] A.C. 932 (H.L.(E.)) in Hedley Byrne & Co. v. Heller & Partners Ltd. [1964]

one party can be reliant upon another to perform their part of the bargain, particularly where the former is at risk to the latter.[36] Nor is it enough that one party is dependant on the other, because the need for information by a party can occasion this dependency[37]. Moreover, a contract, by its nature, is a set of mutual, interdependent obligations to be performed by the parties,

(iii) Ascendancy/Inequality of Bargaining Power

Where one party is in an ascendant position, this inequality of bargaining power between the parties is not conclusive that the party in the ascendant position is in a fiduciary relationship with the

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A.C. 465 (H.L.(E.)). See also Robinson v. National Bank of Scotland 1916 S.C. 154, at p.157, per Viscount Haldane L.C. (H.L.).

[36] A similar view is taken by Lord Mustill in In Re Goldcorp Exchange Ltd. (In Receivership) [1995] 1 A.C. 74, at p.99D-F, who observes that a fiduciary relationship introduces different obligations from those deriving from a contract. His Lordship noted that "[m]any contractual relationships involve . . . reliance by one party on the other, and to introduce the whole new dimension into such relationships which would flow from giving them a fiduciary character would . . . have adverse consequences . . ."

[37] Finn, "The Fiduciary Principle", supra, at p.46. Cf. Ong, "Fiduciaries: Identification and Remedies" (1986) 8 Uni. of Tas L.R. 311, who regards implicit dependency as the common element to all fiduciary relationships - mere execution of a task is not enough. However, for the reasons given above, this view is not correct.

other party.[38] For example, in a contractual relationship, depending on the circumstances, one party may have obtained the better side of the bargain and so will be in the "ascendancy", such as where the other party is heavily indebted and sells its assets cheaply to pay creditors; also, the nature of commerce means that parties of different bargaining strengths enter into transactions with each other, as each side is hoping to obtain a benefit from the transaction. Parties to contracts are commonly in unequal bargaining positions, and often make representations with the aim and result of influencing the other party[39]. Further, competition helps to rebut arguments about disparity of bargaining power, namely, that banking is a competitive enterprise with customers having a free choice[40].

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[38] In Australia, Gibbs C.J. has, rightly, indicated that inequality of bargaining power may, on occasions, show the existence of a fiduciary relationship, but concludes, "it is clear that such inequality alone is not enough to create a fiduciary relationship in every case and for all purposes. . .": see Hospital Products, supra, at pp.169-70. See also La Forrest J. supra, at p.42; Fisher J. in Cook v. Evatt (No. 2) [1992] 1 N.Z.L.R. 676, at p.685; and United States, where inequality of bargaining power has been a significant factor in holding there is a quasi-fiduciary relationship: see Curtis, "The Fiduciary Controversy: Injection of Fiduciary Principles Into The Bank-Depositer and Banker-Borrower Relationship" (1987) Loyola L.A. Law Review 795, at p.818.

[39] Finn, "Contract and the Fiduciary Principle", supra, at p.94.

[40] Curtis, supra, at p.818.

(iv) Practical Capacity To Influence Other Party

It is not enough that one party has a practical capacity to influence the other.[41] Representations are made, and information supplied, or not supplied, as a matter of course with the object of, and in fact, influencing a host of contractual dealings[42].

(v) Trust and Confidence

The existence of some degree of "trust" and "confidence"[43] is also not conclusive that a relationship is fiduciary in character, as these

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[41] Finn, "The Fiduciary Principle", supra, at p.46; and "Contract and the Fiduciary Principle", supra, at p.94. See the judgements of Mason J. in Hospital Products, supra, at pp.96-67; and Wilson J in Frame v. Smith, supra, on this point. Gill, "A Man Cannot Serve Two Masters" supra, at p.129, regards Mason J. as having identified the fundamental element as being "representation".

[42] Finn, "The Fiduciary Principle", supra, at p.46, and "Contract and The Fiduciary Principle", supra, at p.94.

[43] See Tipping J. in Estate Realities Ltd. v. Wignall [1991] 3 N.Z.L.R. 482, at p.492, who regards a fiduciary relationship as one "where one party is reasonably entitled to repose and does repose trust and confidence in the other, either generally or in the particular transaction." Waters says that a fiduciary has been described "as one in whom trust and confidence is placed by the person who looks to the fiduciary for the performance of some act": see "Banks, Fiduciary Obligations and Unconscionable Transactions", supra, at pp.55-56. In these instances, it is submitted, the words "trust" and "confidence" are used without explanation. Cf. La Forrest J. in LAC Minerals, supra, at p.35, who states:

"qualities" are commonly placed in the skill, integrity, fairness and honesty of the other party in contractual dealings[44]. The terms "trust" and "confidence"[45], it is suggested, are imprecise. For

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> "The existence of such a bond plays an important role in determining whether one party could reasonably expect the other to act or refrain from acting against the interests of the other."

See also Curtis, supra, at p.797.

[44]Finn, "The Fiduciary Principle", supra, at p.46; and "Contract and The Fiduciary Principle", supra, at p.94. See also Gibbs C.J. in Hospital Products, supra, at p.69, who does not regard confidence as being either necessary or conclusive of a fiduciary relationship because, on one hand, a trustee is in a fiduciary relationship to a beneficiary, even though the latter at no time reposed confidence in the trustee; and, on the other hand, an ordinary sale transaction does not lead to a fiduciary relationship "simply because the purchaser trusted the vendor and the latter defrauded him."

[45]See Sir Eric Sachs in Lloyds Bank Ltd v. Bundy [1975] Q.B. 326, at pp.340-341; and the comments thereon by Lord Scarman in National Westminster Bank plc. v. Morgan [1985] A.C. 686, at pp.708-709, who agrees generally, but felt the word "confidentiality" should not be used to describe the relationship. But, as Gautreau J., notes it is not clear whether the Law Lords were "referring to a fiduciary relationship or the relationship necessary to give rise to a presumption of undue influence: see "Demystifying the Fiduciary Mistique", supra, at p.9, fn. 30. Cf. La Forrest J. in LAC Minerals, supra, at pp.35-36, who, after noting that the law of confidence and fiduciary relations are distinct and not co-extensive, says:

example, X might say to Y that he trusts Y and has complete "confidence" in him when he has asked Y to do something, but this does not mean that X has placed Y under a fiduciary obligation, and neither party would interpret the situation as such. The statements of trust and confidence in this context are ones of encouragement: and not obligation[46]. Thus, "mere friendship or confidence in the

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> " . . . the facts giving rise to an obligation of confidence are also of considerable importance in the creation of a fiduciary obligation. If information is imported in circumstances of confidence, and if the information is known to be confidential, it cannot be so denied that the expectations of the parties maybe affected so that one party reasonably anticipates that the other will not act or refrain from acting in a certain way."

[46]A similar view is expressed by Finn in "Contract and the Fiduciary Principle", supra, at p.92. See also Gautreau J., supra, at p.9, who opines that confidence does not, of itself, lead to a fiduciary relationship: as confidence is placed in people on a daily basis: there also needs to be an undertaking and power. Where a relationship is of long standing, it may lead to trust and confidence growing over time and, hence, a fiduciary relationship, even though it was not one to start with, especially in the case of a bank: see Lloyds Bank Ltd v. Bundy [1975] Q.B. 326 (C.A.), and Finn, "The Fiduciary Principle", supra, at p.47, fn.272. But, just because parties have dealt with each other for a long time and they "trust" each other, does not mean that one party ("X") is entitled to expect the other ("Y") to subordinate their interests in favour of X. X might expect Y to act honestly and fairly due to the time period with which they have dealt with each other, or, the fact that they have always dealt with each other fairly, which may have engendered this "trust", but that is all; each

professional skill and in the integrity and truthfulness of another", is not enough[47]. What the terms mean in a fiduciary context, it is suggested, are that X trusts Y to act in X's interests ahead of Y's own interests, and X has confidence Y will do so, or X has imparted confidential information to Y, i.e., "bared his soul"[48]. Also, nearly every banker/customer relationship would lead to a fiduciary relationship if all the customer had to do was prove trust and confidence existed[49].

What Else Is Needed?

The question becomes: what is the additional factor which will translate these characteristics from ones in which the other party's interests are considered, or things are done for the other party's benefit[50], into one's in which the other party's interests are paramount[51]?

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side is still free to pursue their own ends, or seek the best deal for themselves: the "trust" built up merely makes the business relationship a happier (and more successful) one, and a continuing one.

[47]Curtis, supra, at pp.798-799.

[48]Standard Investments Ltd. v. C.I.B.C. (1985) 22 D.L.R. (4th) 410.

[49]Curtis, "The Fiduciary Controversy", supra, at p.828.

[50]Finn, "The Fiduciary Principle", supra, at pp.31-32.

[51]See Finn, "Contract and the Fiduciary Principle", supra, at p.84.

The position is authoritatively stated by Professor Finn (as he then was), who says[52]:

> "What must be shown . . . is that the actual circumstances of a relationship are such that one party is entitled to expect that the other will act in his [the first party's] interests in and for the purposes of the relationship. Ascendancy, influence, vulnerability, trust, confidence or dependency doubtless will be of importance in making this out, but they will be important only to the extent that they evidence a relationship suggesting that entitlement. *The critical matter in the end is the role that the alleged fiduciary has, or should be taken to have, in the relationship. It must so implicate that party in the other's affairs or so align him with the protection or advancement of that other's interests that foundation exists for the 'fiduciary expectation*".[53] (Italics added)

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[52] "The Fiduciary Principle", supra, at pp.46-47. This passage was cited with approval by La Forrest J. in LAC Minerals, supra, at p.29. See also Finn, P.D., "Contract and The Fiduciary Principle", supra, at p.93.

[53] Cf. Gautreau J., "Demystifying The Fiduciary Mystique", supra, at p.7, provides the following definition:

> "A fiduciary relationship will occur where a person undertakes, either expressly or by implication, to act in relation to a matter in the interests of another, in a manner that is defined or understood by them, and is entrusted with a power to affect such interests. The other person relies on or is otherwise dependant on this undertaking, and, as a result, is in a position of vulnerability to the exercise of such power; and the first person knows, or should know, of such reliance and vulnerability. The nature and

Or, to put it another way[54]:

> " . . . one party has relaxed, or is justified in believing he can relax, his self-interested vigilance or independent judgement because, in the circumstances of the relationship, he reasonably believes or is entitled to assume that the other is acting or will act in his (or their joint) interests. The trust reposed or invited, the ascendancy acquired, etc. must in all the circumstances be capable of sustaining this conclusion."

Thus, the critical matter is the fiduciary's undertaking to the beneficiary and the expectation it engenders.[55]

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circumstances giving rise to the undertaking are such that loyalty and good faith are intrinsic elements of the consequent duty."

General agreement is expressed with this definition, although it does not quite go to the heart of the fiduciary relationship in the way Professor Finn's description, quoted in the text, does. The difficulty is that Gautreau J. still relies on words like "vulnerability", "reliance" and "dependant" in his definition, when, as he notes earlier, the first, at least, is but a characteristic of a fiduciary relationship.

[54]Finn, P.D., "Contract and The Fiduciary Principle", supra, at p.94. See also Committee on Children's Television Inc. v. General Foods Corp. 35 Cal. 3d 197, 222, 673 P. 2d. 600, 676, 197 Cal. Rptr. 783,799 (1983), where it is said of a fiduciary that he "assumes duties beyond those of fairness and honesty . . . [and] he must undertake to act on behalf of the beneficiary, giving priority to the best interests of the beneficiary."

[55]Austin, Professor R.P., supra, at p.446.

(3) When Will A Bank Be A Fiduciary?

Having defined what a fiduciary relationship is, it is now necessary to look at the circumstances in which the courts will impose a fiduciary obligation in a banking context, which is essentially a commercial/contractual one and one in which the bank is not seeking to prefer the borrower's interests to its own[56].

In deciding whether to impose a fiduciary obligation, the courts have had a balancing act between two competing principles: (i) freedom of contract, and (ii) equitable justice (where the court will intervene in a relationship in which an injustice has occurred to ensure an injured party does not go without a remedy)[57]. In general, where there is an arm's length contract between the parties in a commercial context, the courts have been reluctant to impose a fiduciary duty.[58] The

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56 Cranston, R., "The Bank's Duty of Disclosure" [1990] J.B.L. 163, at p.164.

57 Gill, "Two Masters", supra, at p.120.

58 Hospital Products, supra: see, in particular, Gibbs C.J., at pp.70 and 72. Cf. Mason J., at p.100, who refers to the need to balance the imposition of equitable doctrine in commerce (i.e., fiduciary duties) "against the need in appropriate cases to do justice by making available relief in specie through the constructive trust, the fiduciary relationship being a means to an end." In L.A.C. Minerals, supra, per Sopinka J., at p.61, noted there was a "judicial reluctance" to do so, except where really necessary. In that case, La Forrest J., at p.34, regarded it as trite that fiduciary relationships are not normally invoked in arm's length situations. Similarly, in Smith v. Frame, supra, at p.100, Wilson J, says that experienced business men can agree the scope of the power to exercised (by the fiduciary). See also D.H.L. International (N.Z.) Ltd. v.

reason for this is clearly explained by Kennedy J., of the Supreme Court of Western Australia, in a statement approved by the Canadian Supreme Court[59], in which his Honour says[60]:

> It would seem that part of the reluctance to find a fiduciary duty within an arm's length commercial transaction is due to the fact that the parties in that situation have an adequate opportunity to prescribe their own mutual obligations, and that the contractual remedies available to them to obtain compensation for any breach of those obligations should be sufficient. Although the relief granted in the case of a breach of a fiduciary duty will be moulded by the equity of the particular

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Richmond [1993] 3 N.Z.L.R. 10, noted by Hood, P., "Fiduciary Obligations in a Contractual Commercial/Contract": *DHL International (N.Z.) Ltd. v. Richmond* [1994] J.B.L. 285; and Cegami Investments Ltd. v. A.M.P. Financial Corporation (N.Z.) Ltd. [1990] 2 N.Z.L.R. 308, at p.313.

[59]Per Sopinka J (McIntyre and Lamer J.J., agreeing), at p.60, in LAC Minerals, supra.

[60]"Equity in a Commercial Context" in Equity and Commercial Relationships, (1987) (P.D Finn, ed.), at p.15. A similar view is expressed by Gautreau J., "Demystifying the Fiduciary Mystique" (1989) Canadian Bar Review 1, at p.11, where his Honour states:

> "[T]here is still a common belief that general commercial transactions between experienced businessmen will deny the existence of fiduciary obligations, unless the parties clearly provide for it. It is said that if the parties have worked out the details of their relationship and have reduced it to a written contract, there is not much room for a court to interfere by implying a fiduciary duty that the parties have declined to express."

transaction, an offending fiduciary will still be exposed to a variety of available remedies, many of whom go beyond mere compensation for the loss suffered by the person to whom the duty was owed, equity, unlike ordinary contract law, having regard to the gain obtained by the wrongdoer, and not simply to the need to compensate the injured party."

However, this does not to mean that the courts will not impose a fiduciary obligation in a commercial context, and the fact that the matter is contractual or commercial should not of itself preclude the imposition of a fiduciary obligation, where appropriate[61]. This was acknowledged by Mason J., in Hospital Products Ltd. v. United States Surgical Corporation[62], who, after saying it has never been doubted that contractual and fiduciary relationships may co-exist between the same parties, and that the existence of a contractual relationship has,

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61 See, for example, Elders Pastoral Ltd. v. Bank of New Zealand [1989] 1 N.Z.L.R. 180 at p.192, per Somers J., who notes "that fiduciary obligations are not only excluded by contract but may depend upon contract for their existence." See also Mason J. in Hospital Products (1984) 156 C.L.R. 41, at p.97, who has the same view, and who notes, at pp.99-100, that the fiduciary relationship has to fit in with the contract.

62 Supra, at pp.99-100. Although his Honour dissented in this case, the logic of his view is impeccable and now represents the law; as Austin, supra, at p.448, observes, this view appears to have found favour in the subsequent decision of the High Court of Australia in United Dominion Corp. v. Brian Ltd. (1985) 157 C.L.R. 1, where Dawson J., a member of the majority in Hospital Products appeared to change his view and allow a fiduciary duty in a pre-contractual (partnership) situation.

in many cases, provided the foundation of a fiduciary relationship, said:[63]

> "There has been an understandable reluctance to subject commercial transactions to the equitable doctrines of constructive trust and constructive notice. But it is altogether too simplistic, if not superficial, to suggest that commercial transactions are outside the fiduciary regime as though in some way commercial transactions do not lend themselves to the creation of a relationship in which one person comes under an obligation to act in the interests of another. The fact that in the great majority of commercial transactions the parties stand at arm's length does not enable us to make a generalization that is universally true in relation to every commercial transaction. In truth, every such transaction must be examined on its merits with a view to ascertaining whether it manifests the characteristics of a fiduciary relationship."

A contrary view was expressed by Dawson J., in the same case, who said[64]:

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[63](1984) 156 C.L.R. 46, at p.97.

[64] (1984) 156 C.L.R. 46, at p.149. See the criticisms of this reasoning by Gill, "Two Masters", supra, at p.127, which are based on two grounds: (1) that it fails to recognise commercial fiduciaries, e.g., partners, agents, and trustees, who are fiduciaries even when dealing with parties in a commercial context occupying equal bargaining positions; and (2) Dawson J.'s comments suggest that the obligations imposed on fiduciaries (i.e., to avoid conflicts of interest and duty, and not to make a secret profit) are not as clear as, or are more confused than, obligations imposed by (contract) law.

> To invoke the equitable remedies sought in this case would, in my view, be to distort the doctrine and weaken the principle upon which those remedies are based. It would be to introduce confusion and uncertainty into the commercial dealings of those who occupy an equal bargaining position in the place of the clear obligations which the law now imposes upon them."

A similar concern about the effect of the imposition of fiduciary duties in a commercial context (banking) has been expressed by Professor Allan.[65]

These fears are not well-founded. The imposition of fiduciary duties will not throw commercial law into turmoil[66], or stifle commerce[67], as

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Whilst these criticisms are, generally, agreed with, it is suggested that what Dawson J. is saying is that where there is a contract, this should regulate the duties where they are outside the traditional categories of fiduciary duty, because the parties will not know if they have higher obligations than those set out in their contract. As to the effect on commerce: see Gautreau J. "Demystifying The Fiduciary Mystique", supra, at p11; and LAC Minerals, supra.

[65]"Bankers Liability For Financial Advice" (1987) M.U.L.R. 213, at p.218. Cf. LAC Minerals, supra, and Gill, "Two Masters", supra, at p.146, who argues that all this does is place a requirement on a banker to avoid conflicts between his interest and his duty when advising a customer or promoting a scheme. With this view it is respectfully agreed, especially if the bank suggests that the customer seek independent professional advice.

[66]La Forrest J. in LAC Minerals, supra, at p.47.

[67]Gautreau J., "Demystifying The Fiduciary Mystique", supra, at p.27.

many fiduciary duties often only appear in a commercial context, such as those of an agent, a director or a promoter.[68] Outside these traditional categories, it is rare that commercial relationships will involve fiduciary obligations. This is not because they are immune, but rather, in the circumstances, their application is not appropriate[69], or "they do not satisfy the criteria, not because they are commercial, that such transactions do not usually carry with them fiduciary duties and the remedies flowing from a breach of such duties."[70] Whilst fiduciary duties may exist in a contractual environment, the fiduciary rubric will not be used to rewrite the contractual bargain[71]; and neither can it be inconsistent with the provisions of the contract.[72] It is by their contract that "the parties

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[68]Gill, "Two Masters", supra, at p.126. See also Gautreau J., "Demystifying the Fiduciary Mystique", supra, at p.14; McBryde, The Law of Contract in Scotland (1987), at para.10-35, fn.81, on p.216; and Gloag, W.M., On Contract, 2nd ed., reprinted 1985, in Ch.XXXI, "Contracts By Parties In Fiduciary Positions".

[69]La Forrest J. in LAC Minerals, supra, at p.47.

[70] Lehane, J.R.F., "Fiduciaries in a Commercial Context" in Essays In Equity (1985) (P.D. Finn, ed.) 95, at p.104.

[71]Gill, "Two Masters", supra, at p.140; and Gibbs C.J. and Dawson J. in Hospital Products, supra, at pp.71 and 143, respectively.

[72] See Mason J in Hospital Products, supra, at p.97, who says that the contract regulates the rights and liabilities of the parties to it, and that the fiduciary relationship, if it is to exist, must accommodate itself to the contract: it cannot be superimposed to alter the contract; Lord Clyde in Raymond Harrison & Co.'s

have defined their rights and obligations towards each other . . . [and it is] the court's task to give effect to those wishes in the contract, and not to try to rewrite the contract by imposing a fiduciary relationship, which is inconsistent with them".[73]

Situations In Which Banks Will Be Fiduciaries

In the case of banks, the nature of their business involves them considering their own interests, as they "are not charitable institutions"[74], and seek to make its profits from lending money and providing other financial service to customers. Therefore, the situations in which a bank is likely to be under a fiduciary duty are as follows[75]:

Trustee v. North West Securities Ltd. 1989 S.LT. 718, at p.722G-I; Lothian v. Jenolithe Ltd. 1969 S.C. 111; Kelly v. Cooper [1993] A.C. 74 (P.C.); In Re Goldcorp Exchange Ltd. (In Receivership) [1995] 1 A.C. 74 (P.C.) and DHL International (NZ) Ltd. v. Richmond Ltd. [1993] 3 N.Z.L.R. 10, at p.22.

[73] Hood, P., "Fiduciary Obligations In A Contractual/Commercial Context: *DHL International (N.Z.) Ltd. v. Richmond* " [1994] J.B.L. 285, at p.291.

[74] National Westminster Bank plc v. Morgan [1983] 3 All E.R. 85, at p.91, per Dunn L.J.

[75] Finn, "The Fiduciary Principle", supra, at p.51. See also Hood, P., "Lender Liability Under English Law": Ch. 2 in Banks, Liability and Risk (1995) 2nd edn. (R. Cranston, ed.), at pp.23-24, who refers to: (i) situations where the borrower is clearly relying on the lender for guidance, e.g., where the customer is one of longstanding; (ii) where the lender acts for both parties in a transaction, leading to a conflict of interests, e.g., where the vendor has an overdraft; and (iii) where a lender fails to disclose material facts in a conflict of interest

(1) Where the course of the relationship can found an expectation that advice will be given, but that, where necessary, it will be given adversely to the bank's self interest. It is on this basis that Lloyd's Bank Ltd. v. Bundy[76] can be regarded as a fiduciary case, and not one of unconscionability or undue influence.

(2) Where a bank has created an expectation that it is acting, and will act, in the customer's interests in a matter, as the bank's own interest in it is represented as being a formal one.

(3) Where a bank, though expected to act in its own interests in dealing *inter se*, has created an expectation that it will otherwise advise the customer in the latter's interests. An example of this being the advising on the wisdom of an investment for which the customer has applied for a loan.[77]

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situation. And see too Dassen Gold Resources Ltd. v. Royal Bank of Canada [1995] 1 W.W.R. 171, at p.211, para.18, where the following circumstances were said to give rise to a fiduciary duty: (i) an obligation not to breach a customer's trust; (ii) a duty to advise a borrower on the risks of a transaction, where the bank undertook to give advice; (iii) a duty not to use confidential information derived from the banker customer relationship; and (iv) a duty not to obtain a benefit from a transaction concerning advice the bank is aware that the customer is relying on.

[76] [1975] Q.B. 326. (C.A.).

[77] See Hayward v. Bank of Nova Scotia. (1984) 7 D.L.R. (4th) 135, and on appeal (1985) 19 D.L.R. (4th) 758. Cf. Catt v. Marac [1987] 9 N.S.W.L.R. 639, where the provider of finance did more than that, and, effectively, became a promoter of a business scheme: see the comments by Professor Allan on this case, "Bankers'

What the above emphasises is the importance of the expectations, on the part of the customer, of the undertaking by the fiduciary (bank): because from this, the fiduciary obligation flows.

The Banker As An Adviser

It is primarily when a bank is acting as an adviser to a customer that the bank will be liable as a fiduciary. This is a situation where the bank is required to loyally advise the customer as to what is best for the customer, regardless of the bank's position.

A bank will not be liable as an adviser where the borrower is exercising its independent judgement on the matter, including evaluating any advice given; or, the borrower is assuming responsibility for the way its interests are to be served, regardless of its competence.[78] Neither will there be liability where there has been no request for advice,[79] nor where a bank merely imparts information, rather than gives advice, because, the law draws a distinction between giving advice, and imparting information and ideas[80]: so that merely handing over brochures on a particular

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Liability For Financial Advice" (1987) M.U.L.R. 213, at p.222; and Gill, "Two Masters", supra, at p.146. (The case is also a case of non-disclosure.)

[78] Finn, "The Fiduciary Principle", supra, at p.50. See too Curtis, supra, at p.827.

[79] Lloyds Bank plc v. Cobb, unreported decision of the English Court of Appeal, delivered on 18th December, 1991; noted [1992] J.B.L. 419.

[80] James v. Australia and New Zealand Banking Group Ltd. (1986) 64 A.L.R. 347, at p.369, per Toohey J, in the Federal Court of Australia.

subject is not enough.[81] What the law is concerned with is the situation where the advice being relied on is tainted with a conflict between the bank's self-interest and its duty to advise its customer impartially[82]; under Scots law a fiduciary cannot be an *auctor in rem suam*[83].

Examples Of Banks As Fiduciaries

This then begs the question, what are the factors which will cause a bank to be in a fiduciary position and to breach its fiduciary duty? The typical situation occurs when the bank is in an advisory role and it either has a personal interest in the matter, or it acts for both sides[84], e.g., the borrowing customer and the selling customer, or the predator and target in a take-over. Two cases, in particular, emphasise the pitfalls, and warrant detailed consideration. The first concerned non corporate customers, whilst the second involved valued corporate clients of a bank.

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[81] Royal Bank Trust Co (Trinidad) Ltd. v. Pampellone [1987] 1 Lloyd's Rep. 218 (P.C.).

[82] Cook v. Evatt (No. 2) [1992] 1 N.Z.L.R. 676.

[83] See also Aitken v. Hunter (1871) 9M. 756, at p.762, per Lord Neaves; and Clark v. Clark's Executors 1989 S.L.T. 665, at p.666, per Lord Mayfield. See also Gloag W.M., On Contract, 2nd edn., at p.508.

[84] See Ogilvie, M.H., "Banks, Advice-Giving And Fiduciary Obligations" (1985) 17 Ottawa Law Review 263, at p.282, but see also, at pp.271-272; and Hood. P., "Lender Liability Under English Law": Ch. 2 in Banks, Liability and Risk (1995) 2nd edn., at pp.23-24.

(1) Commonwealth Bank of Australia v. Smith[85]

The Smiths were "a couple of country people who ha[d] got no great experience in the business world who relied on the bank for ordinary sort of financial advice for a long time"[86]. In 1987, the Smiths approached the manager of the bank about purchasing a hotel in their local vicinity which they wished to manage. To finance this purchase, the Smiths intended to sell their house to provide part of the funding, and to seek the balance from the bank.

After looking at several hotels, the choice was narrowed down to two hotels: (1) the Kadina Hotel, which the Smiths were interested in; and (2) the Weeroona Hotel, which was leased by another customer of the bank, ironically named, No Justice Pty. Ltd ("No Justice"). No Justice had purchased the Hotel with the aid of a secured loan from the bank and had a sizeable overdraft in January, 1988 - although there was no indication of any pressure from the bank to reduce this, and its directors' accounts with the bank were in credit. In order to save costs, the bank's manager assumed the role of bringing the parties together, so that an hotel broker was not engaged.

The next month, at a meeting between the Smiths and the manager, the manager discouraged the Smiths from purchasing the Kadina Hotel, and told them that "the Weeroona Hotel would be a good hotel for [them], that it would be a better purchase than the Kadina Hotel

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[85](1991) 102 A.L.R. 453 (Federal Court of Australia).

[86] Twenty four years.

and it would be within their financial reach."[87] He also told the Smiths that the lease expired in July 1992, and that Mr Smith should approach the landlord about extending the lease for two years, as a "longer lease would make the purchase easier to finance"[88] - the manager indicated that the vendors had been granted an extension for two years. At this meeting, the manager also revealed that the vendors were customers of the bank and, thus, he had a conflict of interest, which meant he had to be careful about what he disclosed to the Smiths, as he could not prejudice the vendors' position.

Mr. Smith queried the purchase price of the Weerona Hotel with the manager, who dissuaded him from taking the matter further. However, it is clear that the transaction proceeded on the basis that, in a memorandum to his head office, regarding approval of the loan, the manager stated: (1) that the existing lease had four and a half years to run (which discounted any extension); (2) that the landlord indicated he would renegotiate the extension, but that this was unlikely to occur prior to settlement; and (3) therefore, the repayments would be set within the existing lease[89].

Before completion in March, 1988, the lessor indicated he would consider renewing the lease, but the manager failed to find out

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[87] Supra, at p.460. One apparent reason against the Kadina Hotel was that it was a "Brewery Hotel" with a very short lease.

[88] Supra, at p.460. What appears to have been contemplated was an enquiry concerning the extension of the lease for two years, as was the case under the existing lease, with two rights of renewal for two years each.

[89] Supra, at p.463.

whether, prior to completion, this extension had been granted. Therefore, when the bank sought a valuation of the property, the valuation was based on the erroneous belief that the lease was for the longer period. The valuation of only Aus. $138,000 for the leasehold of the property was below the purchase price, but gave the bank adequate security for the loan. The problem was that the Smiths were not informed of this valuation[90], which was below the $160,000 figure the manager had led the Smiths to believe was a good price.

A subsequent valuation obtained by the Smiths, over a year later, revealed that, at the date of completion, "the property" was worth $80,000; and that, at the date of the valuation it had a value of only $46,000.

Several causes of action were raised, including negligence, but the main one was breach of fiduciary duty.

The Full Court of the Federal Court of Australia, in examining the relationship between the bank manager and his customers, noted that the customers "looked to [the manager] as their guide in the matter. They evinced complete faith in him and they relied on him."[91] The Smiths were customers of longstanding; they had been discouraged to take independent advice; and they were persuaded not to try to negotiate a lower price.[92]

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[90]Supra, at p.472.

[91]Supra, at p.474.

[92]Ibid.

Moreover, the court felt that there was no reasonable basis for the manager's statement regarding the transaction being good value[93], although the Smiths "were entitled to think that the statement was made by a bank manager who had close knowledge of the hotel and what it was appropriate to pay for it."[94] The manager "was not merely acting in the interests of the bank; he had another capacity, namely, that of adviser to the [Smiths]."[95]

Guiding Principles by The Court

In discussing the question of fiduciary obligations, the court set out the following relevant principles, which provide guidance to bankers and customers alike.

(1) Where a bank gave financial advice to a customer, it was not a novel proposition that, apart from any contractual rights of the customer, the parties' relationship may also be one of a duty of care and a fiduciary duty.[96]

(2) Banks as financiers "will have a manifest personal interest"[97] of their own in a particular matter. The issue then is when has the

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[93] Supra, at p.475.

[94] Ibid. The court, infact, felt there "was a substantial degree of recklessness" about the manager's conduct.

[95] At p.475.

[96] At p.476, citing Halsbury's Laws of England (1989) 4th ed., vol.3(1), "Banking", at para.251.

[97] (1991) 102 A.L.R. 453, at p.476.

bank, given its "apparent commercial self interest", also "assumed a fiduciary responsibility"[98] towards its customer? In this regard, their Honours said:

> "A bank may be expected to act in its own interests in ensuring the security of its position as lender to its customer but it may have created in the customer the expectation that nevertheless it will advise in the customer's interests as to the wisdom of a proposed investment. This may be the case where the customer may fairly take it that to a significant extent his interest is consistent with that of the bank in financing the customer for a prudent business venture. In such a way the bank may become a fiduciary and occupy the position of . . . 'an investment adviser' . . . "[99]

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[98] Ibid.

[99] The court referred to two Canadian decisions as examples: Hayward v. Bank of Nova Scotia, supra, and McBean v. Bank of Nova Scotia (1981) 15 B.L.R. 296 (affmd. on appeal). These cases involved the same bank manager advising two separate customers to borrow from the bank to invest in the business of another customer (Polland) concerned with the breeding of exotic cows. This investment turned out to be a disaster in each case, and the manager was held to be in breach of his fiduciary obligations to his customers. The points, it is suggested, which are worth noting from these cases are: that in the first case, the relationship was of long standing, and in the second, there was substantial indebtedness to the bank by Polland and the manager had been actively involved in the business of Polland, leading to a conflict of interest. For a discussion of the cases: see Ogilivie, M.H., "Banks, Advice - Giving and Fiduciary Obligations" (1985) 17 Ottowa Law Review 263.

(3) This was not a case in which the Smiths and the bank were at arm's length with independent professional advice each.[100] These factors are significant in showing the absence of a fiduciary relationship. In the instant case, "the starting points" were: (i) the assumption by the manager of the role of introducing the parties and bringing them together; (ii) his then acting as the Smiths' financial adviser in the case; and (iii) the complete faith the Smiths evinced in him.[101]

(4) The "crucial incident of the fiduciary relationship . . . arose from the conflicting interests between the two sets of customers of the bank . . . "[102]: the bank had become the agent of one customer, No Justice, (and, in substance, two other customers - its directors), in assisting to procure the sale of the hotel business to two more

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[100] (1991) 102 A.L.R. 453, at pp.476-477. Cf. United Dominion Corp. v. Brian Ltd. (1985) 157 C.L.R. 1, where the beneficiary had the advantage of a large city law firm, and yet it was still able to recover for breach of duty: see Austin, "Commerce and Equity - Fiduciary Duty and Constructive Trust" (1986) O.J.L.S. 444, at p.448-449. This factor is not determinative. Perhaps it could be said that in the U.D.C. case, the fact that the breach occurred despite independent advice indicates the seriousness of the breach there.

[101](1991) 102 A.L.R. 453, at p.477.

[102] Ibid.

customers, the Smiths.[103] Where the fiduciary has a conflict of interest and duty, the court stated[104]:

> "Not only must the fiduciary avoid, without informed consent, placing himself in a position of conflict between duty and personal interest[105], but he must eschew conflicting engagements. The reason is that, by reason of the multiple engagements, the fiduciary may be unable to discharge adequately the one without conflicting with his obligation in the other. Thus, . . . where an adviser in a sale is also the undisclosed adviser of the purchaser, an actual conflict of duties arises . . . "

(5) It is not relevant "that the fiduciary may . . . not profit from the transaction he brings about between the parties."[106] Rather, the prohibition is concerned with the avoidance of conflict of duties and not the making of a profit, although breach of fiduciary duty may involve the wrongful acquiring of a profit, and not the infliction of loss. Whilst there was no evidence that the bank was placing pressure on the directors to sell, or that No Justice was encountering difficulties with its payments to the bank, nonetheless, it was not necessary for this to occur in order for there to be fiduciary obligations.[107]

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[103] Ibid

[104] Ibid.

[105] See also Cook v. Evatt (No. 2) [1992] 1 N.Z.L.R. 676, at p.694, line 30.

[106] (1991) 102 A.L.R. 453, at p.477.

[107] Ibid.

(6) The fully informed consent of a principal to the conflict will absolve a fiduciary from liability,[108] but "no precise formula" exists to determine this, and, it is a question of fact in the circumstances of the case. The mentioning by the manager of his conflict to the Smiths in February, 1988, was not sufficient, as he did not tell them to seek independent advice; instead, he persuaded them not to, and did his best to encourage them not to see an accountant or a hotel broker. Therefore, the manager should never have advised the Smiths on the merits of the transaction, and should have explained to them the need to take independent advice.[109]

(7) It is not relevant for a fiduciary to claim that, where there has been a non disclosure of material facts by him in breach of his fiduciary duty (in this case, the valuation) the disclosure of these facts would have made no difference to the customer's/beneficiary's action.[110]

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[108] See Phipps v. Boardman [1967] 2 A.C. 46; and Regal (Hastings) Ltd v. Gulliver [1942] 1 All E.R. 378, [1967] 2 A.C. 134n. In Scotland, on this point: see Sao Paulo Alparata S.A. v. Standard Chartered Bank 1983 S.L.T. 433, at p.439, per Lord Grieve.

[109] (1991) 102 A.L.R. 453, at p.478. As to the taking of independent advice: see Lloyds Bank Ltd. v. Bundy [1975] Q.B. 326 (C.A); and Barclays bank plc v. O'Brien.

[110](1991) 102 A.L.R. 453, at p.479, citing, with approval, Brickenden v. London Loan & Savings Co. [1934] 3 D.L.R. 465 at p.469, per Lord Thankerton. See too Lord Jauncey of Tullichettle, in the later case of Clark Boyce v. Mouat [1994] 1 A.C. 428, at p.437 (P.C.), who said: "Another case of breach [of fiduciary duty] is

(8) The most appropriate remedy, was compensation in equity,[111] rather than a constructive trust or an account of profits. The measure of compensation in this case being the difference between: (i) the value of the lease, and (ii) the sum paid for it, plus interest; there was no allowance for consequential loss once the deficiency in value was discovered.

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where a solicitor acts for both parties to a transaction without disclosing this to one of them or where having disclosed it he fails, unbeknown to one party, to disclose to that party material facts relative to the other party which he is aware of". See also Estate Realties Ltd. v. Wignall [1991] 3 N.Z.L.R. 482, at p.493, where Tipping J. stated that a person in breach of fiduciary duty cannot "excuse himself by saying that full disclosure would have made no difference." To similar effect is the statement of Fisher J. in Cook v. Evatt (No. 2), supra, at p.689; and Hill v. Rose [1990] V.R. 125, at pp.141-142, per Tadgell J. For an example of the severity of this rule: see Phipps v. Boardman, supra. As to a bank's duty of disclosure: see Cranston, R., "The Bank's Duty of Disclosure" [1990] J.B.L. 163, at p.164, where the point is made that, unless the borrower can establish a fiduciary relationship, or the lender has positively assumed a role of adviser or promoter, a borrower is unlikely to establish a duty of disclosure, as "a lender is not undertaking to prefer the borrower's interests to its own."

[111] See this topic discussed below. This would be a remedy of damages in Scots law, which is also discussed below.

(2) Standard Investments Ltd. v. Canadian Imperial Bank of Commerce ("CIBC")[112]

The second case is a somewhat celebrated Canadian case. Two customers (Ellen and Cohen) of long - standing with CIBC, who had built up a business in maritime companies, wished to take-over a company called Crown Trust Company ("Crown"). They decided that they would require the assistance, advice and financial support of the bank. In early 1972, in order to strengthen their relationship with the bank, Cohen and Ellen, who were valued customers, put a substantial amount of business the way of their local branch of the bank by transferring the accounts of two of their companies from a rival bank. This pleased CIBC.

In April, 1972, some time after the loans and purchases had started, Cohen and Ellen met with the President of the bank and "bared their souls" to him about their plans, including their plans to acquire all the shares in Crown. The President (Wadsworth) said he would do everything he could to help them along with their venture and there was no note of discouragement from him. Ellen and Cohen were aware that CIBC were the bankers for Crown and that a director and customer of CIBC, McDougald, was an adviser to an estate which had a large stake in Crown and that the estate relied heavily on McDougall's advice. At the meeting with the President, Ellen and Cohen indicated that they would like an introduction to McDougald to discuss the sale of the estates stake in Crown. The President agreed to arrange this.

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[112] (1985) 22 D.L.R. (4th) 410.

Unknown to Wadsworth in January, 1972, the then chairman and the other directors of CIBC decided to purchase a ten percent stake in Crown, (which was the legal limit under the then Canadian Bank Act, R.S.C. 1970)[113] in order to thwart the take-over, as McDougald wanted to keep Crown a small and tightly controlled company.

Wadsworth subsequently became chairman of CIBC, and also become aware of the facts about the bank's stake in Crown, but he did not disclose them to Cohen and Ellen, and neither did the other directors.

McDougald died in 1978, and was succeeded by one Conrad Black. Black was also a customer and director of the bank, and had acquired a nineteen percent holding in Crown, as well as purchasing an additional twenty-five percent stake in Crown from the estate, which the bank financed. He had made an agreement with the new chairman, Harrison, a personal friend, that one would not sell its shares without the other. Eventually Black sold his stake to a third party (Canwest Capital Corporation) at well below the market price, and the bank sold its pivotal stake to the same third party. The result was that Cohen's and Ellen's bid failed; and they were left with a minority stake, forming part of their security for the advances by the bank for the take-over, which had declined in value.

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[113]Subsequently re-enacted by the Canadian Banks and Banking Law Revision Act, 1980.

The Ontario Court of Appeal held that a bank could be in a fiduciary relationship in certain circumstances[114]. The court took the view[115] that Ellen and Cohen were relying on the advice, assistance and guidance of the bank, and that Wadsworth was aware of their reliance. Consequently, the court said[116] there had been a breach of fiduciary duty in three respects:

> (i) CIBC's failure to declare they had a conflict at any time;
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> (ii) its subsequent providing assistance and advice to rivals of Ellen and Cohen; and
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> (iii) its purchase of the Crown shares - which was never revealed - was for CIBC's own benefit, and to the detriment of Ellen and Cohen.

It summed up the position by saying that the bank:[117]

> " . . . had a duty to disclose any conflict of interest and to deal fairly with the plaintiffs. This it did not do. It practised secrecy and non-disclosure while pursuing its own interests in retaining some of the plaintiffs and obtaining others of the plaintiffs as customers of the bank and the sale

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[114](1985) 22 D.L.R. (4th) 410, at p.432, relying on Lloyds Bank Ltd. v. Bundy [1975] Q.B. 326.

[115] (1995) 22 D.L.R. (4th) 410, at pp.435-436.

[116] Supra, at p.435.

[117] Supra, at p.441.

of its Crown . . . shares for its own benefit and the benefit of another customer."[118]

The court concluded that "a person can, by offering to give advice in a particular matter to another, create in himself fiduciary obligations stemming from the confidential nature of the relationship created."[119]

The Standard Investments case has been criticised as not being a fiduciary case, in the sense of subordinating your interests to someone else's, rather it was a case of lack of good faith.[120] With respect, this is not correct. The customers had every right to expect that the bank would look after their (the customers') interests ahead of its own (and those of any other relevant party): they had come to it for advice, assistance and guidance. The customers did not expect the bank to aid the target (another customer) at the behest of one of the bank's directors (who was also a customer) by purchasing shares in the target for its own benefit and to the detriment of the customers, who had not only put further business the bank's way, something the bank was delighted to accept, but who had also "bared their souls" to the bank, and actively sought advice and

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[118] Waters describes the case as one of "a conflict of duties", rather than a conflict of duty and interest: see "Banks, Fiduciary Obligations and Unconscionable Transactions", supra, at p.40.

[119] (1985) 22 D.L.R. (4th) 410, at p.443.

[120] Finn, "The Fiduciary Principle", supra, at p.48. For a discussion of this case: see Waters, "Banks, Fiduciary Obligations and Unconscionable Transactions", supra.

assistance from it. This lead to the horrendous conflict of interests which the bank had due to the loyalty expected from it by Ellen and Cohen. It was not a case that, because the bank had a conflict, that it was in a fiduciary relationship[121], rather, the duty of loyalty meant there was a conflict where the bank was actively working against the interests of the parties it was engaged to protect.

Conflicts Of Interest

Where the bank is acting in an advisory role to a customer, the bank must be careful when the other side to a transaction is also a customer of the bank. This is especially so when the vendor in a sale is in debt to the bank[122]. The reason is that the customer, who

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[121]Finn, P.D., Fiduciary Obligations (1977), at p.2.

[122]See, for example, Woods v. Martins Bank Ltd. [1955] 1 Q.B. 55, where the manager advised a naive customer that an investment in the business of another customer was a wise one, although there was no basis for this statement, as the bank was pressing the second customer to reduce its sizeable overdraft. Salmon J. (as he then was) considered there was a fiduciary relationship between the parties and said that the bank should never have advised Wood. Hayward's case, supra, and the Smith case, supra, also indicate this. See too Guertin v. Royal Bank of Canada (1984) 1 D.L.R. (4th) 68, where a bank manager used his client's confidential information to help a company which the manager's wife was sole shareholder in to out bid the client for a snack bar in a shopping centre. The owners of the shopping centre were clients of the bank. The court held that there was a breach of fiduciary duty and a positive duty on the manager to disclose his interest to the customer, so

is not exercising independent judgement, is potentially being prejudiced by the bank. In the case of the indebted customer, the bank might wish it to sell so as to reduce its overdraft with the bank. Even if there is no pressure to reduce the overdraft, as in Commonwealth Bank Ltd. v. Smith[123], it leads to a suspicion that the bank is not giving the customer its undivided loyalty, which is what the customer is, not unreasonably, expecting and paying for, but might be recommending the transaction with its indebted customer in order to reduce the debt it owes to the bank, which would profit indirectly. Therefore, the bank is in such a position of conflict, it should decline to act for one of the parties (the borrowing customer), if not both parties, as it will have access to potentially confidential information, which, particularly in a take-over situation, as in Standard Investments, may be of considerable value to the party it decides to act for. The better course is that it declines to act for both sides, although current general commercial practice would seem to indicate that the bank will act for one of the parties; and, if it does so, this is likely to be the indebted customer.

Secondly, the bank should make it quite clear to the borrowing customer that it has a conflict of interest, and what this means. Merely saying to a customer that it has a conflict, which will restrict the information it can provide to that customer[124], is not sufficient and does not amount to informed consent (which, arguably, should

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that the customer could seek alternative financial assistance and, if necessary, make a better offer.

[123] Cf. the Hayward and McBean, cases, supra, on the exotic pigs.

[124] Commonwealth Bank of Australia v. Smith (1991) 102 A.L.R. 453.

be obtained from both customers). Moreover, the bank should strongly urge the customer to take independent advice[125].

Thirdly, the bank should disclose the full facts to its principal customer. Non-disclosure is the cause of so many breaches of fiduciary duty. The Smith case provides a classic case of non-disclosure, where the bank, after saying the transaction was a good one, failed to disclose a valuation which indicated this was not so.

Fourthly, the principal problem faced by a bank where it has a conflict of interests[126], involving two competing customers, is how much information it can disclose to each side. On the one hand, the details of the indebted customer's account, are subject to a duty of confidentiality[127]; and yet, on the other, an adviser is required to "put at his client's disposal not only his skill but also his knowledge, so far as is relevant; and if he is unwilling to reveal his knowledge to his client, he should not act for him. What he cannot do is act for the client and at the same time withhold from him any relevant knowledge that he has."[128] This puts the banker in a situation of "no

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125 Cornish v. Midland Bank Plc [1985] 3 All E.R. 513 (C.A.).

126 For an excellent discussion of the types of conflicts and the problems involved: see Finn, P.D., "Fiduciary Law and the Modern Commercial World" in Commercial Aspects of Trusts and Fiduciary Obligations (1992), (E. McKendrick, ed.), especially at pp.22ff.

127 Tournier v. National Provincial and Union Bank of England [1924] 1 K.B. 461 (C.A.).

128 Spector v. Ageda [1973] Ch. 30, at p.48, per Sir Robert Megarry V.C.

win",[129] because he is either liable for breach of confidence to the indebted customer, or breach of fiduciary duty to the borrowing customer. There is some judicial support for the view that a fiduciary will not be compelled to disclose confidential information to X which would cause the fiduciary to breach his duty to Y (whom the fiduciary acted for originally and whom X knew the fiduciary acted for).[130] But that authority is not strong,[131] being concerned with an unsuccessful attempt by the plaintiff, who insured goods with Lloyds Underwriters, to obtain an assessor's report, regarding lost goods, prior to discovery, which the defendant, an underwriter, commissioned from brokers.

Fifthly, it is highly unlikely that the courts will allow separate parts of a bank to act for each party, where the bank has a conflict of interest. In Standard Investments[132], CIBC - which had a wide network of branches across Canada - was regarded as a single entity,

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[129] Finn, "Fiduciary Law and the Modern Commercial World", supra, at p.25.

[130] North & South Trust Co. v. Berkeley [1971] 1 W.L.R. 470, at pp.484-486, per Donaldson J. (as he then was). See the discussion of this case in Kelly v. Cooper [1993] A.C. 205, at pp.213 and 215-216, per Lord Browne-Wilkinson, delivering the advice of the Judicial Committee, who agreed with the decision.

[131] It is respectfully suggested that Professor Finn overstates the proposition to be extracted from this case, when he says that "the law will not compel [a fiduciary] to make a disclosure to one party thereby breaching his duty to the other.": see Finn, P.D., "Fiduciary Law and the Modern Commercial World" supra, at p.25.

[132] (1985) 22 D.L.R. (4th) 410.

despite having two directing minds: Wadsworth, the President, who was originally ignorant of the bank's action towards Crown; and McKinnon, the Chairman. The court in that case stated that:[133]

> ". . . a corporation cannot be found in law to have a split personality so that it can rely on the lack of knowledge on the part of one of its directing minds of the acts, intention and knowledge of the other directing mind operating in the same sphere to protect it from liability for the actions of the first directing mind or the combined activities of both directing minds . . . [W]hen there are two or more directing minds operating within the same field assigned to both of them, the knowledge, intention and acts of each become together the total knowledge, intention and acts of the corporation which they represent."

The experience with Chinese Walls - most notably in the case of merged law firms - indicates that the Courts have been reluctant to accept them on the basis that they are not foolproof[134]. In one

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[133] At pp.430-431, per Goodman J.A. (delivering the judgement of the court).

[134] See Re a firm of Solicitors [1992] Q.B. 959 (C.A.); and Supasave Retail Ltd. v. Coward Chance [1990] 3 W.L.R. 1278; and the note by C. Boxer, "Chinese Walls: no longer impenetrable", The Lawyer, 15 September 1992, at p.8. Cf. the decision of Lightman J. in Re a firm of Solicitors [1995] 3 All E.R. 482, concerning a partner leaving one law firm and joining another firm, which acted against a client of the first firm. The test applied was whether there was a real risk that he possessed relevant confidential information (i.e., information that: (i) was originally confidential, (ii) is still confidential and recallable, and (iii)

case[135], where a law firm had acted for the plaintiffs in some litigation and were then instructed to defend a party in further litigation which was closely associated with the defendants in the original litigation, the court refused to let the firm act, even though the firm took the following safeguards:

(i) placing a completely different team on the case;

(ii) putting all documents relating to the original case in special storage;

(iii) locating the defendant's team in a different department and building; and

(iv) taking steps to ensure the two teams did not communicate with each other.

Apart from the practical objections, there is also a philosophical objection that segregation does not engender loyalty and may compromise the fiduciary's duty of loyalty[136]. The difficulty will arise when it has acquired confidential information about both sides in what Finn calls a "same matter conflict"[137]. This means the bank

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relevant): see pp.489-490. In that case, there was no such risk. This suggests a softening of approach.

[135]Re a firm of Solicitors [1992] Q.B. 959 (C.A.)

[136]Finn, "Fiduciary Law and the Modern Commercial World", supra, at p.26.

[137]"Fiduciary Law and the Modern Commercial World", supra, at p.22. A same-matter conflict occurs where two sections of a company (or two members of a firm) act for opposing parties in the same matter. Factually, the concern is

will have to decline to act for both sides - barring consent, because it will have information about both sides. The problem, too, for a bank, is it has a duty of confidentiality to both parties, and so disclosure will be difficult, from a practical point of view, especially where one party is agreeable to disclosure and the other is not.

Sixthly, the difficulty for the bank, in the end is a commercial one[138] (a bank's business being to make a profit for its shareholders). If the bank tells the borrowing customer, for example, that it cannot act for it, the bank risks losing not only its fees and interest on that transaction, but also losing the customer to another bank.

Essentially, it is a question of balancing the risks described above, with the possibility of an action for breach of fiduciary duty, and the possible commercial gain (or loss). For the prudent banker, it is a case of honesty and avoiding (obvious) conflicts.

(4) Remedies

There are three main remedies for breach of fiduciary duty: (i) the constructive trust, (ii) an account of profits, and (iii) compensation in equity (under English law), or damages (under Scots law).[139] The first two remedies concern a gain made by the fiduciary (bank) at

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with the information which the adviser possesses; legally, the concern is with the duty of loyalty to each client.

138 As it was for the firm of solicitors in Re a firm of Solicitors [1992] Q.B. 959 (C.A.)

139 Gautreau, the Hon. Mr Justice J.R. Maurice, "Demystifying The Fiduciary Mystique" (1989) Canadian Bar Review 1, at pp.17ff.

the beneficiary's (customer's/borrower's) expense, and is unlikely to occur very often (unless the bank was, ineffect, competing with the customer).[140] The third remedy - compensation/damages - concerns a (financial) loss to the beneficiary (customer/borrower), rather than a gain to the fiduciary (bank). It is the most likely remedy, and will be the focus of this section.

(i) Compensation in Equity under English Law

Compensation is an equitable remedy, under English law, which puts a beneficiary (who is the victim of a breach of trust or fiduciary duty) "in as good a position pecuniarily as that in which he was before the injury",[141] i.e., "make good a loss in fact suffered by [a beneficiary] and which, using hindsight and common sense, can be seen to have been caused by the breach".[142] It is the remedy

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[140] For example, in the Standard Investments case, it was open for the court to have awarded an account of the profits (if any) made by the bank on the sale of its shares to Canwest.

[141] Nocton v. Lord Ashburton [1914] A.C. 923, at p.952, per Viscount Haldane L.C. (H.L.(E.)). See also Brickenden v. London Loan & Savings Co. [1934] 3 D.L.R. 465 (P.C.); Target Holdings Ltd. v. Redferns (a firm) [1996] 1 A.C. 421, at p.434D-E, per Lord Browne-Wilkinson; and Canson Enterprises Ltd. v. Boughton (1991) 85 D.L.R. 129. For a full discussion of this concept: see (i) Davidson, I.E., "The Equitable Remedy of Compensation" (1982) 13 M.U.L.R 349, and (ii) Gummow, The Hon. Mr Justice, "Compensation for Breach of Fiduciary Duty" : Ch.2 in Equity, Fiduciaries and Trusts (1989) (T.G. Youdan, ed.).

[142] Per Lord Browne-Wilkinson in Target Holdings Ltd. v. Redferns (a firm) [1997] 1 A.C. 421, at p.439B.

available to a beneficiary for breach of fiduciary duty where property cannot be restored *in specie*, or profits wrongfully obtained cannot be disgorged.[143]

Compensation differs from an account of profits - which it is not in addition to[144] - as the measure of relief for compensation is the loss to the beneficiary, rather than the gain to the fiduciary,[145] i.e., the difference between: (i) what the beneficiary has received, and (ii) what he would have received if there had not been a breach of trust (or fiduciary duty).[146] This makes compensation similar to - but not always the same as[147] - the measure of damages for deceit or for negligence[148].

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[143]See Canson Enterprises Ltd. v. Boughton (1991) 85 D.L.R. (4th) 129, at p.146, per La Forrest J.

[144]Cook v. Evatt (No.2) [1992] 1 N.Z.L.R. 676, at p.691d, lines 31-43.

[145]Catt v. Marac Aust Ltd. (1986) 9 N.S.W L.R. 639, at p.659G, citing McLelland J in Hospital Products [1982] 2 N.SW.L.R. 766, at p.816. See also Davidson, supra, at p.354.

[146] Per Lord Browne-Wilkinson in Target Holdings Ltd. v. Redferns (a firm) [1996] 1 A.C. 421, at p.435.

[147]La Forest J in Canson, supra, at p.141.

[148] Commonwealth Bank Ltd. v. Smith, supra, at p.480. See also Cooke P. in Day v. Mead [1987] 2 N.Z.L.R. 433, at p.451, who says the difference between compensation and damages in tort is "a difference without distinction". And the majority judgement of La Forrest J. in Canson, supra, at p.141, who took the view that equity should borrow from the common law principles of damages

Despite the similarity between compensation and damages for negligence - which can be misleading - there are important differences, and it is not correct to measure equitable compensation by analogy with tort (and contract) rules as to damages. Compensation in equity depends on treating the fiduciary's obligations as being of a personal nature (i.e., *in personam*) to make restitution to the beneficiary[149] for the value of the loss suffered from the breach".[150]

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for tort (Sopinka, Gonthier and Cory J.J. concurred). See also Millett L.J., delivering the leading judgement, in Bristol and West Building Society v. Mothew [1997] 2 W.L.R. 436, at p449D-F, who took a similar view; and Evans L.J., in Swindle v. Harrison, *The Times*, 17th April, 1997; Hobhouse and Mummery L.J., agreeing. In Nocton v. Lord Ashburton, supra, it was said, obiter, that the measure of compensation was the same as the measure of damages for fraud. The House of Lords in Target Holdings Ltd. v. Redferns (a firm) [1996] 1 A.C. 421, at p.438, agreed with the result in Canson, but declined to choose between the majority and minority views. But Lord Browne-Wilkinson did approve the minority judgement of McLachlin J., on equitable compensation, as good law: see at pp.438D-439B. Cf. the recent decision of the Privy Council and the Court of Appeal, in the context of a mortgagee's/receiver's duties, which have condemned the application of the law of negligence to areas that are the traditional domain of equity: see Downsview Nominees Ltd. v. First City Corporation Ltd. [1993] A.C. 295 (P.C.); China and South Sea Bank Ltd. v. Tan [1990] A.C. 536. (P.C.); and Parker-Tweedale v. Dunbar Bank Plc. [1991] Ch. 12 (C.A.).

[149] Re Dawson (Dec'd); Union Fidelity Trustee Co. Ltd. v. Perpetual Trustee Co. Ltd. [1966] 2 N.S.W.R. 211, at pp. 214-16, per Street J. (as he then was), cited with

Essentially, compensation is "trust-like" in that the measure of damages "is not affected by consideration of foreseeability or remoteness".[151] Compensation is of "a more absolute nature than the common law obligation to pay damages for tort or breach of contract."[152] A further difference, is that there are no consequential damages in compensation, unlike negligence and fraud (and contract).[153]

Why Analogy With Tort/Contract Damages Is False

The flaw with using the tort (and contract) analogy is that not only are there different measures for: (i) fraud (which includes all foreseeable and unforeseeable losses), and (ii) negligence (with its requirements of foreseeability and remoteness), but, they do not take into account the different nature and positions of the parties[154]. In a tortious case, the party at fault is under a duty of reasonable care, and so long as that duty is complied with, his actions are relatively unrestricted; similarly, in contract, the parties are at

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approval by Brightman L.J. (as he then was) in Bartlett v. Barclays Bank Trust Co. Ltd.(No.2) [1980] Ch. 515, at p.543, and by Tadgell J in Hill v. Rose, supra, at p.144.

[150]Davidson, I.E., "The Equitable Remedy of Compensation", at p.351, cited by McLaughlin J. in Canson, at supra, p.157.

[151] Canson, supra, at p.135, per La Forrest J.

[152] Commonwealth Bank Ltd. v. Smith, supra, at p.480.

[153] See Commonwealth Bank Ltd. v. Smith, supra; and Davidson, supra, at p.353.

[154] Canson, supra, at p.161ff.

"arm's length", and can act in their own interests, so long as they do not breach the contract.[155] But in a fiduciary relationship, the higher duty of loyalty is imposed: one in which the fiduciary in breach of duty has agreed, or is required, to put the other party's interests ahead of its own; also, breach of fiduciary duty is a wrong *per se*.[156] Consequently, the beneficiary should be able to recover all he has lost due to the breach, whether or not it was foreseeable or remote. His actual loss, due to the breach of duty, will be assessed with the benefit of hindsight. This means that "compensation is to be assessed by reference to the value of the assets at the date of the restoration and not at the date of deprivation",[157] rather than the date of the breach (as in tort and contract).[158]

Limits On Recovery

As compensation is an equitable remedy, it is subject to requirements of fairness and justice. The crucial need is to ascertain the loss that results from the breach of equitable duty by the

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[155]See Canson, supra.

[156]See Canson, supra.

[157]Street J. (as he then was) in Re Dawson, supra, at p.216; Mclachlin J. in Canson Enterprises Ltd. v. Broughton (1991) 85 D.L.R. (4th) 129, at p.162; and Lord Browne-Wilkinson in Target Holdings Ltd. v. Redferns (a firm) [1996] 1 A.C. 421, at pp.437-438. See also Davidson, I., "The Equitable Remedy of Compensation", supra, at p.353, fn.22.

[158] Canson, supra, at pp.160-161 and 162, per MacLachlin J.

fiduciary and, thus, the position the beneficiary would have been in if it had not been breached:[159] as compensation is not unlimited.[160] Thus, compensation is "limited to the loss flowing from the [fiduciary's] acts in relation to the interest he undertook to protect"[161], but this is not limited by foreseeability.[162]

Whilst there is no duty to mitigate loss in a claim for compensation, where the loss arises from the beneficiary's unreasonable behaviour, then the claim will be disallowed[163]: as the loss "will be adjudged to flow from this behaviour, and not the breach"[164]. Moreover, although foreseeability is not relevant, where a loss, on "a common sense" rather than a legalistic view of causation[165], has not been caused by the breach, then this will not be allowed, i.e., there needs "to be some causal connection between" the fiduciary's breach of

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159 Nocton v. Lord Ashburton [1914] A.C. 932, at p.95, per Viscount Haldane L.C.; Davidson, "The Equitable Remedy of Compensation", supra, at p.354.

160 Canson Enterprises Ltd. v. Broughton (1991) 85 D.L.R. (4th) 129, at p.160, per McLachlin J.

161 Canson, supra, at p.160, per McLachlin J.

162 Canson, supra, at p.161, per McLachlin J.

163 Canson, supra, at p.162, per McLachlin J.

164 Canson, supra, at p.163, per McLachlin J.

165 Ibid; cited with approval in Target Holdings Ltd. v. Redferns (a firm) [1996] 1 A.C. 421, at p.438, per Lord Browne-Wilkinson.

duty and the loss suffered.[166] Hence, the fiduciary should not, "in fairness"[167], be liable for losses which are "unrelated and independent [of] . . . the breach . . . of duty" by him.[168]

(ii) Damages Under Scots Law

In Scotland, the recovery by a beneficiary of financial loss from a fiduciary, for breach of fiduciary duty, is not as clear as in England. A breach of fiduciary duty is regarded as being either a breach of trust or of contract, depending on the nature of the relationship.[169] The measure of damages is the same as for breach of trust or contract.[170] In the case of a breach of trust, the trustee is liable "to make good to the trust estate the loss which he has caused."[171]

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166 Target Holdings Ltd. v. Redferns (a firm) supra, at p.434F-G, per Lord Browne-Wilkinson.

167 Ibid.

168 Canson, supra, at p.165, per McLachlin J.

169 Stair Memorial Encyclopaedia, Vol. 24, "Trusts, Trustees and Judicial Factors", Vol. 24, at paras.171, and 186, on pp.117 and 126.

170 Stair Memorial Encyclopaedia of the Laws of Scotland, Vol.24, "Trusts, Trustees and Judicial Factors", at paras.171 and 186, on pp.117 and 126.

171 Town and Country Bank Ltd. v. Miller (1904) 12 S.L.T. 411, at p.412, per Lord Kyllachy. See too: Green's Encyclopaedia of Scots Law, Vol. XII (1914) 2nd edn., at p.353; Stair Memorial Encyclopaedia, Vol. 24, "Trusts, Trustees and Judicial Factors", Vol. 24, at paras.171, and 186, on pp.117 and 126. And see Gloag and Henderson, The Law of Scotland (1995) 10th edn. (by W.A. Wilson and A.D.M.

However, the suggestion by one judge, that where there has been a breach of fiduciary duty, only a claim for the profit or gain made by the fiduciary, rather than the loss suffered by the beneficiary, is sustainable, is not correct.[172] Such a view would mean that there would be no recovery by a beneficiary, unless the fiduciary obtained a benefit from his breach of duty, which the beneficiary could claw back. This is against common-sense and principle, and it would appear that his Lordship misunderstood the authorities he was referring to.

(iii) Exemplary Damages Under English Law

An award of exemplary damages is an award made over and above the loss suffered by the plaintiff. Its aim is to punish the wrongdoer[173]. Exemplary damages are an exception to the normal rule that damages should compensate the victim, rather than look at the conduct of the wrong-doer, i.e., damages are normally

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Forte and others), at para.46.14, on p.829. For the measure of damages for breach of contract: see Chapter 10 "Damages For Breach of Contract By A Lender".

[172] Sao Paulo Alpargatas S.A. v. Standard Chartered Bank Ltd. 1985 S.L.T. 433, at p.439, per Lord Grieve (O.H.). The decision has been criticised as being contrary to principle and not supported by authority: see Stair Memorial Encyclopaedia, Vol. 24, at para.186, on p.126 fn. 5.

[173] Rookes v. Barnard [1964] A.C. 1129; and Cassell & Co. v. Broome [1972] A.C. 1027.

compensatory in nature, and not punitive[174]. Exemplary damages do not apply to breaches of contract.[175] Recent New Zealand authority has discussed the awarding of exemplary damages to punish fiduciaries for serious breaches of duty.[176]

The general rule is that, in an appropriate case, exemplary damages maybe awarded for breach of fiduciary duty,[177] albeit that there are differences in the law of exemplary damages in New Zealand[178] and England[179]. These damages may be cumulative upon the fiduciary's profits, unlike compensatory damages.[180] The most likely situation

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[174] These are of little practical relevance in England, a view shared by Neill L.J. in Bradford City Metropolitan Council v. Arora [1991] Q.B. 507, who indicated they would rarely be awarded.

[175] Addis Gramophone Co. Ltd. [1909] A.C. 488. (H.L.(E.)).

[176] Cook v. Evatt (No. 2) [1992] 1 N.Z.L.R. 676; and Watson v. Dolmack Industries Ltd. [1992] 3 N.Z.L.R. 311. See also Gummow, the Hon. Mr. Justice, "Compensation for Breach of Fiduciary Duty": Ch. 2. in Equity, Fiduciaries and Trusts (1989) (T.G. Youdan, ed.), at pp.79-80, who sees "no reason why this concept of deterrence should not also play a part in compensation cases" in view of the "strong deterrent element in the formulation of duties upon fiduciaries".

[177] Watson v. Dolmark Industries Ltd., supra, at p.316, lines 23-29, and at p.320, lines 20-22.

[178] Cook v. Evatt (No. 2) [1992] 1 N.Z.L.R. 676, at p.691, lines 36-42, and p.706.

[179] Exemplary damages do not form part of Scots law.

[180] Cook v. Evatt, supra, at p.705, lines 53-54.

is where the fiduciary has been deceitful[181]. However, the cases depend very much on their facts.

Nonetheless, it is likely that, in a commercial context, exemplary damages will not be awarded. In Watson v. Dolmark Industries Ltd.[182], D, the proprietor of DI, approached W about marketing W's products (plastic storage trays) in New Zealand. W, who was in Australia, agreed to this. However, D falsified accounts and used the money "saved" as a result of this fraud to make new moulds and sell a similar product to W's. The New Zealand Court of Appeal held, amongst other things, that DI was a fiduciary, and that, whilst exemplary damages may be awarded for breach of fiduciary duty, it was not appropriate here, as this was a commercial case.

Conversely, where a financial adviser, who pretended to offer impartial advice, advised his client to purchase two flats in which the adviser had an interest (which was not disclosed), it was held it was appropriate to award exemplary damages, particularly to deter others who might seek "to exploit similar positions of trust."[183]

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[181] In Archer v. Brown [1985] Q.B. 401, Peter Pain J. (as he then was), indicated that exemplary damages could be awarded for the tort of deceit (an intentional tort).

[182] [1992] 3 N.Z.L.R. 311.

[183] Cook v. Evatt (No. 2) [1992] 1 N.Z.L.R. 676, at p.706, line 54 - p.707 line 4. See also Aquaculture Corporation v. New Zealand Green Mussel Co. Ltd. [1990] 3 N.Z.L.R. 299, where exemplary damages were awarded, at first instance, for breach of confidence, but the amount was subsumed into compensatory damages, although the principle of exemplary damages was recognised.

Fisher J. regarded the critical question as being whether the adviser set out to deliberately deceive his client[184]; and decided that he had.[185]

The awarding of exemplary damages has been linked with damages for injured feelings. But damages for injured feelings are not awarded in commercial cases[186]. Thus, it is unlikely that a bank in a normal breach of fiduciary duty will also be liable for exemplary damages, in addition to any other remedy, barring, of course, reprehensible or despicable conduct.

(iv) Contributory Negligence[187]

Again, assistance in this area is to be derived from New Zealand authority[188], which has held that, in assessing compensatory damages, where the loss suffered by the beneficiary, due to a breach

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[184] Cook v. Evatt (No. 2) [1992] 1 N.Z.L.R. 676, at p.706, lines 24-25.

[185] Supra, at p.706, lines 37-39.

[186] See Hayes v. James & Charles Dodd (a firm) [1990] 2 All E.R. 815; and Watson v. Dolmark Industries Ltd. 1992] 3 N.Z.L.R. 311, at p.316, lines 287-89. See also the discussion of damages for injured feelings in Chapter 8, Damages For Breach of Contract By A Lender".

[187] The topic of Contributory Negligence is discussed more fully in Chapter 8 "Damages For Breach of Contract By A Lender".

[188] Day v. Mead [1987] 2 N.Z.L.R. 443 (C.A.); Mouat v. Clarke Boyce [1992] 2 N.Z.L.R. 559, at pp.566-568; this issue did not arise on appeal to the Privy Council: see [1994] 1 A.C. 248.

of fiduciary duty, is not totally the fault of the fiduciary, then, there may be an abatement or apportionment in equity; there being no objection to this in principle. However, a note of caution was mentioned by Cooke P, who stated:

> "Of course, before reducing an award [of damages] on the ground that the claimant has been partly the author of his or her own loss, the court will have to give much weight to the well established principle that, largely for exemplary purposes, high standards are expected of fiduciaries. A strong case is needed to relieve the fiduciary of complete responsibility."[189]

Obiter remarks by the Supreme Court in Canson Enterprises Ltd. v. Boughton & Co.[190] indicate, that Canadian law is moving in this direction.

This approach should be rejected. A fiduciary duty is not the same as, and co-extensive with, an independent liability in delict/tort; the fiduciary obligation concerns a breach of duty of loyalty - it is not dependent upon a failure to take reasonable care. The British courts have adopted a narrow approach to allowing claims for contributory negligence anyway[191], and would be wise to heed the advice of

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189 Supra, at p.452.

190 (1992) 85 D.L.R. (4th) 129, at pp.152-153, per La Forrest J, cited with approval by Cooke P. in Mouat, supra at pp.567-568.

191 See Forsikringsaktieselskapet Vesta v. Butcher [1986] 2 All E.R. 488, at p.508, per Hobhouse J, and at [1989] A.C. 582, at p.508, per O'Connor L.J., when the case was in the Court of Appeal; and Barclays Bank plc v. Fairclough Building Ltd.

Gummow, J., (of the High Court of Australia), who speaks of "the unwisdom of entangling the already complex law as to fiduciary duties with notions of contributory negligence".[192]

[1995] Q.B. 214. See the further discussion of this topic in Chapter 8 "Damages For breach of Contract By A Lender".

[192] Cf. Gummow, The Hon. Mr. Justice, "Compensation for Breach of Fiduciary Duty", supra, at p.87.

CHAPTER 5.

THE LENDER'S DUTY TO ADVISE BORROWERS ON THE PRUDENCE OF A TRANSACTION

In this chapter, the question of whether a lender, who lends money to a borrower, is under duty to that borrower to consider the prudence of the transaction for which the money is lent, will be considered.

NO OBLIGATION TO ADVISE

Despite press claims of irresponsible bank lending, from time to time, accompanied by large, high profile corporate collapses, and an admission by a former bank chief that the banks made mistakes in the 1980's, concerning their lending habits, and lent money too easily[1], there is no general duty on a lender, even when it knows the purpose of a loan (which it usually will), to advise a borrower about the prudence of that transaction; and if a lender does not advise a borrower, the lender will not be liable.[2] This is because, with the

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[1] See the views of Sir Peter Walters, the former Chairman of the Midland Bank plc, in an article in the Director magazine, reported in *The Times,* 19th December, 1991, at p.19, who says, amongst other things, that "the banks were too willing to lend to businesses that were only viable during the boom".

[2] Williams & Glyn's Bank Ltd. v. Barnes [1981] Com. L. R. 205, at pp.207-208, 10 Legal Decisions Affecting Bankers (1977-1986) 220, at p.225, and in the transcript. See also May L.J. in Lipkin Gorman v. Karpnale Ltd. [1989] 1 W.L.R.

1340, at p.1356, who said: "There is nothing [in the contract between lender and customer], express or implied, *which could require a lender to consider the commercial wisdom or otherwise of the particular transaction."* (Emphasis added). See also Lord Finlay L.C. in Banbury v. Bank of Montreal [1918] A.C. 626. (H.L.(E.); Redman v. Allied Irish Bank plc [1987] F.L.R. 264, at p.266 per Saville J. (as he then was); Weitzman v. Hendon (1989) 61 D.L.R. (4th) 525, at p.547, per Robins J.A.; Nourse L.J. in Goldsworthy v. Brickell [1987] Ch. 378, at p.405; Robert Taylor J (sitting as a Deputy High Court Judge) in Verity and Spindler v. Lloyds Bank Plc, [1995] Fam. Law 213, [1995] CLC 1557; and Mance J. in Bankers Trust v. P.T. Dharmala [1995] 4 Banking L.R. 381, at p.408, col. 1, per Mance J. Although all but one of these cases are English, there is no reason to believe the Scottish courts would adopt a different approach; and it would be very undesirable if they did, in view of the level of cross-border banking between England and Scotland.

Cf. the position in the Australian State of New South Wales, where a combination of statutory provisions (s.42 of the Fair Trading Act 1987 (N.S.W.) and s.7 of the Contracts Review Act (N.S.W.)) resulted in that State's Court of Appeal holding that "it is not appropriate for financial institutions to lend very substantial sums of money to borrowers without making adequate and candid assessments as to the ability to repay such loans", per Kirby P (as he then was) in Arbest Pty Ltd. v. State Bank of New South Wales, unreported decision of N.S.W. Court of Appeal, noted in [1996] 5 J.I.B.L. N-87. This was a case of very particular facts: see Commonwealth Bank of Australia v. Davridge Pty Ltd., an unreported decision, of the Supreme Court of New South Wales, delivered on 9th November, 1995. See also s.52 of the Federal Commonwealth Trade Practices Act 1974 (as amended), which says that businesses can be liable

relationship between lender and borrower being one of creditor and debtor, the lender is entitled to seek the best arrangement it can obtain for itself: it is an "arm's length" relationship, with each side looking after their own interests[3]. The lender's concern, based on its

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to consumers for deceptive and misleading conduct, or conduct which is likely to mislead or deceive.

[3] Cf. the obligations imposed on lenders, by the courts, in relation to guarantors, that where one partner (especially a spouse) is guaranteeing the debt of the other partner (or that partner's business), the lender should: (i) invite the guarantor to a meeting without the other partner, and (ii) advise the guarantor to take independent legal advise, where the bank has constructive notice of undue influence (or misrepresentation) by the other partner towards the guarantor. The leading case is Barclays Bank Plc v. O'Brien [1994] 1 A.C. 180 (H.L.(E.), and its corollary C.I.B.C. v. Pitt (1994) 1 A.C. 200 (H.L.(E.). O'Brien has generated considerable case law and commentary: see, for example, the cases of: Midland Bank Plc v. Massey [1995] 1 All E.R. 929, TSB v. Camfield [1995] 1 W.L.R. 430, and Banco Exterior International v. Mann [1995] 1 All E.R. 936; and the commentary by: Berg, A., "Wives Guarantees - Constructive Knowledge and Undue Influence" [1994] L.M.C.L.Q. 34, Lehane, J.R.F., "Undue Influence, Misrepresentation and Third Parties" (1994) 110 L.Q.R. 167, and Tjio, H., "New cases applying *O'Brien*" [1996] J.B.L. 266. In Scotland: see the very recent decision of the House of Lords in Smith v. Bank of Scotland 1997 S.C. (H.L.) 111 in which O'Brien was held to be applicable in Scotland, but on the basis of good faith, rather than constructure notice. See the discussion of this case by Gretton, G.L., "Sexually Transmitted Debt" 1997 S.L.T. (News) 195. The obligations imposed on lenders by the courts is reflected The Banking Code (1997) 3rd edn., at para.3.14, which emphasises encouraging taking

natural self-interest, is to recoup the money it has lent to the borrower over the life of the loan. A lender will, usually, only lend to a borrower that the lender believes will be able to repay the loan, or who has provided sufficient security for the loan.[4] Consequently, a borrower - who, presumably, has considered the arguments for and against the transaction, which is why it is applying to borrow money from the lender - should not infer that simply because the lender has provided finance, that the lender has also provided financial advice,[5] and, impliedly, stated that the transaction is a prudent one to enter into.[6] A lender will only come under a duty to advise a borrower about a transaction where there is[7]: (i) a fiduciary obligation[8], or (ii)

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independent advice, it is understood that Lloyds Bank Plc will not lend money, unless they have a certificate from a solicitor stating he has explained the guarantee to the guarantor.

[4] See Lingard, J.R., Bank Security Documents (1993) 3rd edn., at para.5.5, on p.66, who refers to two old maxims of lending: (i) never lend on the basis of security, and (ii) the best form of lending is unsecured, which, the learned author says, should not be taken literally.

[5] See the judgement of Lord Donaldson M.R. in Lloyds Bank plc v. Cobb, unreported decision of the Court of Appeal, delivered on 18th December, 1991; noted [1992] J.B.L. 419.

[6] See Ralph Gibson J. (as he then was) in Williams & Glyn's Bank Ltd. v. Barnes [1981] Com. L.R. 205, at p.207, 10 Legal Decisions Affecting Bankers (1977-1986) 220, at p.225, and in the transcript; and per Scott L.J. (as he then was) in Lloyds Bank plc v. Cobb, supra.

an assumption of responsibility by the lender to the borrower (with reliance by the borrower on that assumption), under the Hedley Byrne principle[9], or (iii) a contract (either express or implied) between the parties to the effect that the lender will advise on the prudence of the transaction[10]; this is so, even if the lender "knows or

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[7] See Ralph Gibson J. (as he then was) in Williams & Glyn's Bank Ltd. v. Barnes [1981] Com. L.R. 205, at p.207, 10 Legal Decisions Affecting Bankers (1977-1986) 220, at p.225.

[8] This would, presumably, be on the basis that whilst "[a] lender may be expected to act in its own interests in ensuring the security of its position as lender to its customer . . . it may have created in the customer the expectation that nevertheless it will advise in the customer's interests as to the wisdom of a proposed investment. This may be the case where the customer may fairly take it that to a significant extent his interest is consistent with that of the lender in financing the customer for a prudent business venture. In such a way the lender may become a fiduciary and occupy the position of . . . a financial adviser": see Commonwealth Bank of Australia v. Smith (1991) 102 A.L.R. 453, at p.476, per Davies, Sheppard and Gummow JJ. (Fed. Ct. of Aust.) See too Lloyds Bank Ltd v. Bundy [1975] Q.B. 326 (C.A.), where an elderly customer of long-standing had an expectation that the bank would advise him, or take into account his interests, in relation to his giving a guarantee for his son.

[9] See Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465 (H.L.(E.)); and the discussion of that case in Chapter 4, "Lender Liability For Negligence".

[10] Williams & Glyn's Bank Ltd. v. Barnes [1981] Com. L.R. 205, at p.207, 10 Legal Decisions Affecting Bankers (1977-1986) 220, at p.225, per Ralph Gibson J. (as he then was).

ought to know that the borrowing and application of the loan, as intended by the customer, are imprudent"[11]: because the lender is only required to consider its own position, i.e., will it be repaid?

The Leading Cases

This position is made clear by the two leading English cases on the subject. In the first case, Williams & Glyn's Bank Ltd. v. Barnes[12], Barnes sought to argue that the bank should have advised him on the prudence of a loan by the bank to Barnes to purchase shares in a property development company ("NDH"), which Barnes was the majority shareholder in, and head of, when the bank "knew or ought to have known that NDH's business was exposed to serious risk".[13] It was argued that there was sufficient proximity in the banker - customer relationship to impose a duty on the bank to advise Barnes on the loan's prudence. The court rejected this, and said that no duty of care, under the Donoghue v. Stevenson[14] principle, could apply to the lender in relation to its granting a loan to Barnes, as the lender, merely did what it was requested to do: it lent money, and "[n]either [Barnes] nor NDH was required to borrow" money from the bank.[15]

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[11] Ibid.

[12] [1981] Com. L.R. 205, 10 Legal Decisions Affecting Bankers (1977-1986) 220.

[13] [1981] Com. L.R. 205, at p.207, 10 Legal Decisions Affecting Bankers (1977-1986) 220, at p.225.

[14] 1932 S.C. (H.L.) 31, [1932] A.C. 562 (H.L.(Sc.)).

[15] Supra, at p.207, and at p.225, respectively, of the two Law Reports. NDH subsequently became insolvent.

Ralph Gibson J. (as he then was), said it was "impossible to sustain" the argument that a lender, dealing with a competent business man, without the lender being asked for advice, or assuming a responsibility to advise, is obligated to consider the prudence of a loan it makes to a customer from the customer's point of view, in the absence of a fiduciary relationship.[16] His Lordship, when giving his abridged reasons for judgement in open court, made the pertinent comment that: "Banks and their customers are entitled to take commercial risks; indeed, they must do so."[17] Consequently, the lender is not to be regarded as an insurer of the borrower's project's success - this success or failure is then a matter for the borrower. Moreover, it seems odd that, as majority shareholder and head of NDH, Barnes, who would have had access to financial information about NDH, was unable to make an informed decision, as a business man, on the company's future prospects. It also begs the question: why did Barnes borrow the money in the first place, if there was a risk (which Barnes should have known about)?

Similarly, in Lloyd's Bank plc v. Cobb[18], before the English Court of Appeal, a borrower, who was an experienced, if unsuccessful,

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16 Williams & Glyn's Bank Ltd. v. Barnes [1981] Com. L.R. 205, at p.208, 10 Legal Decisions Affecting Bankers (1977-1986) 220, at pp.225-226.

17 At p.8 of the Lexis transcript of the abridged reasons for judgement, delivered, in open court, on 26th March, 1980.

18 Unreported decision, delivered on 18th December, 1991; noted in [1992] J.B.L. 419, and available on Lexis.

business woman[19], sought to resist a claim for repayment of a loan of £15,000 from the lender for a failed business venture, on the basis that the lender owed her a duty to advise her on the prudence of the transaction. Again, the borrower was unsuccessful. In that case, Scott L.J. (as he then was) put the position thus[20]:

> "The ordinary business of a High Street bank is to hold on current account terms the funds of its customers, to make arrangements for overdrafts on current accounts and to make loans to customers.[21] The ordinary business of a High Street bank does not include giving advice to customers on the wisdom of commercial projects for the purposes of which the bank is asked to lend money.
>
> In my judgement, the ordinary relationship of bankers and customers does not place on the bank any contractual or tortious duty to advise the customers on the wisdom of commercial projects for the purpose of which the bank is asked to lend money.[22] If the bank is to be placed

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19 See the judgement of Lord Donaldson M.R.

20 See the Lexis transcript of the case.

21 Banks are, of course, now involved in more activities than this, such as selling insurance and pensions, and foreign currency, but Scott L.J.'s point is still valid.

22 This is similar to the position in Germany: see Re the Duties of a Banker (Case II ZR 173/77), decision of the Bundesgerichtshof, reported in English in [1979] European Commercial Cases ("E.C.C.") 1, at p.4[4]. See also the opinion of the Bundesgerichtshof in its later decision of Re a Bank's Duty To Supply

under such a duty, there must be a request from the customer, accepted by the bank, or some arrangement between the customer and the bank, under which the advice is to be given.

If a customer applies to the bank for a loan for the purposes of some commercial project, and the bank examines the details of the project for the purpose of deciding whether or not to make the loan, the bank does not thereby assume any duty to the customer. It conducts the examination of the project for its own prudent purposes as lender and

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Information on its Customer's Creditworthiness (Case XIZR52/88) [1992] E.C.C. 118, at p.123[7], where the court said:

> "Under the settled case law of the Bundesgerichtshof, a bank is not in principle under any obligation to give warning of risky credit transactions or to give information about the financial circumstances of the potential participant in the transaction . . . It is not even obliged to point out to its customer that it is not itself prepared to continue to grant credit to the prospective participant in the transaction."

See too Sandrock, O. and Klausing, E., "Germany": Ch.4 in European Banking Law: The Banker-Customer Relationship (1993) (R. Cranston, ed.), especially at pp.85 and 89. Germany does, however, have a concept of good faith and fair dealing (*Treu und Glauben*), under Art. 242 of the B.G.B., under which a bank will be required to advise of certain risks. Cf. the Uniform Commercial Code ("UCC") (ss.1-201(19), 1-203 and 1-208) in the United States, which recognises such a concept, which may also be implied, at common law, in certain circumstances: see the discussion of this by Professor J.J. Norton, "Lender Liability In The United States: A Decade In Perspective": Ch.12 in Banks, Liability and Risk (1995) 2nd edn., (R. Cranston, ed.), at pp.343-345 (outside the UCC), at pp.365-367 (under the UCC), and at pp.389-392.

not for the benefit of the proposed borrower. If the borrower chooses to draw comfort from the bank's agreement to make the loan, that is the borrower's affair. In order to place the bank under a duty of care to the borrower the borrower must, in my opinion, make clear to the bank that its advice is being sought. The mere request for a loan, coupled with the supply to the bank of the details of the commercial project for whose purposes the loan is sought, does not suffice to make clear to the bank that its advice is being sought . . ."

Scott L.J. then went onto state that, even if Mrs Cobb's case was accepted, there was nothing to suggest that the bank either: (i) was asked to advise Mrs Cobb, or (ii) had accepted any such request from Mrs Cobb to advise her, about the transaction's prudence. His Lordship continued:

> "People who engage in speculative commercial ventures must accept the consequences of the failure of their ventures just as they will enjoy the consequences of their success. They cannot be allowed to transfer the burden of the failure of their ventures on to the shoulders of a bank lender which was never asked to and never assumed to give advice on the wisdom of the venture."[23]

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[23] Cf. the position in Belgium, France and the Netherlands, where a lender has to consider the consequences of its decision to lend money to, or maintain a credit arrangement with, a financially troubled borrower, on third parties who deal, or are connected, with the borrower; in this context, third parties include: other creditors, guarantors (who may be called upon to make up any short fall in the debt owed by the borrower to the lender) and, the receiver of the borrower. The rationale for the lender's liability to co-creditors is that, by granting the loan to the borrower or maintaining its existing credit lines, the

A Possible Exception To The General Rule About No Duty To Advise

In Williams & Glyn's Bank Ltd. v. Barnes[24], Ralph Gibson J. suggested, that it was possible for a case of implied representation and reliance to be made out, if it could be shown that the lender knew of: (i) "the imprudence of the borrowing", (ii) the intended application of the money, and (iii) "the likelihood of damage to the borrower . . . having regard to the terms of advertisements frequently used by banks".[25]

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lender is "artificially extending" the borrower's commercial life, and is, thereby, creating the impression of solvency or "creditworthiness". This misleads the other creditors, who, relying on this granting of credit by the bank as indicating that the borrower is financially viable, believe that it is safe to do business with the borrower: as otherwise why would the lender lend money to the borrower? See Wymeersch, E., "Bank Liability For Improper Credit Decisions in the Civil Law:" Ch. 7 in Bank's Liability and Risk (1995) 2nd edn. (R. Cranston, ed.); Moully, C., "France": Ch. 3. in European Banking Law: The Banker-Customer Relationship (1993) (R. Cranston, ed.), at pp.49 and 57-58; and Van Gerven, D., "Liability of Credit Institutions towards Creditors of their Clients in Financial Difficulty under Belgian Law" [1994] J.I.B.L. 532.

24 See the transcript of the case.

25 See the transcript of Williams & Glyn Bank Ltd. v. Barnes, per Ralph Gibson J. See also: Salmon J. (as he then was) in Woods v. Martin's Bank Ltd. [1959] 1 Q.B. 55, at pp.71 and 72; Brightman J. (as he then was) in Bartlett v. Barclays Bank Trust Co. Ltd. [1980] Ch. 515, at p.534, concerning lender's advertisements and holding out by lenders; Andrew, E, "Customer Care and Banking Law" [1989] J.I.B.L. 101, at p.104; and Ward, A., and Wright, R.E., "The Liability of UK Banks for Financial Advice - Recent Developments" [1996] J.I.B.L. 472, at pp.475-476.

Whilst this is a possibility, it is a remote one, because for such an exception to apply, the facts would need to be very specific, and would be bordering on either: (i) a duty of care in delict/tort[26], or (ii) a fiduciary relationship[27]; these circumstances are unlikely to arise often, particularly where the borrower is experienced in business.

CONCLUSION

The approach of the British courts is correct, and is consistent with the debtor/creditor relationship between bank and customer. To make a lender liable to the borrower, or to a third party, where the bank has lent money to a borrower experiencing financial difficulties (as happens in certain Continental systems)[28] is wrong in principle,

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Cf. Millett L.J. in James v. Barclays Bank Plc [1995] 4 Banking L.R. 131, at p.135, col. 2, dismissing the borrower's claim that the bank owed a duty to advise him, based on its promotional literature. In that case, his lordship said that the bank's promotional literature did not suggest that the bank would be a general financial adviser with an obligation to volunteer advice, rather than give advice, if it was sought, and it did not alone show the bank undertook a general advisory role.

[26] See, for example, Verity and Spindler v. Lloyds Bank Plc [1995] Fam. Law 213, [1995] C.L.C. 1557.

[27] As in Lloyds Bank Ltd v. Bundy [1975] Q.B. 326 (C.A.). See too Commonwealth Bank of Australia v. Smith (1991) 102 A.L.R. 453, at p.476, per Davies, Sheppard and Gummow JJ in the Federal Court of Australia.

[28] See fn. 23. This, however will have ramifications for British lenders with subsidiaries in other European countries under the Second Directive on the Co-ordination of Banking Law, 89/646/EEC. And see too: Banking Co-ordination

and does not make corporate rescues a particularly attractive option[29] - after all, it is more desirable to try to save a business, rather than be too cautious and put it into receivership.

(Second Council Directive) Regulations 1992 (S.I. 1992, No. 3218), which came into effect on 1st January, 1993.

[29] Cf. the so-called "London Rules", or "London Approach", on corporate rescues, in which the Bank of England has said that lenders, with floating charges, should try to support ailing companies, rather than place them straight into receivership, as used to be the case: see Draper, M.G., "'The London Approach'" (1991) The Law Society Gazette 27; Kent, P., "The London Approach - Lessons From Recent Years", Bank of England Press Notice of speech delivered in London on 27th January, 1994; and Bird, C., "The London Approach" (1996) vol. 12 Insolvency Law & Practice 87. One French banker, apparently, accused the Bank of England of "behaving like the Pope": see Draper, M.G., "'The London Approach'" (1991) The Law Society Gazette 27. In 1993, Mr Christopher Morris, a very senior, and well-respected, insolvency partner in Messrs Touche Ross, chartered accountants, said:

> "One of the dominant features of the lending market today is the level of support given to financially distressed companies by their bankers. . . It is now the recognition of economic realities and the sharing of pain that characterises banking relationships. . . I hope and believe that the banks will generally act sympathetically to their customers and continue to support them back to prosperity. After all, there is little point in sharing the pain if they are not also able to share the gain."

Quoted in an article in *The Times*, of 6th January, 1993, by Graham Serjeant, Financial Editor, "Banks keep businesses afloat".

Moreover, to make a lender responsible for the business decisions of other creditors (of whom the lender may have limited, or no, knowledge) even though they may not be as financially well informed as the lender (which will usually be the case), is harsh and difficult to justify. This is because the other creditors should do their best to independently ascertain the viability of the business they are proposing to transact with[30], and should not rely solely on the lender's judgement, which may be flawed. It is accepted, however, that this may be hard for small trade creditors dealing with a well-known company that is concealing its cash flow problems. Alternatively, many large and successful corporations are in a very good position to judge the financial stability of a company they are proposing to do business with. It seems unlikely that top class companies, such as Marks and Spencer Plc, ICI Plc and Hanson Plc, would not assess the financial position of a party they were proposing to do business with beforehand, but, instead, would rely on a bank's (not necessarily their own bank's) decision to lend money to the other party. Also, by placing blame on the lender, the blame for a business's failure is being transferred away from those who are most likely responsible for the failure: the management of the insolvent borrower,[31] and placing it on a lender.

If a borrower or creditor wants financial advice about a particular transaction, it should ask the bank specifically for it; commerce is

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[30] In Belgium, other creditors are required to make some minimum assessment of the borrower's financial strength: see Van Gerven, supra, at pp.534 and 536. This seems both a natural and a prudent thing to do.

[31] Cf. the insolvent trading provisions, under s.214 of the Insolvency Act 1986.

about taking risks, which creditors have to accept. To make a lender liable to a borrower (or third party) for a business decision taken by that borrower (or third party) has more than a hint of "the deep pockets" syndrome, of attaching blame to whoever can pay; this is not the right approach[32] - as the banks can just as easily lose money if a borrower becomes insolvent. Moreover, banks - which have their own businesses to run and make a profit from - are not guarantors or insurers of their borrowers', for the benefit of other creditors dealing with those borrowers, even though the lender has a natural interest in its borrower's success.

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[32] A similar view is held by Wymeersch, supra, at p.215.

CHAPTER 6.

BANK LIABILITY FOR NEGLIGENCE

Whilst a bank is not under a general duty to give advice[1], when it does so, and does so negligently[2], with loss to the recipient of that advice, the bank may be required to pay damages for the loss suffered. The circumstances in which liability may arise can range from negligent advice to a customer prior to entering into a loan agreement[3], to incorrect advice about a customer's financial standing to a third party enquirer[4]. This loss will be purely financial in nature, and its recovery will involve the vexed, and

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[1] See the discussion on this in Chapter 5, "The Lender's Duty To Advise On The Prudence Of A Transaction".

[2] See, for example, Lord Finlay L.C. in Banbury v. Bank of Montreal [1918] A.C. 626, at p.654, approved by Lord Devlin in Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465, at p.526 (H.L.(E.)).

[3] See, for example, Verity and Spindler v. Lloyds Bank plc [1996] Fam Law 213, [1995] C.L.C. 1557, decision of Judge Robert Taylor (sitting as a Deputy High Court Judge), delivered on 4th September, 1995; noted [1995] J.I.B.L. N-248; and see case notes by Gleeson, S., and Parsons, C., "Banks' Liability For Advice: Spindler and Verity v Lloyds Bank plc" [1996] J.I.B.L. 36, and Wise, L.M., "Biting the hand that lends" (1996) Solicitors Journal 128.

[4] As in Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465 (H.L.(E.)).

much debated, issue of recovery for pure economic loss. This liability to pay damages for negligence can be: (a) at common law, either where: (i) there is no contract, or (ii) concurrently with a contractual claim, where there is a contract between the parties, or (b) under statute, where a contract between the adviser and enquirer has been induced by a negligent misrepresentation from the adviser.[5] However, in either (a) or (b), the loss must be actual: not prospective.[6]

Traditionally, British courts have been reluctant to allow recovery for pure economic loss in delict/tort for fear of widespread and incalculable liability[7] (i.e., the so-called "floodgates" argument),

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[5] See s.10 Law Reform (Misc. Provisions) (Scotland) Act 1985 and s.2(1) of the English Misrepresentation Act 1967.

[6] See Wardley Australia Ltd. v. Western Australia (1992) 175 C.L.R. 514, at p.527, per Mason C.J., Dawson, Gaudron and McHugh JJ.

[7] The courts have traditionally relied on the dictum of Cardozo C.J. in Ultrameres Corp. v. Touche (1931) 255 N.Y. 170, at p.179, on this point. See also the High Court of Australia in San Sebastian Pty. Ltd. v. Minister Administering the Environmental Protection and Assessment Act (1986) 161 C.L.R. 340, at p.355. For a comprehensive discussion of the issues involved in recovery of pure economic loss: see the Canadian Supreme Court in Norsk Pacific Steamship Co. Ltd. v. Canadian National Railway Co. [1992] 1 S.C.R. 1021; noted by Markesinis, B., "Compensation For Negligently Inflicted Pure Economic Loss: Some Canadian Views" (1993) 109 L.Q.R. 5.

although, in certain circumstances, recovery for pure economic loss is permitted.[8]

In the discussion which follows on the liability of lenders for negligence, four areas will be considered:

(a) The constituent elements involved in imposing a legal duty of care on a lender, which, if breached, will allow the pursuer/plaintiff (a customer or third party) to recover the pure economic loss it has suffered; this will include a discussion of: (i) assumption of responsibility, and (ii) reasonable reliance. Also, the issues of the effect of any disclaimer of liability and concurrent liability in delict/tort and contract will be looked at.

(b) Whether the lender has breached the duty of care; here, the focus will be on: (i) the standard of care required to be reached, and (ii) causation.

(c) Damages: both at common law and under statute.

(d) The types of situations, in which banks have been held liable for their negligence. These include: (i) investment/transactional advice to its customers; (ii) advice on take-overs; (iii) credit references; and (iv) negligent information by a lead bank in a syndicated loan

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[8] Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465 (H.L.(E.)). In German law, the Courts have also had a fear concerning unlimited liability: see case 16 Bundergerichtshof (Second Civil Division), 28th February, 1977, BGHZ 69, at p.882, in Markesinis, B., A Comparative Introduction To The German Law of Torts (1994) 3rd edn., at pp.271-276, especially at p.273.

to a potential syndicate member, which induces the latter to enter into the syndicate.

[A] Recovery For Pure Economic Loss - The Duty of Care Requirements

Duty of Care

In the celebrated case of Hedley Byrne Ltd. v. Heller & Partners Ltd.[9], the House of Lords said, for the first time, that there could be recovery by a claimant for pure economic loss where the parties were in a "special relationship"[10], with the adviser assuming responsibility for its advice, and the recipient of the advice relying on the reasonable skill and care of the adviser, in circumstances in which it was reasonable to do so.[11] The case concerned a negligent

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[9] [1964] A.C.465 (H.L.(E.)).

[10] A relationship, in that case, "equivalent to contract" - there being no consideration under English law. The principle in Hedley Byrne now applies whether there is a contract or not: see Henderson v. Merrett Syndicates Ltd. [1995] 2 A.C. 145 (H.L.(E.)).

[11] See Hedley Byrne, supra, at pp.486-487, per Lord Reid; at pp.494-495, and 502-503, per Lord Morris of Borth-y-Gest; at pp.511 and 514, per Lord Hodson; at pp.528-531, per Lord Devlin; and at p.531, per Lord Pearce. See also the speeches of Lord Goff of Chieveley in Henderson v. Merrett Syndicates Ltd. [1995] 2 A.C. 145, Spring v. Guardian Assurance Plc. [1995] 2 A.C. 296, re-affirming Hedley Byrne, and White v. Jones [1995] 2 A.C. 207, extending the application of Hedley Byrne, by way of analogy. See Brodie, D., "The Analysis

credit reference by a bank to a third party enquirer about one of the bank's customers; the third party relied on the reference and, as a consequence, suffered economic loss; the bank was only able to escape liability due to a disclaimer of liability, which negated any assumption of responsibility for the reference.

Narrowing of Duty of Care and Restriction of Recovery For Pure Economic Loss - mid 1980's to early 1990's

After Hedley Byrne, and Anns v. Merton L.B.C., with its two stage test[12], the law of negligence went through a turbulent period[13] in

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of Negligence: Economic Loss and Responsibility", in Scot's law into the Twenty-first Century (1996) (Essays in honour of the late W.A. Wilson) (H.L. MacQueen, ed.), pp.204-213; Thomson, J., "Delictual Liability For Pure Economic Loss: Recent Developments" 1995 S.L.T.(News) 139; Mulcahy, L.A., case note of Henderson v. Merrett Syndicates Ltd., "Arbuthnott v. Fagin and Feltrim Underwriting Agencies and Ors", (1994) 15 The Company Lawyer 246; Hedley, S., "Negligence - Pure Economic Loss - Goodbye Privity, Hello Contorts" [1995] C.L.J. 27; and Murphy J., "Expectation Losses, Negligent Omissions and the Tortious Duty of Care" [1996] C.L.J. 43.

12 [1978] A.C. 728 (H.L.(E.)), at pp.751-752, per Lord Wilberforce, who spoke of: (i) proximity and foreseeability, and (ii) policy. Lord Wilberforce's test was erroneously interpreted by some judges as meaning foreseeability only, negatived by any policy factors: see Lord Keith of Kinkel in Yuen Kun-yeu v. A.G. of Hong Kong [1988] A.C. 175, at p.191; Gibbs C.J. in Sutherland Shire Council v. Heyman (1985) 157 C.L.R. 424, at p.441; and Lord Oliver of Aylmerton in Murphy, supra, at p.487, all of whom made this point, as did

which the House of Lords changed its view about recovery for pure economic loss and narrowed the duty of care requirement[14], with the result that recovery for pure economic loss was restricted, despite statements to the contrary that there was no prohibition

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Lord Wilberforce in McLoughlin v. O'Brian [1983] A.C. 410, who said that foreseeability alone is not sufficient to impose a duty of care.

[13] This is acknowledged by Lord Mustill in White v. Jones [1995] 2 A.C. 207, at p.288F, who refers to the courts "wrestling with the problems of the general law of negligence" for some years, and to the line of cases from the Anns to Caparo period.

[14] See Caporo Industries plc v. Dickman [1990] 2 A.C. 605, and Murphy v. Brentwood D.C. [1991] 1 A.C. 398 (H.L.(E.)). Murphy has not been followed in Commonwealth countries: see (i) the Supreme Court of Canada in Norsk, supra and Winnipeg Condiminium Corp No.36 v. Bird Construction [1995] 1 S.C.R. 85, in Canada; (ii) the New Zealand Court of Appeal in Invercargill C.C. v. Hamlin [1994] 3 N.Z.L.R. 513, whose decision was recently upheld by the Privy Council: see [1996] 2 W.L.R. 367; see the article on the New Zealand court's decision by I.N. Duncan-Wallace, "No Somersault After Murphy: New Zealand Follows Canada" (1995) 111 L.Q.R. 285; and (iii) the High Court of Australia in Bryan v. Maloney (1994-95) 182 C.L.R. 609; see the case note by Miller, D., "Builder's Negligence Liability To Subsequent Purchaser" [1995] L.M.C.L.Q. 326. See also the view of Brennan J. (as he then was), in the High Court of Australia, that the law of negligence should be able to be worked out in a solicitor's office, and not have to be litigated to obtain a result: Bryan v. Maloney (1994-95) 182 C.L.R. 609, at p.653. In this regard, the courts, in the United Kingdom, at least, have to take some of the blame for the constant re-statements of the principles and boundaries of negligence.

against recovery for pure economic loss.[15] The general duty of care questions were determined by a three part test of: (i) foreseeability, (ii) proximity, and (iii) whether it was fair, just and reasonable, in all the circumstances, to impose a duty of care. However, the House of Lords doubted whether any "single general principle" could satisfactorily be applied to decide duty questions in all cases.[16] Instead, their Lordships favoured an incremental approach to developing novel categories of negligence by way of analogy with existing categories, rather than a large extension of the duty of care principle.[17] Also, it was felt that there needed to be a limitation or

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[15] See, for example, D & F Estates, supra; Caparo, supra; and Murphy, supra. For a fuller discussion: see Hood, P., "Lender Liability Under English Law : Ch.2 in Banks, Liability and Risk (1995) 2nd edn. (R. Cranston, ed.), at pp.36-47.

[16] Caparo, supra. See also on the tripartite test: Peabody Donation Fund (Governors) v. Sir Lindsay Parkinson & Co. Ltd. [1985] A.C. 210; Yuen Kun-yeu v. Attorney General of Hong Kong [1988] A.C. 175; and Marc Rich & Co. A.G. v. Bishop Rock Marine Co. Ltd., The Nicholas H [1996] 1 A.C. 211 (H.L.(E.)).

[17] Per Lord Bridge of Harwich in Caparo, supra, at p.618, citing Brennan J. (as he then was) in Sutherland Shire Council v. Heyman (1985) 157 C.L.R. 424, at p.481. See also Lord Oliver in Caparo, supra, at p.633, approving Brennan J. in Sutherland, supra. In a similar vein, see Lord Brandon of Oakbrook in Leigh and Sillivan Ltd. v. Aliakmon Shipping Co. Ltd.; the Aliakmon [1986] A.C. 785, at p.815. The incremental approach has been acknowledged by the First Division in Weir v. National Westminster Bank plc 1994 S.L.T. 1251.

control mechanism.[18] As a result of this approach, one commentator remarked, in 1991, that if Hedley Byrne had come before the House of Lords (as then constituted) "it would come in for harsh treatment".[19]

Hedley Byrne Re-affirmed

Nonetheless, liability under the Hedley Byrne principle remained open[20]. Under the leadership of Lord Goff of Chieveley, the House of Lords, in three recent cases[21], has re-affirmed and re-examined

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[18] See Lords Bridge of Harwich and Oliver of Aylmerton in Caparo [1990] 2 A.C. 605, at pp.621 and 638, respectively.

[19] Stapleton, J., "Duty of Care And Economic Loss: A Wider Agenda" (1991) 107 L.Q.R. 249, at p.259.

[20] This is acknowledged in Murphy, supra, at pp.466 and 458 by Lord Keith of Kinkel, and at pp.483 and 486, by Lord Oliver of Aylmerton. See also Lord Goff in Spring v. Guardian Assurance Plc [1995] 2 A.C. 296, at p.317B.

[21] Spring v. Guardian Assurance Plc [1995] 2 A.C. 296, a negligent reference case. Two Law Lords (Lords Slynn of Hadley and Woolf) approached the matter on the basis of the foreseeability, proximity and fair, just and reasonable approach; however, Lord Goff of Chieveley, with whom Lord Lowry agreed, approached the matter using Hedley Byrne as his starting point for recovery for pure economic loss; Henderson v. Merrett Syndicates Ltd [1995] 2 A.C. 145, a case involving liability in delict/tort and contract of underwriting agents to Lloyd's names in which Lord Goff delivered the

Hedley Byrne. It is now accepted that the principles which arise from these cases provide the basis for recovery of pure economic loss,[22] namely that: (i) there must be an assumption of responsibility to the recipient by the lender,[23] and (ii) reliance by the recipient on the exercise of reasonable skill and care of the lender.[24] Reliance is crucial as it establishes the "causative effect" of the negligence,[25] and, hence, results in the loss suffered due to acting on the advice[26]; the requirement of "special skill", referred to in Hedley Byrne, which is being applied by the adviser for the benefit of the recipient, who relies on it, is to be interpreted

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leading speech and White v. Jones [1995] 2 A.C. 207, a solicitor's negligence case.

[22] Cf. Potter J. in Aiken v. Stewart Wrightson Members Agency Ltd. [1995] 1 W.L.R. 1281; and Mance J. in Bankers Trust International PLC v. P.T. Dharmala Sakti Sejahtera [1995] 4 Banking Law Reports 381, noted in (1996) B.J.I.B.F.L., at pp.43 (Banking and Insolvency) and 46-47 (Capital Markets). See also Lord Steyn in the Marc Rich case, supra.

[23] Henderson, supra, at pp.180C-D and 186G-187A. See also Spring, supra, at pp.316E and 318D-G.

[24] Henderson, supra., at p.180D and F-G. See also Spring, supra, at pp.316E and 318D-E; and Lord Oliver in Caparo, supra, at p.638. Cf. the Canadian cases of V.K. Mason Construction Ltd. v. The Bank of Nova Scotia [1985] 1 S.C.R. 271, at p.273, per Wilson J., and Queen (D.J.) v. Cogros Inc. [1993] 1 S.C.R. 87

[25] Henderson, supra, at p.180F.

[26] See Lord Oliver in Murphy, supra, at p.638.

broadly to include special knowledge[27]. Liability under Hedley Byrne can arise "by way of analogy from the categories of relationship already recognised as falling within Hedley Byrne[28] . . . or by a straight application of the principle stated in the Hedley Byrne case itself".[29] But once there has been an assumption of responsibility, there is no need to enquire whether it is "fair, just and reasonable" to impose liability for pure economic loss.[30]

With respect, it is a little simplistic to think that policy does not play a role in setting the boundaries in pure economic loss cases. As Lord Pearce said in Hedley Byrne:[31]

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[27] Henderson, supra, at p.180D. See also Spring, supra, at p.318G-H.

[28] Such an approach was taken by Lord Goff in White v. Jones, supra, in which Hedley Byrne was extended, by way of analogy, to satisfy the (perceived) requirements of "practical justice" in that case, involving the failure to draw up a new will by solicitors before the testator died, which left the intended new beneficiaries not provided for as the testator would have wished. See also Spring, supra., at p.317B.

[29] Henderson v. Merret Syndicates Ltd. [1995] 2 A.C. 145, at p.182F-G, per Lord Goff of Chieveley.

[30] Henderson, supra., at p.181D, per Lord Goff. Cf. his Lordship's appeal to "practical justice" in White v. Jones, supra, and Lord Pearce in Hedley Byrne, supra, at p.536.

[31] [1964] A.C. 465, at p.536.

"How wide the sphere of the duty of care in negligence is to be laid depends ultimately upon the court's assessment of the demands of society for protection from the carelessness of others."

The emphasis in pure economic loss cases is now on the nature of the relationship between the parties - not how it arose.[32] The control mechanism, referred to in Caparo Industries plc. v. Dickman[33] - which could have been decided on Hedley Byrne criteria - is provided by there being: (i) an assumption of responsibility (by the adviser), and (ii) reliance (by the recipient of the advice), which are indicators of proximity[34]. These concepts are discussed below.

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[32] See Oliver J. (as he then was) in Midland Bank Trust Co. Ltd. v. Hett Stubbs & Kemp [1979] Ch. 348, at p.413, approved by Lord Goff in Henderson, supra, at p.190B. See also Lord Oliver of Aylmerton in Murphy v. Brentwood District Council [1991] 1 A.C. 398, at p.486A-B, who spoke of the relationship of the parties (which he also referred to as proximity) as being such "that it imposes upon [a defender] a duty to take care to avoid or prevent that loss which has infact been sustained." His Lordship went on to observe (at p.486B) that proximity can be established where the pursuer is relying on "statement[s] or advice upon which he was entitled to rely and upon which it was contemplated that he would be likely to rely is clear from Hedley Byrne. . ."

[33] [1990] A.C. 605, per Lord Bridge of Harwich, at p.621; and per Lord Oliver of Aylmerton, at p.638.

[34] Being a close and direct relationship: see Lord Atkin in Donoghue v. Stevenson 1932 S.C. (H.L.) 31, [1932] A.C. 562 (H.L.(Sc.).

(a) Assumption of Responsibility

Assumption of responsibility is a concept not capable of precise definition[35], which has not had universal acceptance.[36] What it is concerned with is the situation where one party (the adviser/lender) says[37], expressly or implicitly[38], to another party

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[35] Lord Devlin in Hedley Byrne, supra, at pp.529-530, said it was not "possible to formulate with exactitude all the conditions under which the law will in a specific case imply a voluntary undertaking." See also Lord Oliver of Aylmerton, in Caparo, supra, at p.637G-H, who described "voluntary assumption of responsibility" as a "convenient label". And see too Brodie, D., "The Analysis of Negligence: Economic Loss and Responsibility" in Scot's law Into The Twenty-first Century (1996) (H.L. MacQueen, ed.) (Essays in honour of the late Professor W.A. Wilson), at pp.204-213.

[36] See Lord Griffiths in Smith v. Eric S. Bush [1990] 1 A.C. 831, at pp.864-865; and Lord Roskill in Caparo, supra, at p.628, whose views no longer represent the accepted position. See also Gummow J. (in the High Court of Australia) who described "assumption of responsibility" and "known reliance" as "imprecise and beguiling but deceptively simple terms": Hill v. Van Earp (1997) 188 C.L.R. 159, at p.229; Brodie, D., supra. But, see the riposte by Lord Browne-Wilkinson, in White v. Jones, supra, at p.274B, to the views of Lords Griffith and Roskill; and see the opinion of Lord Goff in Henderson v. Merrett Syndicates Ltd., supra.

[37] As Lord Reid observes in Hedley Byrne, supra, at p.486, a person knowing his skill or judgement was being relied on or trusted, has three options:
(i) decline to say anything, or

(the borrower enquirer/recipient) that it (the adviser) will perform a particular act or service for the recipient[39] - such as, giving advice - with reasonable skill and care. This has the legal consequence that - in the absence of an effective disclaimer, which goes to the question of whether the responsibility has been assumed - the adviser comes under a duty of care in law to perform the particular act or service with the requisite skill and care[40], and a failure to meet that standard results in liability.

(ii) give an answer which is qualified by a statement that no responsibility is accepted for it or that the answer is given without reflection, or

(iii) answer without qualification.

In Hedley Byrne, "the crucial element was that by choosing to answer the enquiry, the bank had assumed to act and thereby created the special relationship on which the necessary duty of care was founded": see Lord Browne-Wilkinson in White v. Jones [1995] 2 A.C. 207, at p.272G-H.

38 See Lord Devlin in Hedley Byrne, supra, at p.529; Lord Reid in Hedley Byrne, supra, at p.483; Lord Denning M.R. in McInerney v. Lloyds Bank Ltd. [1974] 1 Lloyd's Law Reports 246, at p.253; and Lord Oliver of Aylmerton in Caparo Industries Plc v. Dickman [1990] 2 A.C. 605, at p.638.

39 It does not matter "that the [act or] service is to be given by means of the instrumentality of words": see Lord Morris of Borth-y-Gest, in Hedley Byrne, supra, at p.503.

40 See Lord Morris of Borth-y-Gest in Hedley Byrne, supra, at p.497, who said:

This assuming of responsibility by the adviser to the enquirer/recipient is voluntarily undertaken: it is not imposed by the law[41]. What such an assumption does create is the necessary proximity between the parties[42], and "means no more than the act

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> " . . . [T]here may be many situations in which one person voluntarily or gratuitously undertakes to do something for another person and becomes under a duty to take and exercise reasonable care."

See too Lord Morris, at pp.496-497 and 502-503. Lord Morris later says (at p.503):

> "[I]f in a sphere in which a person is so placed that others could reasonably rely upon his judgement or his skill or upon his ability to make careful inquiry, a person takes it upon himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows or should know, will place reliance upon it, then a duty of care will arise."

See also Lord Browne Wilkinson in White v. Jones, supra., at p.273H."

41 Per Lord Devlin, at p.529. See also Lord Goff in Henderson v. Merrett Syndicates Ltd. [1995] 2 A.C. 145, at p.180C-D.

42 Per Lord Devlin, in Hedley Byrne, supra, at p.530, who regarded this "as an application of the general conception of proximity". See also Lord Oliver of Aylmerton in Murphy, supra, at p.486. Cf. the view of the Australian High Court in San Sebastian v. Minister Administering the Environmental Protection and Assessment Act. 161 (1986) C.L.R.340, at p.355, per Gibbs C.J., Mason, Wilson and Dawson JJ., who state that negligent words are part of

of the [adviser] in making the statement or tendering the advice was voluntary and that the law attributes to it an assumption of responsibility if the statement or advice is inaccurate and is acted upon."[43] It can arise either: (i) generally, where a general

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Donoghue v. Stevenson. See too Burnie Port Authority v. General Jones Pty Ltd. (1994) 179 C.L.R. 520, at p.543, per Deane, Dawson, Toohey and Gaudron JJ.; and Bryan v. Maloney (1994-95) 182 C.L.R. 609, at p.619, per Mason C.J., Deane and Gaudron JJ. It is submitted that the reasoning of the High Court of Australia is correct, and that the difference between the Hedley Byrne approach, and the foreseeability, proximity and fair, just and reasonable (or policy) approach to pure economic loss is not substantial - it is the application to the facts of a case which is critical, and whether the courts are willing to entertain recovery for pure economic loss. In Australia, the courts are willing to entertain claims for pure economic loss and there has not, as far as this writer is aware, been a flood of claims involving pure economic loss.

43 Per Lord Oliver of Aylmerton in Caparo, supra, at p.637. His Lordship goes on to say voluntary assumption of responsibility says "nothing about the circumstances from which such attribution arises." Cf. Lord Browne-Wilkinson in White v. Jones [1995] 2 A.C. 207, at p.274B-C, who said that the assumption of responsibility relates to the adviser's assumption of responsibility for the act or service: not "the assumption of legal liability" if it is not performed properly.

This view has been criticised by Murphy, J., "Expectation Losses, Negligent Omission and the Tortious Duty of Care" (1996) C.L.J. 43, at pp.49-50. This

relationship, such as that of solicitor and client, or banker and customer, is created, or (ii) specifically, in relation to a particular transaction[44]. Thus, where a lender advises a company incorrectly, the shareholders of the company have no cause of action against the lender: as there is no reason to suppose that they will be relying on the advice given (unless it is clearly to be made available to them by the company with the adviser's consent), and so do not come within Hedley Byrne.[45]

But when a bank manager tells a customer that he will advise him on a particular transaction, the manager is voluntarily assuming

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criticism was approved by McHugh and Gummow JJ. in Hill v. Van Earp (1997) 188 C.L.R. 156, at p.205, and p.231, respectively (High Court of Aust.).

[44] Specific relationships are referred to as ad hoc relationships by Lord Browne-Wilkinson in White v. Jones, supra., at p.273F-G.

[45] See Williams & Glyn's Bank Ltd. v. Barnes (1981) Com L.R. 205, at pp.206-207, (1997-1986) Vol. 10 Legal Decisions Affecting Bankers 220, at pp.223-225, per Ralph Gibson J. (as he then was), who said that a lender which had caused loss to a company did not owe a duty of care to the company's shareholders. Cf. Caparo Industries plc v. Dickman, supra. In such a situation, the company may have a cause of action against the advising bank, but the shareholders will not (even where the company is a "one man company"). To hold otherwise, would ignore the effect of Salomon v. Salomon & Co. Ltd. [1897] A.C. 22 (H.L.(E.)), that the shareholders are separate and distinct from the company; in this situation, the rule works against the shareholder.

responsibility for the advice that he is to give to the customer.[46] If, however, the customer passes that advice on to a third party, without the bank's knowledge or consent, then it is unlikely that the banker will be liable, because he did not assume any responsibility to the third party.

In deciding whether there has been an assumption of responsibility (by a lender to a borrower), the context of the situation needs to be considered. Was it a situation in which the adviser knew, or ought to have known, that his advice would be relied on?; was the enquiry a serious one by the enquirer?; what was it that the adviser did - did he give advice or merely act as a conduit and pass on information? Related to these questions is the issue of a disclaimer of liability. These issues are considered below.

(i) The Distinction Between Giving Advice and Merely Passing on Information

Where a lender merely passes on information to a borrower, rather than proffering advice, e.g., concerning a proposed investment, the lender will not be liable, as there has been no assumption of responsibility by the lender, regarding that information - the lender has merely acted as a conduit, and any reliance is not reasonable.

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[46] Verity and Spindler v. Lloyd's Bank plc. [1996] Fam. Law 213, [1995] C.L.C. 1557, decision of Judge Robert Taylor (sitting as a Deputy High Court Judge).

The law, thus, distinguishes between: (i) the giving of advice, and (ii) merely passing on information.[47]

This proposition is illustrated by the Privy Council decision in Royal Bank Trust Co. (Trinidad) Ltd. v. Pampellone[48], where, amongst other things, a customer (P) approached his bank manager (K) about investing in a U.K. deposit company.[49] K said he had a credit report on P.F. Ltd., and he orally passed on the contents of the report to P; K also gave P a brochure and other literature, plus an application form for persons wishing to make a deposit with P.F. Ltd. P made several investments in P.F. Ltd., which later became insolvent, and P suffered loss.

P sued the bank for his loss on P.F. Ltd., but was denied relief.[50] Lord Goff of Chieveley, who delivered the majority's advice, said that K, the bank manager, did no more than provide information about P.F. Ltd. - albeit that the information here was tendered

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47 See Toohey J. in James v. Australia and New Zealand Banking Group Ltd. (1986) 64 A.L.R. 347, at p.368 (Federal Court of Australia).

48 [1987] 1 Lloyd's Rep. 218 (P.C.) (On appeal from Trinidad).

49 P had previously approached the manager about investment in another company.

50 P also sued, again unsuccessfully, in relation to his earlier investment.

orally[51] - and K, on behalf of the bank, did not tender advice[52]; also, there was no evidence of reliance - the decision to invest had been P's[53], so that the loss suffered could not be said to have been caused by K.

(ii) Seriousness of the Enquiry

One of the difficulties of allowing recovery for negligent words, as opposed to negligent acts, is that negligent words can be spread widely and quickly, and result in further damage to different parties, whereas a negligent act is, generally, confined to a "one off" situation and to the parties involved.[54] Consequently, care has to be taken with ascribing an intention to assume responsibility for negligent words - as the giver has to realise that the enquiry is a serious one, in which his answer is being relied on, and, for which he is, thus, assuming responsibility. Therefore, words uttered in a social context, will not, usually, involve a voluntary assumption of liability[55], but words uttered in a business context will.[56] Hence,

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51 With regard to P's first investment, concerning a different company, a letter had been written by K to P.

52 [1987] 1 Lloyd's Rep. 218, at p.222, col. 2.

53 At pp.223 and 225, col. 2.

54 See Lord Reid in Hedley Byrne, supra, at pp.482-483.

55 Hedley Byrne, supra, per Lord Reid, at pp.482-483. See also Lord Goff in Henderson v. Merrett Syndicates Ltd. [1995] 2 A.C. 145, at p.181, who says:

the so-called "off the cuff", or "kerb side", opinion does not give rise to liability, as the giver of the advice is not aware that his views are being relied on, nor is he intending that they should be[57] - and so, no responsibility is assumed for them. Thus, an informal enquiry over the telephone does not necessarily make the giver of the reply aware that the enquiry is on a serious matter and that his answer will be relied on.[58] But where, payment is involved for information or advice, this is a very good indication that information or advice is being relied on and that the adviser is aware of this.[59]

"The concept [of a voluntary assumption of responsibility] indicates too that in some circumstances, for example where the undertaking to furnish the relevant service is given on an informal occasion, there may be no assumption of responsibility and likewise that an assumption of responsibility may be negatived by an appropriate disclaimer."

[56] Hedley Byrne, supra., at p.539, per Lord Pearce.

[57] Mohr and Mohr v. Cleaver and Cleaver [1986] W.A.R. 67, at p.72, per Burt C.J., in the Supreme Court of Western Australia; and Toohey J. in James v. Australian and New Zealand, supra, at p.72, in the Federal Court of Australia, citing Mohr with approval. See also Lord Denning M.R. in Howard Marine and Dredging Co. Ltd. v. A. Ogden & Sons (Excavations) Ltd. [1978] Q.B. 574, at pp.591-592.

[58] Shaddock v. Parramatta City Council (1981) 150 C.L.R. 225. (High Court of Australia).

[59] Lord Devlin in Hedley Byrne, supra, at p.528.

It is the seriousness of the enquiry, in a business context, that the adviser needs to be made aware of.[60] For example, in the Pampellone case[61], where the customer (P) made two separate visits to his bank manager (K) to seek investment advice, it was held that the customer's approach to the bank was a casual one which did not indicate the gravity of the enquiry and the importance to be attached to the reply.[62] Lord Goff of Chieveley[63], observed, in relation to P's first visit, after which the bank sent a

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[60] Howard Marine v. Ogden, supra, at p.591, per Lord Denning M.R. See also Lord Pearce in Hedley Byrne [1964] A.C. 465, at p.539, who said:

> "To import such a duty [of care] the representation must normally, I think, concern a business or professional transaction whose nature makes clear the gravity of the inquiry and the importance and influence attached to the answer . . . A most important circumstance is the form of inquiry and of the answer."

To similar effect is the minority advice of the Privy Council in M.L.C. v. Evatt [1971] A.C. 793, at p.812, per Lords Reid and Morris of Borth-y-Gest. The minority opinion is regarded as better than that of the majority.

[61] [1987] 1 Lloyds Rep. 218 (P.C.).

[62] [1987] 1 Lloyds Rep. 218, at pp.221, col. 1 and 223, col. 2.

[63] [1987] 1 Lloyd's Rep. 218, at p.221, col. 1. The majority also comprised Lords Bridge of Harwich and Oliver of Aylmerton; Lord Templeman and Sir Robin Cooke delivered a powerful dissent.

letter in guarded terms[64], that: (i) the visit was made without prior appointment or warning; (ii) no fee was charged[65]; (iii) no information was given by P concerning his assets; (iv) that no document was signed by P regarding the alleged request for advice; (v) P gave no indication of the sums to be invested; and (vi) the guarded nature of the bank's letter with its closing words that it was hoped the information helped P to make up his mind. The same points applied in relation to the second visit, except that what was given was information in the form of a pamphlet and not advice; and there was no letter.

That was an unusual case, and the minority of the Privy Council took a different view, saying that the bank should have known that this was a serious matter. Normally, however, when a borrower goes to a bank and asks for advice, it is clear to the bank that its expertise is being relied on, especially if the customer is not commercially experienced, or, even if he is, that he wants advice on

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64 In the letter, the bank wrote:

> " . . . All our reports indicate that this company may be regarded as trustworthy for its ordinary business engagements. We trust that this information will assist you in making up your mind as to the deposit."

65 The charging of a fee being an important indicator that the information being sought is being relied on, as Lord Devlin observed in Hedley Byrne [1964] A.C. 465, at p.529 (H.L.(E.)).

an area in which he is not experienced, such as, foreign currency loans,[66] or derivatives.

(b) Reasonable Reliance

The second criteria, under Hedley Byrne, that needs to be satisfied is reliance. Does the recipient follow, or rely on, the advice given by the adviser/lender (and, as a consequence, suffer loss).

(i) What Constitutes Reliance?

A person is said to have relied on a negligent misrepresentation, or negligent advice, when it can be shown that the misrepresentation or advice played "a real and substantial part, though not of itself a decisive part, in inducing [the recipient] to act, it is a cause of his loss and he relies on it, no matter how strong or how many are the other matters which play their part in inducing him to act"[67], i.e.,

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66 The literature on this subject is considerable: see, for example, Nankivell, P., "The Liability of Australian Banks For Swiss Bank Loans": Ch. 11 in Banks, Liability and Risk (1995) 2nd edn. (R. Cranston, ed.); and Allen, Professor D., "Bankers' Liability For Financial Advice" (1987) 16 M.U.L.R. 213, at pp.237-241.

67 Per Stephenson L.J. in JEB Fasteners Ltd. v. Marks Bloom & Co. [1983] 1 All E.R. 583, at p.589a-b (C.A.). See also Donaldson L.J. (as he then was), at p.588b-d, who commented that there can be a narrow sense of reliance, meaning "wholly dependent on", and a wider sense, which his lordship appeared to favour, in which factors could collectively, rather than individually, result

has the recipient acted in the way they have because of the misstatement/misrepresentation? Determining whether the statement was relied on, and whether it induced the recipient to enter into the transaction "involves a subjective investigation of the actual impact of the representation on its actual recipient, having regard to his actual characteristics and knowledge, whether or not these were within the knowledge of the maker of the representation."[68]

(ii) Reliance Must Be Reasonable

In addition to the effect the advice or misrepresentation has had on the recipient, the reliance on that advice or misrepresentation must be reasonable. This means that the adviser must, or should, be aware that the advice provided is to be relied on by the recipient[69] - this is linked with the question of the seriousness of the enquiry.

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in a particular act, or of "subsidiary factors which support or encourage the taking of the decision".

[68] Per Mance J. in Bankers Trust International PLC v. P.T. Dharmala Sakti Sejahtera [1995] 4 Banking Law Reports 381, at p.394, noted in (1996) B.J.I.B.F.L. (Banking and Insolvency Section), at p.43 and (Capital Markets Section), at p.46, and [1996] 4 J.I.B.L. N-81.

[69] Hedley Byrne Ltd. v. Heller and Partners Ltd. [1964] A.C. 465, at pp.486 and 503, per Lords Reid and Morris of Borth-y-Gest, respectively.

The relationship between reliance and inducement is cogently explained, in a lengthy passage, by Mance J., in the following terms[70]:

> "The meaning and effect of words never fails to be viewed in a vacuum. It is shaped by the context of their communication, including the parties respective positions, knowledge and experience. A description or commendation which may obviously be irrelevant or may even serve as a warning to one recipient, because of its generality or superficiality or laudatory nature, or because of the recipient's own knowledge and experience, may constitute a material representation if made to another less informed or sophisticated receiver. Even in the case of a written description, there may be cases where a proposal or presentation misrepresents the nature or working of a transaction to a particular reader, although another sophisticated, more analytical or legally qualified reader would have been expected to appreciate the real nature or working of the transaction. What is fair and adequate presentation in one context between one set of negotiating parties may be unfair or inadequate in another context. Whether there was any and if so what particular representation must thus depend upon an objective assessment of the likely effect of the proposal or presentation on the recipient. In making such an assessment, it is necessary to consider the recipient's characteristics and knowledge as they appeared, or ought to have

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70 Bankers Trust International PLC v. P.T. Dharmala Sakti Sejahtera, [1995] 4 Banking Law Reports 381, at p.393, noted in (1996) B.J.I.B.F.L. (Banking and Insolvency Section), at p.43, and (Capital Markets Section), at p.46, and [1996] 4 J.I.B.L. N-81.

> appeared, to the maker of the proposal or presentation. A recipient holding himself out as able to understand and evaluate complicated proposals would be expected to be able to do so, whatever his actual abilities. These are problems on which it is commonly not necessary to focus in a commercial context. The assumption on which most business is conducted is that both parties understand, or avail themselves of advice about, the area in which they are operating and the documentation which they use. Business could not otherwise be carried on."

His Lordship went onto state that the case before him might be different because of "the novelty and complexity of the products in question" (i.e., derivatives), the bank's "role in devising and marketing them and because of [the customer's] lesser involvement with them."

Examples of Reasonable Reliance

The following examples serve to illustrate the concept of reasonable reliance:

(i) a bank manager giving the impression to a customer that a loan, to be approved by the lender's head office, would be a mere formality, when there was never any chance of the loan being approved, and as a result of (i.e., in reliance on) the manager's statement, the customer drew on a bank account with the lender,

which resulted in the customer having financial difficulty, after the loan was refused.[71]

(ii) a bank officer describing a bakery business to commercially inexperienced borrowers, who wished to purchase it, as "a good little business", when it was not, with the consequence that the borrowers, in reliance on this statement, borrowed money from the bank to purchase the business, which failed[72].

(iii) a lender circulating inaccurate information in a letter to a small group of potential private investors (which included the claimant), recommending an hotel venture of one of its customers (who was, unknown to the potential investors, heavily indebted to the bank), as an investment[73], with the result that the claimant invested in the company, and lost money when it collapsed.

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[71] Box v. Midland Bank Ltd. [1979] 2 Lloyd's Rep. 391 (approved on appeal, [1981] 1 Lloyd's Rep. 434 (C.A.)).

[72] Bown v. Commonwealth Bank of Australia, unreported decision of Von Doussa J., in the Federal Court of Australia, delivered on 12th June, 1992. See also Verity and Spindler v. Lloyds Bank Plc, supra, and Cornish v. Midland Bank [1985] 3 All E.R. 513.

[73] Bundesgerichtshof (Sixth Civil Division) 12th February, 1979, WM 1979, 548 = NJW 1979, 1595, translation reproduced in Professor Markesinis' book, A Comparative Introduction to the German Law of Torts (1994) 3rd edn., at pp.266-271. The court allowed recovery, but reduced the quantum, due to the claimant's contributory negligence. The case is distinguishable from the English case of Caparo, as here the number of investors was known to the

(iii) Exercising Independent Judgement

Where a borrower or third party receives negligent advice from a lender, but exercises its own independent judgement on the matter, so that the recipient does not rely on the negligent advice received, the lender will not be liable for the loss suffered, as there is no reliance on the lender's skill and judgement.[74] For example, in Royal Bank Trust Co. (Trinidad) Ltd. v. Pampellone[75], a customer (P), who had asked for investment advice from his bank manager (K) and had received a letter from K - who had consulted a ratings agency, suggesting a company to consider investing in - decided to invest in the company referred to in the letter one year later, but without reference to, or reliance on, K's letter. It was held that P could not recover from the bank for his loss when the company P invested in subsequently went into liquidation, as there was no reliance on K's skill and judgement, i.e., P had exercised his own

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adviser, and the bank, which had specifically sought them out, had assumed responsibility to them, and knew there would be reliance on the circular - that was its purpose.

[74] Royal Bank Trust Co (Trinidad) Ltd. v. Pampellone [1987] 1 Lloyd's Rep. 218 (P.C.); James v. Australia and New Zealand Banking Group Ltd. (1986) 64 A.L.R. 347; and Lord Oliver of Aylmerton in Caparo, supra, at p.638. An argument to this effect failed in Verity and Spindler v. Lloyds Bank plc, supra.

[75] [1987] 1 Lloyd's Rep. 218 (P.C.).

judgement and, therefore, no duty of care was owed.[76] Clearly, in this case, the customer, at the very least, should have sought to obtain an up-date on the company at the time of investing.[77] Hence, "[a] recipient holding himself out as able to understand and evaluate complicated proposals would be expected to do so, whatever his actual abilities."[78]

Sophistication of the Recipient

The reasonableness of the reliance may depend on the level of experience and sophistication of the borrowers. Large corporations will, normally, have a team of independent advisers acting on their behalf in any transaction with a lender. In Ginora Investments Ltd v. James Capel & Co. Ltd.[79] it was held that the defendants (who

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[76] Royal Bank Trust Co. (Trinidad) Ltd. v. Pampellone [1987] 1 Lloyd's Rep. 218 (P.C.).

[77] An expert witness called by the customer said that it would be "foolhardy" to invest in a company again one year later without reviewing the advice originally given, and that any advice given concerning investments is given in the light of the prevailing circumstances, which may change: see at pp.223, col.1 and 225, col.1.

[78] Per Mance J. in Bankers Trust International PLC v. P.T. Dharmala Sakti Sejahtera, [1995] 4 Banking Law Reports 381, at p.393, noted in (1996) B.J.I.B.F.L. (Banking and Insolvency Section), at p.43, and (Capital Markets Section), at p.46, and [1996] 4 J.I.B.L. N-81.

[79] Unreported decision of Rimer J., delivered on 10th February, 1995, referred to in [1995] J.I.B.L. N-108, in the contributed note, "Professional

were acting as advisers in a take-over) were not liable in negligence, or for misrepresentation, as their client had had experience in take-overs. Likewise, in Bankers Trust International PLC v. P.T. Dharmala Sakti Sejahtera[80], where the bank's customer in a swaps transaction had had experience of swaps, it was held that the bank was not liable, on a counter-claim by the customer, in negligence for alleged misrepresentations and breaches of duty.

Difficulty does arise where the borrower is not so sophisticated. For example, a lender was liable to pay damages for negligence where the wife of a borrower ("C") signed a mortgage document giving the lender security over their matrimonial home (a farm), as she was told by a manager of the lender that the mortgage was the same as a building society mortgage (i.e., for a fixed amount), whereas the mortgage was an "all moneys" mortgage, and was used by the bank to make further advances to her husband. It was held that, as the bank manager had chosen to explain the effect of the mortgage to C, who the bank manager was aware "was confused and was relying (and did rely) on him to give an explanation"[81] of the mortgage, he

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Negligence and the Courts" (1995) B.J.I.B.F.L. 351, and Hammond, I., (1996) 17 The Company Lawyer 53.

[80] [1995] 4 Banking Law Reports 381, noted in (1996) B.J.I.B.F.L. (Banking and Insolvency Section), at p.43, and (Capital Markets Section), at p.46, and [1996] 4 J.I.B.L. N-81.

[81] Cornish v. Midland Bank [1985] 3 All E.R. 513, per Croom-Johnson L.J., at p.517.

was under a duty of care not to mis-state its effect, and here he had done so.[82]

Thus, banks will need to be aware of situations where the borrower is not, unreasonably, seeking advice from them, and the borrower is not familiar with the particular area of finance it has consulted the bank on. If the borrower has not consulted other independent advisers, e.g., an accountant or lawyer, then this is likely to indicate that the borrower will be placing great reliance on the bank, which should not take anything for granted. Examples will include small business or individuals, who do not have the need (or resources) to employ a team of lawyers and accountants.

Disclaimers of Liability - Unfair Contract Terms Act 1977 ("UCTA")

One way in which a lender may seek to protect itself from liability for negligence - but not fraud[83] - is by means of a disclaimer in any

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[82] Cornish v Midland Bank [1985] 3 All E.R. 513. See also Bown v. Commonwealth Bank of Australia, supra, and Verity and Spindler v. Lloyd's Bank Plc, supra, where a bank manager advised commercially unsophisticated borrowers - who had approached the bank for advice in reliance on promotional literature from the bank - that a project to purchase a property with a loan from the bank, renovate the property and re-sell it, was alright, when it was not.

[83] Boyd v. Glasgow Rly 1915 S.C. (H.L.) 20, at pp.35-36, per Lord Shaw of Dunfermline, Commercial Banking Co. of Sydney v. R. H. Brown & Co. (1972) 126 C.LR. 337, [1972] 2 Lloyd's Rep. 360, holding that fraud unravelled such a

advice given. In Hedley Byrne, such a disclaimer of liability (in the form of a non-contractual notice) proved effective and prevented the bank from being liable in negligence, as it had not assumed any responsibility to the recipient of a credit reference. However, since then, the Unfair Contract Terms Act 1977 ("UCTA") has been enacted, which provides that exclusion clauses in contracts[84], or disclaimers in notices (i.e., non-contractual documents)[85], which

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disclaimer; and S Pearson & Sons Ltd. v. Dublin Corpn. [1907] A.C. 351, at p.362, per Lord James (H.L.).

[84] S.15 sets out, for Scotland, the types of contract to which UCTA applies *vis-a-vis* ss.16-18. For England, Schedule 1 sets out the types of contract to which ss.2-4 and 7 apply. (It is curious that it was thought necessary to introduce separate parts of the Act for England and Wales, on the one hand, and Scotland, on the other, when there are no material differences between the separate parts.)

[85] S.16 of UCTA for Scotland, and ss. 1(3) and 2(2) of UCTA for England.

S.1(3) provides that s.2 applies only to "business liability", being liability for breaches of duties or obligations from things a person has done or is to do "in the course of a business" (whether his own or another's) or "the occupation of premises used for business purposes of the occupier".

Business is not specifically defined in UCTA (see ss.25 and 14), except that it includes professions and Government Departments or local authorities. Where a transaction is only incidental to a business activity, there needs to be a degree of regularity before the transaction can be said to be in the

seek to exclude liability for negligence, must satisfy a requirement of what is fair and reasonable[86], (i.e., reasonableness), where liability for loss or damage due to a breach of duty, in Scotland[87], or, negligence, in England[88], is sought to be excluded (or restricted), either by a contractual provision, or by a non-contractual notice.[89]

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course of business: see R & B Customs Brokers Co. v. United Dominion Trust [1988] 1 W.L.R. 321 (C.A.).

86 Ss.16(1)(b) and 24, in Scotland; and ss.2(2) and 11(3), in England.

87 See the definition in s.25 of UCTA in Scotland.

88 See the definition in s.1(1) of UCTA in England. The definitions of "breach of duty" and "negligence" are, substantially, the same, and relate to a failure to exercise reasonable skill, just as under the common law.

It is arguable that pre-printed bank loan and security documentation come within the standard form contract provisions, and so any exclusion clauses in them would have to satisfy the test of reasonableness test: ss.17 (Scotland) and 3 (England) and Schedule 2 (both). But negotiated documents would not be regarded as standard form contracts. See also the Unfair Terms in Consumer Contracts Regulations 1994 (S.I. 1994 No.3159), which apply to consumers for non-negotiated contracts for the sale and supply of goods and services. The new regulations will not apply to non-contractual notices. Whilst they do include contracts for financial services with consumers, it is unlikely that a consumer will make a credit enquiry, for example, and so be subject to a disclaimer *qua* consumer. A consumer is defined to mean a person who contracts for a purpose outside his business: see reg.2(1). Non-negotiated contractual terms which are too one-sided against a consumer will be

In determining whether a contractual term, which seeks to exclude liability, is a fair and reasonable one to incorporate into a contract, the court will look at "the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties to the contract at the time the contract was made".[90] Likewise, with a non-contractual notice, the court will consider "all the circumstances obtaining when the liability arose or (but for the provision) would have arisen".[91] Agreement to, or awareness of, a disclaimer does not indicate a voluntary acceptance of it[92], nor does a previous agreement to, or awareness of, an exclusion clause alone

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invalidated. For a discussion of the regulations: see Gloag and Henderson, The Law of Scotland (1995) 10th edn. (by the late W.A. Wilson and A.D.M. Forte and others), at para.10.24, on pp.137-138, and Chitty on Contracts: General Principles (1994) 27th edn. (A.G. Guest Q.C., ed.), at paras.14-090ff.

89 In Scotland: see s.24 of UCTA; and in England: see ss. 11 and 13 of UCTA, and s.3 of the Misrepresentation Act 1967.

90 S.24(1) of UCTA, for Scotland, and s.11(1), for England. In England, the wording of the reasonableness test is slightly different, as there is no reference to "only" *vis-a-vis* what is to be taken into account at the time of contracting. It is submitted that this makes no difference, and it is intended that the section should be read as if the only matter to be taken into account is what was reasonably contemplated at the time of contracting.

91 S.24(2A) of UCTA, in Scotland, and s.11(3), for England.

92 See s.16(3) of UCTA, in Scotland, and s.2(3), in England.

amount to a voluntary acceptance[93]. It is for the party relying on the term or notice to prove it is fair and reasonable[94].

When deciding whether a non-contractual notice seeking to exclude liability for negligence is reasonable[95], the courts will take into account the following factors, which are not exhaustive[96]:

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93 Ss.16(3) of UCTA, in Scotland, and s.2(3) of UCTA, in England. The provisions of s.24, for Scotland, and ss.11 and 13, for England, introduce a "but for" test concerning exclusionary provisions in a contract or notice. The question of the common law duty of care is judged by deciding whether it would exist, but for the exclusionary provision - mainly a notice in this context: see Lord Griffiths in Smith v. Eric S. Bush [1991] 1 A.C. 831, at p.857.

94 Ss.24(4) and 11(5) of UCTA in Scotland and England, respectively. This is a statutory version of the *contra proferentem* rule of construction.

95 Cf. Schedule 2 UCTA for consumer and standard form contracts and the factors listed there; and see Schedule 2 of Unfair Terms in Consumer Contracts Regulations (S.I. 1994 No.3159). The criteria of reasonableness in Schedule 2 of UCTA, although applying to contracts for the sale and supply of goods (ss.6(3), 7(3) and (4), 20 and 21), has been considered to be of general application: see Flamar Interocean Ltd. v. Denmac Ltd.; The Flamar Pride [1990] 1 Lloyd's Rep. 434, at pp.438-439, per Potter J.; Stewart Gill Ltd. v. Horatio Myer & Co. Ltd. [1992] Q.B. 600, at p.608, per Stuart-Smith L.J.; and Singer Co. (UK) Ltd. v. Tees and Hartlepool Port Authority [1988] 2 Lloyd's Rep. 164, at p.169, per Steyn J. (as he then was).

96 Per Lord Griffiths in Smith v. Eric S. Bush, supra, at pp.858-859. This case was cited with approval by the First Division in Melrose v. Davidson And

(i) the bargaining power of the parties - if it is a "one-off" situation between parties of equal bargaining power, then the reasonableness requirement is more readily satisfied;

(ii) whether, where advice is given, it is "reasonably practicable to obtain advice from an alternative source, taking into account considerations of cost and time";

(iii) the difficulty of the task being undertaken, liability for which is being excluded - a very difficult, or dangerous, task may involve a high risk of failure and this will be a factor in not invalidating the exclusion clause; and

(iv) the practical consequences of reasonableness - this relates to the sum of money involved, and the parties' abilities to bear the loss, which, in turn, concerns the questions of the availability and cost of insurance - something "all prudent professional men carry"[97].

So, where "breathtaking sums of money" are involved, it may be reasonable to give advice on a no, or limited, liability basis "to the extent of the adviser's insurance cover", where it is difficult to

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Robertson 1993 S.L.T. 611. For a review of the English authorities: see Chitty, On Contract: General Principles (1994) 27th edn. (A.G. Guest, ed.), at paras.14-072-14-075. See also ss.11(4), for England, and s.24(3), in Scotland, regarding the factors to be taken into account concerning limitation clauses.

[97] Per Lord Griffiths, in Smith v. Eric S. Bush, supra, at p.858. There is reference to insurance and the resources available to the defender/defendent in ss.24(3), for Scotland, and 11(4), for England of UCTA.

obtain adequate insurance cover, and the adviser would be ruined if he was held liable.[98]

With regard to contractual terms seeking to exclude negligence, the criteria in Schedule 2 of UCTA (although applying to contracts for the sale and supply of goods), has been said to be of general application[99]. This criteria involves looking at:

(a) the parties' bargaining power;

(b) whether there was an inducement to accept a particular term;

(c) whether the customer knew, or ought to have known, of the term, e.g., through a course of dealing, or custom, or trade;

(d) whether it was reasonable to expect compliance with a term excluding or restricting liability if a condition was not complied with; and

(e) whether the customer had specific requirements.

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[98] Per Lord Griffiths in Smith v. Eric S. Bush [1990] 1 A.C. 831, at p.859.

[99] See Flamar Interocean Ltd. v. Denmac Ltd.; The Flamar Pride [1990] 1 Lloyd's Rep. 434, at pp.438-439, per Potter J.; Stewart Gill Ltd. v. Horatio Myer & Co. Ltd. [1992] Q.B. 600, at p.608, per Stuart-Smith L.J.; and Singer Co. (UK) Ltd. v. Tees and Hartlepool Port Authority [1988] 2 Lloyd's Rep. 164, at p.169, per Steyn J. (as he then was).

The difficulty, despite the above guidance, is that there is no certainty that the courts, in balancing the various considerations[100], will regard a disclaimer as reasonable, and, therefore, effective.[101] It would appear that where the innocent party is sophisticated, the court is less likely to hold that a disclaimer, which negatives a liability for negligence, is unreasonable.[102] Also, where it is likely that the party concerned has had an opportunity to regulate his conduct *vis-a-vis* the disclaimer and to have made an independent examination of the matter under consideration, for example, through professional advice, again, a court will probably regard the disclaimer as reasonable.[103] Furthermore, where an established practice has grown up regarding the use of disclaimers in a particular type of transaction, then, the court is unlikely to hold that the disclaimer is unreasonable. For example, in McCullagh v.

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100 See Lord Bridge of Harwich in George Mitchell (Chesterhall) Ltd. v. Finney Lock Seeds Ltd. [1983] 2 A.C. 803, at pp.815-816.

101 Adams, J. and Bronsword, R., "The Unfair Contract Terms Act: A Decade of Discretion" (1988) 104 L.Q.R. 94.

102 McCullagh v. Fox Lane & Partners Ltd. [1996] 1 E.G.L.R. 35 (C.A.). In this case, Mr McCullagh was described as "a sophisticated and experienced member of the public", and it was held that a disclaimer in the listing particulars by real estate agents of a residential property purchased by Mr McCullagh was not unreasonable under UCTA.

103 McCullagh v. Fox Lane & Partners Ltd., supra, at p.46F-G, per Hobhouse L.J.

Fox Lane & Partners Ltd.[104], there was a claim by a house buyer that an estate agent negligently misdescribe the size of a property, and it was held that "[t]he use of disclaimers to insulate the estate agent and the estate agent's principals, from responsibility for representations made by estate agents is commonplace and is the normal basis upon which house sale transactions are carried out every day across the country."[105] By analogy, the use of disclaimers in credit references by banks is common place[106], and so a disclaimer may not be unreasonable, particularly when the enquirer is sophisticated. For example, in Ata v. American Express Ltd.[107], A, a private banking client, claimed American Express Ltd. ("Amex") failed to carry out his instruction and/or did not implement an agreed investment strategy, in relation to unsuccessful trading by Amex on A's behalf. It was held that Amex was not prevented by UCTA from relying on exclusion/indemnity clauses. This was because A was a very experienced investor; and Amex's standard terms were not unusual or especially onerous. Thus, A was able to either go to another bank, or negotiate terms with Amex. Consequently, the exclusion/indemnity clauses were reasonable.

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104 [1996] 1 E.G. L.R. 35 (C.A.).

105 Per Hobhouse L.J., supra, at p.46 G-H.

106 Certainly since Hedley Byrne. See the discussion of bank references by Lord Devlin, in Hedley Byrne, supra, at p.528.

The difficulty will arise where the innocent party is not sophisticated, or is perceived by the court as being unsophisticated. In such a case, the court is unlikely to hold a disclaimer is reasonable, and will look at the question of which party is best able to bear the loss[108].

So, where a borrower is a small corporate business, for example, in which the management is probably (but not always) less sophisticated than a large business, and will not, usually, have either the bargaining power of a larger corporation, or its degree and level of independent professional advice, the potential for such a clause to be invalidated is greater, because the lender has a greater capacity to bear the loss.

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107 Unreported decision of Rix J., delivered on 7th October, 1996; noted New Law Digest, Commercial Communication 150.

108 See, for example, St. Alban's City and District Council v. International Computers Ltd. [1997] F.S.R. 251, at pp.263-264, per Nourse L.J., who upheld the finding of unreasonableness by Scott Barker J. ([1995] F.S.R. 686); Hirst L.J. and Sir Ian Glidewell agreed. The decision at first instance is noted by MacDonald, E., "The Council, the Computer and the Unfair Contract Terms Act 1977" (1995) M.L.R. 585; see also Bhattacharyga, G., "The Duties and Liabilities of Lead Managers In Syndicated Loans" (1995) B.J.I.B.F.L. 172, at p.174. See an updated version of this article: (1995) 16 The Company Lawyer 259, at p.262.

Concurrent Liability in Contract and Delict

In an oft cited quotation, the Privy Council has said that, where a party has sought to sue in both delict tort and contract, they[109]:

> " . . . do not believe that 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. *This is particularly so in a commercial relationship. Though it is possible as a matter of legal semantics to conduct an analysis of the rights and duties inherent in some contractual relationships including that of banker and customer* either as a matter of contract law . . . or as a matter of tort law . . . their Lordships believe it to be correct in principle and necessary for the avoidance of confusion in the law to adhere to the contract analysis: on principle because it is a relationship in which the parties have, subject to a few exceptions, the right to determine their obligations to each other, and for the avoidance of confusion because different consequences do follow according to whether the liability arises from contract or tort . . ." (Emphasis added.)

The rationale for this is that in a contract, the parties are able to determine their obligations and liabilities between themselves,

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[109] Tai Hing Cotton Mill Ltd. v. Liu Chong Hing Bank Ltd. [1986] A.C. 80, at p.107, per Lord Scarman (delivering the advice of the Judicial Committee). A similar view, regarding the delineation of liability in tort and contract, was expressed by Lord Bridge of Harwich in D. & F. Estates Ltd. v. Church Commissioners for England [1989] A.C. 177, at p.206 (H.L.(E.)).

whereas in delict, the injured party cannot so protect himself[110]; also, in delict, duties can be owed to the world at large, whereas a contract will normally only affect the parties to it.[111] Views differed as whether this passage, which was perhaps misunderstood, permitted concurrent liability[112] or not.[113]

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110 See Lord Reid in Koufos v. Czarnikow Ltd.; The Heron II [1969] 1 A.C. 350, at p.386.

111 In Scots law, third parties can have rights in relation to a contract, which they are not a party to, under the *jus quaesitum tertio*: see Gloag and Henderson, The Law of Scotland (1995) 10th edn. (by the late W.A. Wilson and A.D.M. Forte and others), at paras.11.4-11.9.

112 See, for example, Lord Jauncey of Tullichettle in Smith v. Eric S. Bush [1990] 1 A.C. 831, at p.870; and Lord Bridge of Harwich in Caparo Industries Plc v. Dickman, [1990] 2 A.C. 605, at p.619, who said a professional man can be liable in contract and delict for breach of duty to his client. See further the article by Burrows, A., "Solving The Problems of Concurrent Liability" (1995) Current Legal Problems 103.

113 For examples of cases in which the plaintiff could not recover for both breach of a duty of care and breach of contract: see Pacific Associates Inc. v. Baxter [1990] 1 Q.B. 993 (C.A.); Greater Nottingham Co-op. Society Ltd. v. Cementation Piling and Foundations Ltd. [1989] Q.B. 71; and National Bank of Greece v. Pinios Shipping (No.1); The Maira [1990] 1 A.C. 637 (C.A.) (This part of the decision was not appealed against in the House of Lords.)

This issue was recently reconsidered by the House of Lords,[114] which said that whilst the result of permitting concurrent liability maybe "untidy", the common law is not "antipathetic" to it, and there is no sound basis for automatically restricting liability to contract or delict/tort.[115]

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[114] Henderson v. Merrett Syndicates Ltd. [1995] 2 A.C. 145. See also Lord Goff in the earlier case of Spring v. Guardian Assurance Plc [1995] 2 A.C. 296, at p.320B-C.

[115] Per Lord Goff (with whom the other Law Lords agreed), citing, with approval, the views of Oliver J. (as he then was) in Midland Bank Trust Co. Ltd. v. Hett Stubbs and Kemp [1979] Ch. 384; see Henderson v. Merrett Syndicates Ltd., supra, at pp.188-194.

Thus, where there is an assumption of responsibility under Hedley Byrne, which is not inconsistent with, or excluded by, an existing contractual chain or structure[116] between the parties, there can be concurrent liability in contract and delict/tort, which permits the pursuer/plaintiff to choose the remedy best suited to him.[117] The

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[116] Lord Goff gave as an example of this a construction case where there is: (i) one contract with the owner and the head contractor, and (ii) another contract between the head contractor and a sub-contractor, with the latter assuming no responsibility to the owner: see Henderson v. Merrett Syndicates Ltd., supra, at pp.195G-196E.

[117] In this case, it was the advantage of bringing an action in delict/tort, in terms of the limitation period, under English law, that meant the action could be brought at all. Lord Goff lists other advantages of concurrent liability, such as, "the rules as to remoteness of damage, which are less restricted in tort than they are in contract": see Henderson v. Merrett Syndicates Ltd., supra, at p.185.

Lord Goff also conducted an extensive review of other common law countries, such as Canada and Australia, in which there is concurrent liability; his Lordship also looked at civil law countries, like France (where concurrent liability is not permitted) and Germany (where it is permitted), and bemoaned the lack of academic writing on the topic (in the United Kingdom), which he felt had hindered debate on the issue: see, at pp.184ff. For Canada: see Central Trust Co. v. Rafuse [1986] 2 S.C.R. 147 and CP Hotels Ltd. v. Bank of Montreal (1987) 40 D.L.R. (4th) 385; in the latter case, it was said that where the court had refused to imply a duty (of care) into a contract (the normal

House of Lords said that what the Privy Council was concerned with was whether, there could be a delictual/tortious duty of care which was more extensive than the obligations provided for by the parties in their contract: they were not saying that there could not be concurrent liability.[118] However, the Court of Appeal has subsequently held, in the context of a solicitor's negligence, that there can be greater liability in delict/tort than in contract under Hedley Byrne, where the duties in delict/tort and those under a contract were concurrent, but not co-extensive.[119] With respect, this appears to directly contradict the House of Lords (and Privy Council), and can not be correct in principle.

The result of this clarification of concurrent liability is that a borrower, who has an express contract with a lender, e.g., a loan

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banker/customer contract), this duty could not be recognised in delict/tort, and, thus, there could not be concurrent liability, in that case. For Australia: see Hawkins v. Clayton (1988) 164 C.L.R. 539. See also the interesting, and perceptive, opinion of Lord Browne-Wilkinson in Henderson v. Merrett Syndicates Ltd. [1995] 2 A.C. 145, at pp.204-206, who reaches the same result, regarding allowing concurrent liability, but who analyses the matter by way of analogy with the fiduciary principle; and the case note of his Lordship's speech by J.D. Heydon, "The Negligent Fiduciary" (1995) 111 L.Q.R. 1.

[118] Per Lord Goff of Chieveley in Henderson v. Merrett Syndicates Ltd., supra, at p.186F, agreeing with the view of Sir Thomas Bingham M.R. (as he then was) in the Court of Appeal.

[119] Holt v. Payne Skillington (a firm), *The Times*, 22nd December, 1995.

agreement, inaddition to the general banking contract[120], can choose its cause of action, which may have limitation period advantages. These limitation period advantages may be important concerning advice, because there may be a gap between the giving of the negligent advice and the loss suffered.[121] Under English law, if a claim was brought in contract, the six year limitation period runs from the date of the breach,[122] whereas, in tort,[123] the six year limitation period runs from the date of the damage[124]. Under Scots

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120 See, for example, Lee J. in Fernyhough v. Westpac Banking Corpn., unreported decision, in the Federal Court of Australia, delivered on 18th November, 1991, who, in the context of a foreign currency loan, held that: (i) a duty of care in tort was owed, and (ii) there were terms implied into the banker/customer relationship that the bank would "provide sufficient and accurate advice": see Lexis, at para.86 of the judgement; and the Canadian case of Raypath Resources Ltd. v. Toronto Dominion Bank (1995) 170 A.R. 81.

121 Vroegop, J., "A Banker's Liability For Financial Advice" [1993] J.I.B.L. 58, at pp.58-59.

122 S.5 of the Limitation Act 1980, for contract.

123 S.2 of the Limitation Act 1980, for tort.

124 See Vroegop, supra, at pp.58-59.

law,[125] the prescriptive period, concerning breach of contract[126] and delict,[127] is five years from the date "when the obligation became enforceable".[128] An obligation is considered to "become enforceable when loss, injury or damage occurred".[129] This also contemplates that there may be a gap between giving negligent advice and suffering loss.

Where a loan agreement was induced by a negligent misrepresentation of the lender, the contract can be set aside and damages awarded.[130] It will mainly be this area of negligent

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125 For a discussion of Prescription under Scots law: see Ch. 15 in Gloag and Henderson, The Law of Scotland (1995) 10th edn. (by W.A. Wilson and A.D.M. Forte and others).

126 See the Prescription and Limitation (Scotland) Act 1973, s.6(2); schedule 1, para.(g), in relation to contract.

127 The Prescription and Limitation (Scotland) Act 1973, s.6(2); schedule 1, para.(d), in relation to delict.

128 S.6(3) of the Prescription and Limitation (Scotland) Act 1973.

129 S.11(1) of the Prescription and Limitation (Scotland) Act 1973.

130 See s.10 of the Law Reform (Misc. Provisions) (Scotland) 1985, and, in England, s.2(1) of the Misrepresentation Act 1967, allowing damages for negligent misrepresentation. NB. s.2(2) of the Misrepresentation Act 1967, giving the court a discretion to permit rescission.

advice, or misrepresentation, in precontractual negotiations,[131] which will be the focus of liability. Breaches of provisions of a loan agreement or security documentation by a lender are unlikely to invoke delictual/tortious liability, as the contracts will govern the parties relationship and their liabilities and obligations to each other. In Raypath Resources Ltd. v. Toronto Dominion Bank[132], a lender (TDB) failed to advise a corporate borrower (RRL) that its credit limit, under a facility letter[133], had been reduced, because of concerns by TDB about RRL's business, from Can. $300,000 to $200,000. TDB was held liable in negligence for its breach of duty to the borrower due to this omission and for breach of an "implied term in the banker-customer contract to perform banking duties in a reasonable and prudent manner"[134], after the borrower eventually became insolvent, as a consequence of the reduction of

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131 See, for example, Esso Petroleum Co. Ltd. v. Mardon [1976] Q.B. 801 (C.A.), cited without disapproval by the House of Lords in Banque Keyser Ullmann SA v. Skandia (UK) Insurance Co. Ltd. [1991] 2 A.C. 249, at p.275, per Lord Templeman. See also Oliver J. (as he then was) in Midland Bank Trust Co. Ltd. v. Hett Stubbs and Kemp [1979] Ch. 384, and the Court of Appeal in Howard Marine and Dredging Co. Ltd. v. A. Ogden & Sons (Excavations) Ltd. [1978] Q.B. 574 (C.A.). See too: s.10 of the Law Reform (Misc Provisions) (Scotland) 1985, and s.2(1) of the (English) Misrepresentation Act 1967.

132 (1995) 170 A.R. 81.

133 The line of credit was "subject to review and change therein from time to time in the normal course of business".

134 At para.114, on p.134.

the line of credit and its eventual cancellation, when a director of RRL refused to give a personal guarantee for RRL's debt, which had been erroneously overstated.[135]

[B] BREACH OF DUTY AND CAUSATION

Once a customer or third party has established that a duty of care is owed to it by a lender, it will be necessary for the customer or third party to show that the lender breached that duty of care by falling short of the standard of care expected of it in the circumstances, and that the breach of duty by the bank caused the loss suffered by the pursuer/plaintiff.

(a) Standard of Care

The standard of care expected of a banker in Scotland and England is such skill and care as an ordinary competent banker would be expected to exercise; it does not have to be the highest level of skill (as different people have different abilities), and there can be genuine differences of opinion.[136]

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[135] There was also a breach by TDB of an agreement to provide RRL with an electronic deposit tracking system. When TDB's computer system indicated that a cheque, which RRL proposed to issue to a supplier for petrol purchases would exceed RRL's credit limit by $200,000 (which was not the case), this was the catalyst for the series of events leading to RRL's demise.

[136] See Hunter v. Handley 1955 S.C. 200, at pp.207-208, per Lord Clyde, noted "Medical Negligence: Hunter v. Hanley 35 years on" 1990 S.L.T. (News) 325;

Thus, the question in each case is: what would the reasonable banker, or reasonably careful bank manager,[137] do in a particular situation?[138] When advising a customer, or giving a credit reference, for example, a reasonable banker would provide accurate, impartial and up to date information to the customer about the transaction, or to the enquirer about the banker's

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and Bolam v. Friern Hospital Management Committee [1957] 1 W.L.R. 582, at pp.586-587, per McNair J.; see also Lord Fraser of Tullybelton in Sidaways v. Governors of Bethlem Royal Hospital [1985] A.C. (H.L.(E.)). See too: Lord Fraser of Tullybelton in Whitehouse v. Jordan [1981] 1 W.L.R. 246, at p.263E-F; and Maynard v. West Midlands Regional Health Authority [1984] 1 W.L.R. 634. The Bolam test has been applied to lawyers: see Saif Ali v. Sydney Mitchell & Co. [1980] A.C. 1948.

137 Per Judge Robert Taylor (sitting as a Deputy High Court Judge) Verity and Spindler v. Lloyd's Bank Plc [1996] Fam. Law. 213, [1995] C.L.C. 1557.

138 In Verity and Spindler, supra, Judge Robert Taylor said "[i]f a bank manager undertakes to give financial advice to customers, then . . . he must expect to be judged by the same standards as those applicable to other professionals who give financial advice, such as [chartered accountants]": see the transcript. Cf. Bray C.J., in the South Australian case of O'Learly v. Lamb (1973) 7 S.A.S.R. 159, at p.191, who said the standard of care expected of a financial adviser, "was not that of an expert accountant, but that of an ordinary prudential skilful financial adviser." See too Langley J. in Sumitomo Bank Ltd. v. Banque Bruxelles Lambert S.A. [1997] 1 Lloyd's Rep. 487, at p.517, col. 1, who refers to "the standard of the reasonably competent bank"; and, at p.515, col. 1, to discharging duties "as a responsible and prudent bank".

customer, subject to any caveat contained in the advice; in doing so, the banker should take account of the nature of the enquirer, its experience and understanding[139]. An example of a failure to reach the requisite standard where a credit reference was sought, arose in the South African case of Standard Chartered Bank of Canada v. Nedperm Bank Ltd.[140], where a negligent credit reference was given by one bank ("N") to another bank ("SCBC") concerning TC, a customer of N. SCBC had sought the reference so as to decide whether to renew a credit facility to TC. In the reference, N stated that: (i) TC was "trading normally", and (ii) TC would be considered good for "their normal commitments in the course of business". In both respects, this was inaccurate as: (i) TC had been manufacturing at greatly reduced capacity - it was wholly dependent on borrowings/bank support - and N had been rather concerned about

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[139] Stewart McLean Baird & Nelson 1915 S.C. 13, at p.19, per Lord Dundas; and County Personnel (Employment Agency) Ltd. v. Alan R. Pulver & Co. Ltd. [1987] 1 All E.R. 289, at p.295a-b, per Bingham L.J. (as he then was). See also Mance J. in Banker's Trust International PLC v. PT Dharmala Sakti Sejahtera [1995] 4 Banking Law Reports 381, at p.393, noted in (1996) B.J.I.B.F.L. (Banking and Insolvency Section), at p.43, and (Capital Markets Section) at p.46, and [1996] 4 J.I.B.L. N-81.

[140] 1994(4) S.A. 747. See also Nat West Aust Ltd. v. Tricontinental Corp. Ltd. (1993) A.T.P.R. 46-109 (Digest), [1993] 11 J.I.B.L. N-203, at N-203, where MacDonald J. refers to what a "prudent banker" would do in the context of a negligently prepared information memorandum for a syndicated loan, which was distributed to a potential syndicate member, and a subsequent incorrect answer by the lead bank to a question about the information memorandum.

T's financial position, and (ii) TC could only meet its normal facilities with bank support, as TC's credit facilities stretched beyond the agreed maximum of its credit limit and some commitments had not been honoured. The Supreme Court of South Africa held that, in view of N's intimate knowledge of T's affairs, "a skilled banker in [N's] position, acting reasonably, would not have furnished the report".[141] Thus, there was a breach of the standard of care expected and damages were awarded.

In deciding whether a lender has failed to reach the standard of a reasonable banker, the benefit of hindsight should not be used; the professional judgement of the lender must be examined in the light of the circumstances prevailing at the time it was made, and it must be a judgement "which no reasonable and competent adviser could have made".[142]

(b) Causation

(i) New Approach - Common Sense

After establishing a duty of care and breach of that duty, the borrower or third party has to show that the loss it suffered was caused by the lender's negligence and not some other factor, i.e.,

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[141] Supra, at p.762.

[142] Ginora Investments Ltd. v. James Capel & Co. Ltd., discussed in the contributed article, "Professional Negligence and the Courts" (1995) B.J.I.B.F.L. 351, and noted in [1995] J.I.B.L. N-108, and Hammond, I., "Providing negligence on the part of a financial adviser: the lessons to be learnt from Ginora Investments Ltd. v. James Capel" (1996) 17 The Company Lawyer 53.

there was an unbroken causal link; causation, which is a factor limiting recovery, is a question of fact[143]. In seeking to establish this link, the courts have traditionally used the "but for", or *causa sine qua non*, test[144], however, more recently, the courts have regarded the "but for" test as not being definitive, and in its place, two alternatives have emerged, which are not materially different.[145] The first, is the "pragmatic test", which assesses whether the negligence of the lender "was a substantial factor in producing the result".[146] The second, is a common-sense approach, concerned with whether there was "a sufficient causal connection"[147]. In this latter test for causation, the courts rely more on their, so-called, "gut feeling" and experience as to whether the

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143 Smith New Court Securities Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1997] A.C. 254, at pp.284G-285A, per Lord Steyn; Lords Keith of Kinkel, Mustill and Slynn of Hadley expressed agreement with Lord Steyn's speech.

144 See Clerk and Lindsell on Torts (1995) 17th edn. (M. Brazier, General Editor), at paras.2-10 - 2-12, and the cases cited there; and Hart, H.LA. and Honore, A., Causation in Law (1985) 2nd edn., Ch. V, "Causation and *Sine Qua Non*".

145 See Lord Steyn in Smith New Court Securities Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1997] A.C. 254, at p.285A-C.

146 Smith New Court, supra, at p.285A-B, per Lord Steyn.

147 Ibid.

defender's negligence caused the pursuer's loss;[148] the causation has to be the effective or dominant cause of the pursuer's loss.[149] In applying this "common sense" test, the sorts of factors that may be taken into account include: foreseeability, reasonableness, directness and natural and probable consequence[150], as well as "whether the negligent act increased the risk of the subsequent loss"[151].

The commonsense approach was applied by the English Court of Appeal where the managing director of a company had misapproriated company moneys, which was not reflected in the audited accounts of the company because it was not known about at the time; it was held that a claim by the purchaser of the company (which went into liquidation) against the auditors for negligence, failed. The court said that the auditor's negligence provided an

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148 See, for example, Galoo Ltd. v. Bright Grahame Murray [1994] 1 W.L.R. 1360; and March v E & M Stramare Pty Ltd. (1991) 171 C.L.R. 506, noted (1992) 66 A.L.J. 3 (Current Topics); and Alexander v. Cambridge Credit Corporation Ltd. (1987) 9 N.S.W.L.R. 310.

149 Galoo Ltd. v. Bright Grahame Murray [1994] 1 W.L.R. 1360 at pp. 1370, per Cilldewell L.J., especially at (C.A.); noted by O'Sullivan, J., "Auditors' Negligence - Getting The Balance Right" [1995] C.L.J. 25.

150 Cooke P. in Fleming v. Securities Commission [1995] 2 N.Z.L.R. 514, at p.524.

151 Beale, H., "Valuer's Negligence and Falls in the Property Market" (1995) 111 L.Q.R. 571, at p.574.

opportunity for the losses, but did not cause them[152]; the cause of the losses was the poor trading performance of the companies and their directors.[153] If the company had traded well and there had been no fraud, its problems would not have arisen. The decision reflects the view of Lord Wright that causation is concerned "with ordinary everyday life", and not "philosophic speculation".[154] Thus, if a company's failure, on a common-sense view, is due to poor management and/or external factors, rather than negligent advice from a lender, there will be no liability.

The importance of establishing a link between the conduct of a bank and the loss of a borrower is shown by the recent case of

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[152] At p.1375B. See Young v. Purdy, *The Times*, 7th November, 1995 (C.A.), per Leggatt L.J., who applied similar views, to hold that a solicitor's wrongful termination of his retainer provided the occasion of the plaintiff's loss, but did not cause it, when the plaintiff acted negligently. His lordship earlier expressed the view that "[t]he test as to the application of judicial commonsense in the Galoo case was an unsure guide in seeking to ascertain whether a particular breach of duty of care which resulted in loss was to be judged in law as having caused it. That depended essentially on whether the breach relied on was what was sometimes called the effective cause of the loss, or on the other hand was merely an occurrence without which no loss would have been sustained."

[153] A similar view is expressed by O'Sullivan, J., "Auditors' Negligence - Getting The Balance Right" [1995] C.L.J. 25, at p.26.

[154] Monarch Steamship Co. Ltd. v. Karlshamns Oljefabriker (A/B) 1949 S.C. (H.L.) 1, at p.25, [1949] A.C. 196, at p.228.

Bankers Trust International PLC v. P.T. Dharmala Sakti Sejahtera.[155] There, a customer (DSS) sought to evade liability under a complicated interest rate swap arrangement with the bank. Pursuant to the swap contract (which replaced an earlier swap between the parties), if LIBOR went above 5.2%, then DSS would pay an increased spread to the bank under a formula set out in the swap contract. LIBOR rose to 6.22%, and DSS ended up with an interest liability of $U.S. 45m. The bank sued DSS for the money owed to it under the swap contract; DSS counter-claimed against the bank alleging negligence, misrepresentation and breaches of the bank's duty to explain the nature of the swap fully to DSS.

Mance J. upheld the bank's claim, and dismissed the counter-claim. His Lordship said the bank was not under a duty to advise DSS about the swap. He further said that although the bank's written and oral presentations could give a misleading impression to a party that did not carefully analyse the transaction with the replacement swap, DSS could not show that it had been misled by the bank. DSS was able to evaluate the position for itself and did so. Moreover, there was nothing to suggest that, even if it had appreciated the extent of the losses more fully, DSS would have done anything differently, or would not proceed with the transaction. Therefore, the bank's conduct or representations did not cause the supposed "loss" suffered by DSS: DSS's own conduct did.

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155 [1995] 4 Banking Law Reports 381, noted (1996) B.J.I.B.F.L. p.43 (Banking and Insolvency Section) and pp.46-47 (Capital Markets), [1996] 4 J.I.B.L. N-81, and [1996] J.I.B.L. N-81.

(ii) No Intervening Event

Where the sequence of events is disturbed by a new cause, which is "unreasonable or extraneous or extrinsic"[156], and this breaks the causative effect of the adviser's conduct[157], the adviser (i.e., lender) is not liable. Whether such *novus actus interveniens* breaks the "chain of causation" is a "question of fact and degree",[158] which will "be resolved as a matter of experience and common sense"[159]. An illustration of an intervening event occurred in the Scottish case of Bank of Scotland v. 3i plc.[160] There, a member of a loan syndicate (3i plc), whose syndicate was lending money to a company (IPS), had previously told another lender to IPS (Bank of Scotland ("BS")), during a telephone conversation, that it had firm commitments for its loan. The next month, 3i telephoned BS, and told BS that 3i was having difficulties obtaining security from IPS for its syndicated

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156 Per Lord Wright in The Oropesa [1943] P. 32, at p.39, cited with approval by McHugh J. in Bennett v. Minister of Community Welfare (1992-93) 176 C.L.R. 408, at p.428.

157 M'Kew v. Holland & Hannen & Cubitts (Scotland) Ltd. 1970 S.C. (H.L.) 20, at p.25, per Lord Reid.

158 Cooke P., in Fleming v. Securities Commission [1995] 2 N.Z.L.R. 514, at p.524, after referring to M'Kew. See also Mason C.J., Deane and Toohey JJ. in Bennett, supra, at pp.412-413.

159 Medlin v. State Government Insurance Commission (1994-95) 182 C.L.R. 1, at p.6, per Dawson, Toohey and Gaudron JJ.

160 [1993] B.C.L.C. 968 (Outer House of the Court of Session).

loan, and warned BS to watch its exposure to IPS. BS, however, subsequently made loans to IPS and lost money when IPS could not repay the loans and became insolvent. It was held, in a claim for negligence by BS against 3i, that this second call amounted to a *novus actus interveniens*, which broke the chain of causation between: (i) the first telephone call (saying there were firm commitments for the syndicate), and (ii) the loans made to IPS by BS after the second call.

Conclusion

The courts, in adopting a common sense approach, are looking at the circumstances of the loss claimed, and examining whether the loss is attributable to the adviser's negligence, as is being alleged, or, the activities or conduct of the recipient, i.e., what was the main cause of the loss suffered?[161] If a lender has acted properly, and reached the appropriate standard of care, it is unlikely any causal link will be found.

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161 There may also be a claim for contributory negligence: see s. 10 of the Law Reform (Contributory Negligence) Act 1945.

[C] DAMAGES FOR NEGLIGENCE

After establishing a duty of care, the breach of that duty and causation, a borrower (or third party) needs to establish that it suffered damage due to the breach of duty by the lender.[162]

(a) Common Law - Delict/Tort: Remoteness and Measure

Remoteness

A borrower (or a third party) suing a lender for negligence must show that its loss was not too remote, in that the loss was foreseeable.[163]

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[162] Overseas Tankship (UK) Ltd. v. Morts Dock and Engineering Co. Ltd.; The Wagon Mound (No. 1) [1961] A.C. 388. (P.C.) (on appeal from New South Wales).

[163] Overseas Tankship (UK) Ltd. v. Monts Dock and Engineering Co. Ltd.; The Wagon Mound (No. 1) [1961] A.C. 388 (P.C.). See also Hughes v. Lord Advocate 1963 S.C. (H.L.) 31; and the statement of Lord Kinloch (Lord Ordinary) in Allan v. Barclay (1864) 2 M. 873, at p.874:

> "The grand rule on the subject of damages is, that none can be claimed except such as naturally and directly arise out of the wrong done; and such, therefore, as may reasonably be supposed to have been in the contemplation of the wrongdoer."

See further under Scots law: McKillen v. Barclay Curle & Co. 1967 S.L.T. 41; Dynamco v. Holland & Hannen & Cubitts (Scotland) 1971 S.C. 257; and Thomson, J., Delictual Liability (1994), at pp.227-228.

Measure of Damage

At common law, the measure of damages for negligence is such amount that will, as far as it is possible in monetary terms, put the injured party (here, the borrower or third party), in the position it would have been in had the negligence, and the resultant loss it suffered as a consequence, not occurred[164], i.e., a reliance loss. Where negligent advice has induced an investment in a project which collapses, the measure of damages will be the difference in value between: (i) the price paid, less (ii) the actual value of the investment.[165]

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164 See the classic statement of Lord Blackburn in Livingstone v. Rawyards Coal Co. 1880 7 R. (H.L.) 1, at p.7, (1880) 5 App. Cas. 25, at p.39 (H.L.(Sc.)); Cassell & Co. Ltd. v. Broome [1972] A.C. 1027, at p.1085, per Lord Reid; and Swingcastle Ltd. v. Alastair Gibson (a firm) [1991] 2 A.C. 223 (H.L.(E.)).

165 See, for example, Verity and Spindler v. Lloyds Bank Plc., supra. See also Staughton L.J. in Hayes v. James & Charles Dodd (a firm) [1990] 2 All E.R. 815. Cf. Banque Bruxelles, Lambert S.A. v. Eagle Star Insurance Co. Ltd. [1997] A.C. 191 (H.L.(E.).

(b) Statutory Liability - Negligent Misrepresentation Inducing A Contract

(i) Scotland - S.10 Law Reform (Misc. Provisions) (Scotland) Act 1985

In Scotland, s.10(1) of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985[166], allows a party to a contract to recover damages for a negligent misrepresentation which induced that contract; previously, there had been doubt.[167] That section provides:

> "A party to a contract who has been induced to enter into it by a negligent misrepresentation made by or on behalf of another party to the contract shall not be disentitled, by reason only that the misrepresentation is not fraudulent, from recovering damages from another party in respect of any loss or damage he has suffered as a result of the misrepresentation; and any rule that such damages can not be recoverable unless fraud is proved shall cease to have effect."[168] (Emphasis added.)

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166 This section was in response to the Scottish Law Commission Report, "Obligations: Report on Negligent Misrepresentation", Report 92, 1985.

167 See Manners v. Whitehead (1898) 1 F. 171.

168 There is very little case law on s.10 of the 1985 Scottish Act: see Coates v. Dawson International plc v. Coats Patons plc 1988 S.L.T. 854, at p.865K-L, per Lord Cullen, whose decision was approved on appeal: 1989 S.L.T. 655; Bank of Scotland v. 3i plc 1990 S.C. 215, at pp.225-226, per Lord Cameron of Lochbroom,

So, if a lender has negligently - rather than fraudulently - induced or mislead a borrower to enter into a contract, the lender can be liable for damages.

(ii) England - S.2(1) of the Misrepresentation Act 1967

In England, due to fears that Hedley Byrne might not cover pre-contractual misrepresentations, s.2(1) of the English Misrepresentation Act 1967 was introduced.[169] S.2(1) of the 1967 Act is in similar terms to s.10 of the 1985 Act, but is less straight forward, and provides:

> "Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable in damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made

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approving Lord Cullen, that, under Scots law, there can now be damages for negligent misrepresentation, including where it has induced a contract, and that normal delictual principles under Hedley Byrne apply; and the unreported decisions of: Kennedy v. Phoenix Assurance Plc, unreported decision of Lord Penrose, delivered on 16th December, 1992; and Main v. Sharps Reliable Wrecks Ltd., unreported decision of Lord Sutherland, delivered on 7th August, 1991. The discussion of s.10 of the 1985 Act (which is fairly self evident as to its meaning) is very limited in these cases.

[169] Chitty On Contract: General Principles (1994) 27th edn., at para.6-045, on p.363. This is not the case now: see Esso Petroleum Co. Ltd. v. Mardon.[1976] Q.B. 801 (C.A.).

fraudulently, unless he proves that he had reasonable grounds to believe and did believe up to the time the contract was made that the facts represented were true."

The section, thus, "for most practical purposes equate[s] liability under it with liability for negligence".[170]

The difficulty with this provision, is its "fiction of fraud"[171], which, subject to the proviso, equates all misrepresentations with fraudulent misrepresentations at common law, and allows both rescission[172] and damages. Under the proviso, the onus of proof is reversed. Once it is shown that a misrepresentation has been made, this representation is treated as if it were fraudulent, unless the defendant can show that he had reasonable grounds for believing in the truth of the statement and that he did believe in its truth "up to the time" of the contract.[173] At common law, the essence of a

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[170] Chitty On Contracts: General Principles (1994) 27th edn. (A.G. Guest Q.C., ed.), at para.6-036, on p.358.

[171] See Atiyah, P.S., and Treitel, G.H., "Misrepresentation Act 1967" (1967) 30 M.L.R. 369, at p.373. See their criticisms of the provision, at pp.372-375.

[172] Where damages are awarded under s.2(1) of the Misrepresentation Act 1967, the court has a discretion under s.2(2) to allow rescission; see note by Beale, H., on s.2(2), "Damages in Lieu of Rescission for Misrepresentation" (1995) 111 L.Q.R. 60.

[173] Chitty On Contracts: General Principles, supra, at para.6-040, on p.361. There is no such proviso in s.10 of the 1985 Scottish Act. That section achieves a similar result by the opposite method: of saying that it does not

fraudulent misrepresentation is that it is made without belief in its truth, either deliberately or recklessly[174], but the onus is on the plaintiff to show this. What the section tries to do is to say that all misrepresentations are fraudulent, unless the defendant shows it reasonably believed at the time of contracting the misrepresentation was true. This latter part of proviso equates the misrepresentation with a negligent misrepresentation at common law. The difficulty facing any defendant is the objective part of the proviso: the reasonableness of the belief; to escape liability will be hard, and a negligent party will virtually be put in the position of an innocent misrepresentor if it wishes to escape liability.[175] And it may be that a lender, who is a professional, will find it harder to show reasonable grounds[176] for his beliefs than a laymen.[177]

Thus, if the lead manager in a syndicated loan, in response to a question whether the debtor had any contingent liabilities,

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matter that a misrepresentation is not fraudulent - where the misrepresentation induces a contract, damages may be recovered; there is also no statutory discretion as to rescission (as there is under s.2(2) of the 1967 Act).

[174] Derry v. Peek (1889) 14 App. Cas. 337 (H.L.(E.)).

[175] The section goes to the question of the formation of a contract, and not its performance.

[176] Atiyah and Treitel, "Misrepresentation Act 1967" (1967) 30 M.L.R. 369, at p.373.

[177] Ibid.

answered no, when infact there were several guarantees, including one in favour of the lead manager, it would not have been able to rely on the proviso, as there would not be a reasonable belief in the truth of various statements concerning the contingent liabilities.[178]

Measure of Damages Under s.2(1) of the Misrepresentation Act 1967

The Court of Appeal, in Royscott Trust Ltd. v. Rogerson[179], has said the tortious measure, rather than the contractual measure, must apply, on the wording of the section[180], and that the relevant tortious measure, as a matter of construction, is the measure for fraud, rather than the measure for negligence.[181] The significance of this is that the plaintiff is allowed to recover "any loss which flowed from the defendant's fraud, even if the loss could not be

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178 See Nat West Australia Bank Ltd. v. Tricontinental Corp. Ltd. (1993) A.T.P.R. 46-109 (Digest), noted [1993] 11 J.I.B.L. N-203.

179 [1991] 2 Q.B. 297. See the criticisms of this case by R. Hooley, "Damages and the Misrepresentation Act 1967" (1991) 107 L.Q.R. 547. The correctness of this decision was left open by the House of Lords in Smith Newcourt Securities Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1997] A.C. 254, at p.267E-F, per Lord Browne Wilkinson, and at p.283B-C, per Lord Steyn.

180 [1991] 2 Q.B. 297, at pp.304-305.

181 [1991] 2 Q.B. 297, at pp.304-305.

foreseen".[182] Thus, the measure of damages will be more severe under the Act for negligence than under the common law, which requires the loss to be foreseeable[183].

[D] SITUATIONS IN WHICH LENDERS CAN BE LIABLE IN NEGLIGENCE

(i) Giving Advice on Transactions or Investments

The classic example of lender liability for negligence is where a borrower, actively or implicitly, seeks advice[184] from a lender upon a particular transaction, and the lender gives negligent advice resulting in loss to the borrower. The claim of the borrower will be strengthened where the lender held itself out as having special

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182 [1991] 2 Q.B. 297, at p.305, citing with approval the seminal judgement of Lord Denning M.R. in Doyle v. Olby (Ironmongers) Ltd. [1969] 2 Q.B. 158, at p.167. Cf. Smith New Court securities Ltd. v. Vickers Scrimgeour (Asset Management) Ltd. [1997] A.C. 254 (H.L.(E.)).

183 Overseas Tankship (UK) Ltd. v. Morts Dock and Engineering Co. Ltd.; The Wagon Mound (No. 1) [1961] A.C. 388. (P.C.).

184 See Scott L.J. (as he then was) in Lloyds Bank Plc v. Cobb, unreported decision of the Court of Appeal, delivered on 18th December, 1981, who said that it is not part of the business of the normal high street bank to give advice on a particular transaction, and that there must be a request, either express or implied, to the bank for advice; decision noted [1992] J.B.L. 419.

skills or expertise to advise on transactions.[185] With lenders branching out into other areas, such as, securities transactions, e.g., derivatives[186], insurance[187] and pensions[188], because traditional lending work is not sufficiently profitable, the scope for liability in negligence increases.[189] Liability for negligent advice will can

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185 See, for example, Woods v. Martins Bank Ltd. [1959] 1 Q.B. 55, and more recently Verity and Spindler v. Lloyds Bank plc [1996] Fam. law. 213, [1995] C.L.C. 1557, decision of Robert Taylor J, (sitting as a Deputy High Court Judge), delivered on 4th September, 1995.

186 See Blair, W., "Liability Risks in Derivatives Sales" [1996] J.I.B.L. 18.

187 For example, the purchase by National Westminster Bank Plc of Clerical Mutual, the mutual life insurance company, for in excess of £800m in March, 1996: see *The Sunday Times,* 3rd March, 1996, Business Section. The limits of a banker's business cannot be laid down as a matter of law - the nature of the business must be a question of fact in each case: see Salmon J. in Woods v. Martins Bank Ltd. [1959] 1 Q.B. 55, at p.70.

188 In 1995, Barclays Life, a subsidiary of Barclays Bank Plc, set aside £58m as compensation for mis-selling of pensions; and Lloyds Abbey Life, a subsidiary of Lloyds Bank Plc, set aside £80m: see *The Times*, 7th December, 1995, at p.27.

189 See the claim against Morgan Stanley for alleged mismanagement of an investment fund in Luxembourg, which is vigorously denied: *The Times*, 4th January, 1996, p.1. See also the position in Germany concerning bad advice by banks for stock market products: Lorenz, F., "The Liability of Banks and

overlap with a claim for breach of fiduciary duty[190], and it is likely that both causes of action (negligence and breach of fiduciary duty) will be pleaded.[191]

Verity and Spindler v. Lloyds Bank Plc

The area of negligent investment advice was looked at in the recent, and well publicised, case of Verity and Spindler v. Lloyds Bank Plc,[192] which did not create new law, but is important because of

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their Staff for Bad Advice on Stock Market Products in Germany" [1995] 5 J.I.B.L. 166.

190 See Chapter 4, on "Lenders as Fiduciaries". See also the incisive speech of Lord Browne-Wilkinson in Henderson v. Merrett Syndicates Ltd. [1995] 2 A.C. 145, at pp.204-206.

191 See, for example, Commonwealth Bank of Australia v. Smith (1991) 102 A.L.R. 453, in which the lender was held liable both in negligence and for breach of fiduciary duty. See also the "exotic pig" case of Hayward v. Bank of Nova Scotia (1984) 7 D.L.R. (4th) 135 (Ont. H.C.); affmd. (1985) 19 D.L.R. (4th) 758 (Ont. C.A.), and Vita Health Co. (1985) Ltd. v. Toronto Dominion Bank (1995) 22 B.L.R (2d) 195, in which a customer (VH) of long-standing, used a bank's (TDB's) credit inquiry service; VH was wrongly told that another customer (GNC), known to be financially unsound, was operating within its credit limits; GNC became insolvent owing money to VH for goods supplied, VH successfully sued TDB for the amount of the invoices, less the profit element in them.

192 [1996] Fam. Law. 213, [1995] C.L.C. 1557, decision of Judge Robert Taylor, sitting as a Deputy High Court Judge, delivered on 4th September, 1995,

the facts of the case and the application of the law to them. In that case, a couple were able to recover damages for negligent advice from their bank manager (H). H advised the couple that their plans to borrow £150,000 to purchase, renovate and sell a house in 1988, with a view to a quick profit of £10,000, were not imprudent, and he encouraged them to proceed with the scheme. The couple bought the house for £126,000 and spent £25,000 on renovations. However, the property market subsequently collapsed, and the couple were only able to sell the house for £135,000 in May, 1990, which was £25,000 less than they had anticipated. This resulted in the couple incurring huge debts in unpaid interest on their bank loans[193].

Verity and Spindler - who were described by the trial judge as "financially naive", and "very naive and inexperienced in money matters"[194] - sued the lender in negligence for its (employee's)

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available on Lexis, and noted in [1995] J.I.B.L. N-248; see also case notes by Gleeson, S., and Parsons, C., "Banks' Liability For Advice: Spindler and Verity v. Lloyds Bank plc" [1996] J.I.B.L. 36, and by Wise, L.M., "Biting the hand that lends?" (1996) Solicitors' Journal 128. All quotations are from the Lexis transcript.

193 This was the subject of a successful counter-claim by Lloyds Bank Plc on 19th January, 1996: see *The Financial Times*, 20th January, 1996, and *The Times*, 20th January, 1996.

194 Per Judge Robert Taylor (sitting as a Deputy High Court Judge) in Verity and Spindler v. Lloyds Bank plc [1996] Fam Law 213, [1995] C.L.C. 1557,

incorrect advice. The plaintiff's said they had relied on publicity material from the bank[195], contained in its pamphlet, entitled: "Starting Your Own Business", in which it was stated, amongst other things:

> "Your bank manager will help you decide how much you can really afford to invest. Every business needs a margin of safety against the unforeseen".

The pamphlet went on to state later, that:

> "We don't help only with money. Our advice is tailor-made, confidential and free . . . It draws on years of experience and is given

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decision delivered on 4th September, 1995, per the transcript of the judgement.

[195] See also Woods v. Martins Bank Ltd. [1959] 1 Q.B. 55, a pre Hedley Byrne case, in which the bank also had publicity material (an advertisement and a booklet), stating that the bank would give financial advice. The bank advised a customer on an investment in a company which was financially unsound and which had a large overdraft with the bank, and was held liable in negligence. The bank argued that they owed no duty of reasonable care or skill in giving such financial advice, which provoked Salmon J. (as he then was) to say:

> "It is remarkable that the defendant bank, who seem to be keen competitors with other banks to obtain custom and who, in order to do so, apparently spend large sums of money on advertising that one of the advantages that they offer is expert advice in all financial matters without obligation, are taking the point in this court that they are under no duty to use any care or skill in giving such advice."

by people with a special understanding of your local business environment. It is frank, professional and yours for the asking . . .

Now it is time to discuss your plans person to person, to fit your requirements and our services together.

WHY NOT RING YOUR LLOYD'S MANAGER NOW"

During their discussions with the bank manager, V made it clear she needed to make a profit of £10,000 on the transaction.

The judge held that, whilst a bank is not under a duty to advise a customer, except where there is an express or implied request for advice[196], the bank manager had crossed that threshold and had assumed an advisory role, which he had performed negligently. This resulted in Verity and Spindler suffering financial loss, and they were awarded damages of £77,529, assessed on a "no transaction" basis[197], being, here, the difference between (i) the price of the property, plus expenses, less (ii) the resale price, plus expenses.

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196 After referring to Williams & Glyn's Bank Ltd. v. Barnes [1981] Com. L.R. 205 (1997-1986), Vol. 10 Legal Decisions Affecting Bankers 220; Lloyds Bank plc v. Cobb, unreported decision of the Court of Appeal, on 18th December, 1991, noted [1992] J.B.L. 419; and Goldsworthy v. Bricknell [1987] Ch. 378, at p.405, per Nourse L.J.

197 This method of assessment, which was outlined by Staughton L.J. in Hayes v. James & Charles Dodd (a firm) [1990] 2 All E.R. 815, was criticised by the

The judge looked at four main areas: (a) why the bank manager was an adviser, and so under a duty of care; (b) the breach of that duty; (c) the failure to warn of foreseeable risks; and (d) reliance.

(a) The Bank as Adviser

In holding H, to have assumed an advisory role, the learned trial judge took into account four factors:

(i) V's and S's naiveté and inexperience in money matters;

(ii) the project was a business venture with the aim of making a profit. The claim in the bank's pamphlet that the bank would give "tailor-made advice", meant there was "nothing implausible" in V's and S's claim that "they went to their bank manager for advice and that he gave it";

(iii) that the availability of sources of advice did not make it implausible that the plaintiffs sought advice from H on the transaction, as the bank's pamphlet had envisaged other advisers; also, V and S had previously received advice from the bank on the purchase of another house; and

(iv) that it was not "unlikely that [H] would have taken on the role of [V's and S's] adviser or have acted as they say he did." H was a "kindly man" - described by V as being like an uncle" - and so, in view of the plaintiffs' financial naiveté, it did not appear "at all unlikely that [H] would have advised and encouraged the plaintiffs as they say he did."

House of Lords in Banque Bruxelles Lambert S.A. v. Eagle Star Insurance Co. Ltd. [1997] A.C. 191.

(b) Breach of Duty

For the project to make a profit of £10,000, it was found that property inflation would have had to have stayed at historically high levels. Consequently, the project "amounted to a huge gamble for a couple who lacked the liquid resources to meet any significant failure"; and it was hard to "see how any reasonably careful adviser in [H's] position could conceivably have taken the view that the project was viable or sensible for the plaintiffs to undertake." The problem was that the bank manager had not properly assessed the transaction's viability, and had given the impression it was viable; also, he had not looked at its impact on the borrowers and what they could really afford to borrow.

(c) Failure to Warn of Foreseeable Risks

The trial judge said that "in assessing the viability of the plaintiffs' project, any reasonably careful adviser would have been bound to take account of [the] risks and to advise accordingly that the project was not worth pursuing." These risks related to: (i) possible increased costs; (ii) delays in work being done; (iii) the possibility that the renovations may not add the value anticipated; (iv) re-sale problems; and (v) house prices declining. It was a combination of: (i) increased costs, (ii) a delay in selling, and (iii) a fall in house prices, which resulted in the project's failure. All of these were foreseeable.

(d) Reliance

The trial judge found that there was reliance by the plaintiffs on the bank manager (not surprisingly). His lordship felt that if H had advised V and S "that the project was highly imprudent and clearly

pointed out to them the risks that they would be running they would have abandoned the project for good". An argument that V and S had made up their minds about the project, regardless of what might be said to them, was rejected.[198]

What Did The Verity Case Decide?

Whilst this case caused considerable comment at the time, it does not add anything new to the law, and needs to be considered, in context, on its facts. What it does show is the sorts of circumstances in which a lender will be regarded by the courts as having "crossed the line" from being an arm's length party with a borrower/customer, in which it is under no duty to the borrower, to one who has assumed a duty to advise the borrower/customer, and for which it will be liable in negligence if it does so incorrectly. The sorts of factors, such as, the pamphlet, which the court took into account in the Verity case, will not be applicable in large corporate loans, where the parties will have their own advisers and a greater degree of financial sophistication. However, if it is an area in which the borrower is not experienced, such as swaps[199], or foreign currency transactions, then the lender is more likely to have

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198 A claim for emotional distress was dismissed. See Chapter 11 "Damages For Breach of Contract By A Lender" and Hayes v. James & Charles Dodd (a firm) [1990] 2 All E.R. 815 (C.A.).

199 See Mance J. in Bankers Trust International PLC v. P.T. Dharmala Sakti Sejahtera, [1995] 4 Banking Law Reports 381, noted in (1996) B.J.I.B.F.L., at p.43 (Banking and Insolvency), and pp.46-47 (Capital Markets), and [1996] 4 J.I.B.L. N-81.

assumed a duty of care regarding advice to the borrower/customer on an investment or transaction.

(ii) Advice on Take-overs

One area where banks, predominantly merchant banks, can be liable for negligent advice or mis-statements is in the area of take-overs. In Morgan Crucible Co. plc v. Hill Samuel & Co. Ltd.[200], allegations of negligence were made against: (i) a merchant bank, who acted as advisers to a company ("the target") taken over by the plaintiffs, (ii) the target's accountants, and (iii) the directors of the target. The allegations concerned financial statements (profits forecasts) made by the defendants about the target when the plaintiffs were identified as a bidder for the target, and which, it was claimed, were inaccurate and constituted "continuous representations". It was alleged that because of these, the plaintiffs increased their bid, and that if they had known the true position, no bid would have been made, and the shareholders would not have voted for it; moreover, with the plaintiffs being identified as the bidder, there was a sufficient relationship of proximity between the parties and it was foreseeable the plaintiffs would rely on the defendant's statements.

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[200] [1991] 2 W.L.R. 655 (C.A.). See also Galoo Ltd. v. Bright Graham Murray [1994] 1 W.L.R. 1360, at p.1382, per Glidewell L.J.

A strong Court of Appeal[201] permitted the plaintiffs to amend their pleadings to include these allegations because they were not bound to fail at trial; there being reliance on these allegations, which was intended, and sufficient proximity between the parties.

The more common case arises when the adviser's customer claims it was wrongly advised and sues, as occurred - unsuccessfully - in the recent English case of Ginora Investments Ltd. v. James Capel & Co. Ltd.[202]

In this matter, there were allegations against JCL by GIL of misrepresentation and negligence arising out of a hostile take-over bid. JCL were the financial advisers to GIL (who were substituted as plaintiffs for another company, Priest Marians Holdings ("PMH")).

The basis of the matter was that PMH made a hostile bid for Local London Group ("LLG"), with the aim of selling the majority of LLG's property portfolio quickly, so as to repay most of LLG's debt, whilst retaining a select number of development sites. Another substantial asset of LLG - its shareholding in The Marina

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201 Comprising Slade L.J., Mustill L.J. (as he then was) and Nicholls L.J. (as he then was).

202 Unreported decision of Rimer J., delivered on 10th February, 1995, and referred to in [1995] 5 J.I.B.L. N-108, the contributed note, "Professional Negligence and the Courts" (1995) B.J.I.B.F.L. 351, and Hammond, I., "Providing negligence on the part of a financial adviser: the lessons to be learnt from Ginora Investments Ltd. v. James Capel" (1996) 17 The Company Lawyer 53.

Development Group - was to be sold, and PMH believed, prior to its bid being made public, that it had a purchaser for it, who was a significant shareholder in LLG.[203] The bid appears to have been made on three assumptions: (i) the property could be disposed of quickly; (ii) The Marina Development Group's shares would be sold; and (iii) that LLG's indebtedness would be roughly the same as that set out in its listing particulars which had been published recently.[204] After the bid, the value of the property portfolio declined, and LLG's debt position was worse than expected.[205]

PMH sued JCL for misrepresentation and negligence. The allegations concerning misrepresentation were as follows:

(1) JCL had misled PMH concerning the level of LLG's indebtedness;

(2) JCL failed to advise PMH to seek a recommended bid from the beginning and not to proceed with a bid without obtaining access to LLG's unpublished books and records (i.e., financial information);

(3) JCL failed to advise of the high level of risk involved in the bid; and

(4) That once an offer had been made, JCL failed to take steps to stop the bid becoming unconditional.[206]

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[203] See "Professional Negligence and the Courts" (1995) B.J.I.B.F.L. 351.

[204] Ibid.

[205] Ibid.

[206] [1995] 5 J.I.B.L. N-108.

The allegations of negligence were in the following terms: whether JCL, as financial advisers, were under a duty of care to advise PMH with regard to:

(1) The financial implications of the proposed acquisition of LLG;

(2) The suitability of the proposed acquisition, including the level of risk inherent in it, and whether the possible benefits justified the level of risk?;

(3) The timing, price and terms of the bid; and

(4) The tactics to be used: whether the bid should have been recommended or hostile, and whether it should have been unconditional?[207]

JCL's letter of engagement expressly provided JCL assumed an obligation to "advise on 'tactics and strategy'"[208], but was silent on the, allegedly, wider duties claimed by PMH, of advising on the risks and merits of the proposed acquisition.

Rimer J. held that, on the evidence given by JCL's officers[209], JCL owed PMH a duty of care to advise it on the implications of the bid,

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[207] [1995] 5 J.I.B.L. N-108. See also contributed note, "Professional Negligence and the Courts" (1995) B.J.I.B.F.L. 351, and Hammond, I., (1996) 17 The Company Lawyer 53.

[208] [1995] 5 J.I.B.L. N-108.

[209] JCL's main witness (an officer of the company) said, under cross-examination, that JCL "was under a duty to give 'competent and objective'

including the level of risk involved.[210] However, there had been no breach of the duty of care. The learned judge seems to have been influenced by his view of PHM's understanding of the matter, due to their experience, without the advice of JCL, and the degree to which it was permissible for JCL to rely on PMH's understanding.[211] His Lordship said that PMH "'was not an elderly widow with failing eyesight and no business experience".[212] The company had been involved in take-overs before, and was not entitled to detailed advice from JCL.[213]

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advice on the pros and cons of the deal": see "Professional Negligence and the Courts" (1995) B.J.I.B.F.L. 351.

210 [1995] 5 J.I.B.L. N-108, and "Professional Negligence and the Courts" (1995) B.J.I.B.F.L. 351.

211 "Professional Negligence and the Courts" (1995) B.J.I.B.F.L. 351.

212 Ibid.

213 Ibid, and [1995] 5 J.I.B.L. N-108. The learned judge approved the statements in the report of the Department of Trade and Industry Inspectors in Atlantic Computers plc, dated 22nd April, 1994, at para.12.144, concerning the conventional role of merchant bankers in relation to a take-over bid for a listed company, namely that of "'essentially a co-ordinating and facilitating role, advising on the regulatory and tactical matters and on the financing of the bid and its presentation to the market, and responsibility for ensuring that all the documentation was properly prepared and all regulatory requirements were satisfied.'"

The judge appears not to have been impressed with the merits of the plaintiff's case, which was that, "'put crudely, PM[H] concluded after the acquisition that they suffered a loss on it and this action is an attempt to pass that loss on to [JCL]'"[214]. Nonetheless, the decision does indicate the need to have clarity, preferably in writing, about the advice being sought.[215]

(iii) Giving Negligent Credit References

Where a bank gratuitously[216] gives a negligent credit reference to a third party, concerning a customer's financial standing (rather than the customer's identity)[217] then, in the absence of an effective

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214 Cited in "Professional Negligence and the Courts" (1995) B.J.I.B.F.L. 351, at p.352. His lordship also appears to have formed an unfavourable view of PMH's main witness, of whom he stated "there were times when . . . his evidence was motivated more by a consideration of what was expedient than what was true".

215 (1995) 5 J.I.B.L. N-108, at N-109.

216 The practice now is that the customer gives written consent to the bank providing the credit reference to the third party; the bank will charge the customer for the reference. See The Banking Code (1997) 3rd edn., at para.4.5.

217 See Gold Coin Joailliers S.A. v. United Bank of Kuwait plc [1997] Banking Law Reports 60 (C.A.), where it was held that a lender had assumed no responsibility to the plaintiff, concerning the identity of an impostor, who purported, by telephone, to be a customer of the lender when the lender had

disclaimer, the bank can be liable in negligence to the recipient of the reference if it is not correct for the loss suffered by the third party.[218] For example, an enquirer (E Ltd.) asks a bank whether a customer of the bank (X Ltd.) has sufficient funds to allow X Ltd. to enter into a business transaction for £100,000 with E.Ltd., as E Ltd. wishes to sell goods to X Ltd. for that sum, and needs to know if X Ltd. is able to pay for the goods. The bank, in reply, tells E.Ltd. that X Ltd. has sufficient funds to meet such an obligation, i.e., has adequate finance, and E Ltd., in reliance on this statement, enters into the sale transaction with X Ltd. Subsequently, E Ltd. discovers that X Ltd., who has yet to pay for the goods and has become insolvent, has on-sold them to a manufacturer who has converted them into another product, so that, due to *specificatio*, E Ltd. is unable to recover its goods - even if it has a retention of title clause. In such a case, on the Hedley Byrne principle, the bank would be liable to E Ltd. for the loss E Ltd. has suffered, which would be the whole amount of E. Ltd.'s investment in the absence of an effective disclaimer.[219]

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given a reference to the plaintiff about the real customer (believing the impostor to be that customer).

[218] Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465 (H.L.(E.)).

[219] See, for example, Vita Health Company (1985) Ltd. v. Toronto Dominion Bank (1995) 22 B.L.R. (2d) 195; Standard Chartered Bank of Canada v. Nedperm Bank Ltd. 1994(4) S.A. 747; and the Supreme Court of Canada in V.K. Mason Construction Ltd. v. Bank of Nova Scotia [1985] 1 S.C.R. 271, where BNS advised a building contractor (VKM) that a developer had sufficient finance

A lender can also be liable to its customer, under Hedley Byrne,[220] if a credit reference given by the lender to a third party about the customer is not correct, and the customer suffers loss as a consequence. For example, if the bank indicates to an enquirer, incorrectly, that a customer is not an acceptable credit risk for the purpose of the enquiry, when infact the customer has sufficient funds or lines of credit to enter into the transaction, and, as a result of the bank's negligent credit reference, the customer misses out on a profitable business transaction, the bank would be liable, under Hedley Byrne, for its negligence and the loss suffered.[221] In assessing this loss, the court would be examining the difficult issue of allowing recovery for the loss of a chance suffered by the customer; this involves questions of causation and remoteness of damage, and will require the customer proving (most likely by oral

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for a project, when it did not; VKM suffered loss, accordingly, and sued BNS successfully for negligence.

220 There would also be a claim under the general banking contract; and under an express contract, as banks now charge the customer for the reference; the customer's consent in writing for the reference is required. If the reference is given without consent, there would be a claim by the customer for breach of confidence and breach of mandate.

221 See Spring v. Guardian Assurance plc [1995] 2 A.C. 296 (H.L.(E.)), where S was able to recover damages from his former employer for a negligent reference which resulted in S not being able to obtain other jobs in the financial services industry. There is also the possibility of an action for defamation, although the defence of qualified privilege would be likely to apply, in the absence of malice.

evidence from the third party) that the loss of this business chance was substantial, and not speculative[222], i.e., that the other party would have entered into the transaction with the customer if that party had been given correct information by the customer's bank.

(iv) Liability of a Lead Bank in a Syndicate to Other Syndicate Members

The large sums of money involved in commercial transactions today, such as the Docklands or the Channel Tunnel projects, mean that no one lender may be willing - or, indeed, able - to raise all the finance that a particular borrower (or group of borrowers) needs for a project, with all the associated risk if the borrower fails to repay the loan made to it. Therefore, instead of one bank providing all the facilities to a borrower, a syndicate of banks will,

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222 See Hotson v. East Berkshire Area Health Authority [1987] A.C. 750 (H.L.(E.)), which has subsequently been explained by the Court of Appeal in Allied Maples Group Ltd. v. Simmons & Simmons [1995] 1 W.L.R. 1602. There, the court said that to succeed in loss of a chance cases, the plaintiff needs to show that the loss of the business chance was substantial and not speculative - the position is likely to be the same in Scotland. Allied Maples, which now governs the position, was applied in the following cases: see Stovold v. Barlows [1996] European Commercial Cases 101, and First Interstate Bank of California v. Cohen Arnold & Co. [1995] 5 Banking Law Reports 150. For a sophisticated judicial analysis of the topic of loss of a chance: see the High Court of Australia in Malec v. J.C. Hutton Pty. Ltd. (1990) 169 C.L.R. 638, at pp.639-40, per Brennan and Dawson JJ. See also Hogg, M., "Lost Chances in Contract and Delict" 1997 S.L.T. (News) 71.

collectively, provide all of a borrower's finance - sharing the benefits and risks.[223] The formation of such a syndicate will require one bank (normally the main lender to the borrower) to co-ordinate matters (i.e., be the lead bank or lead manager) and invite other banks to join the proposed syndicate. Before joining a syndicate, these invitees will need to have information about the borrower, the proposed loan and the syndicate. This will involve the lead bank issuing an information memorandum to prospective members before any loan documentation is executed and money lent. On the basis of this memorandum, a potential participant will usually decide whether or not to join the syndicate. Thus, there will be a strong element of reliance by other potential lenders on the information contained in this memorandum. The lead bank will seek to reduce this reliance on the information memorandum by including provisions in the memorandum which place the onus on the other banks to undertake due diligence.[224] By doing this, the

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[223] This can occur: (i) where a particular project is being financed, which is the most common case, or (ii) as part of a rescue package, in which the existing or new lenders to a corporate borrower experiencing financial problems will be invited to contribute new money to the company in return for more stringent security and operating conditions, and a success fee; for existing lenders, such a rescue package is entered into because it represents a better chance of recovering their money than putting the troubled borrower into receivership.

lead manager is purporting not to assume any responsibility for the contents of the memorandum to other banks.

If the information contained in the information memorandum is not accurate, and another lender has been induced to enter into the syndicate on the basis of it, the misled lender has causes of action against the lead bank: (i) at common law for negligence, under Hedley Byrne, in the absence of an effective disclaimer; and (ii) under s.10 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985, in Scotland, and, in England, under s.2(1) of the Misrepresentation Act 1967. The problem is most likely to arise when the borrower is unable to repay the loan and the misled lender will be seeking to recover the loan from whoever it can. The misled lender will have to argue that had it known the true facts at the time of contracting to lend money, it would not have entered into the syndicate.

This problem arose in the Australian case of Nat West Australia Bank Ltd. v. Tricontinental Corp. Ltd.[225] There, TC (a bank)[226],

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224 Bhattacharyya, G., "The Duties and Liabilities of Lead Managers In Syndicated Loans" (1995) B.J.I.B.F.L. 172, and an updated version in (1995) 16 The Company Lawyer 259.

225 (1993) A.T.P.R. 46-109 (Digest), [1993] 11 J.I.B.L. N-203, and referred to in Bhattacharyga, G., "The Duties and Liabilities of Lead Managers In Syndicated Loans (1995) B.J.I.B.F.L. 172, (1995) 16 The Company Lawyer 259. See also the Colocotronis litigation: Re Colocotronis Tankers Securities Litigation 420 F. Supp. 988 (B.D.N.Y. 1976). See Wood, P.R., International Loans, Bonds and Security Regulations (1995), at para.17-25, on p.319, who acknowledges there

prepared and circulated an information memorandum to potential members of syndicate, which included NW. The information memorandum did not disclose that the borrower (PI) had given guarantees in favour of third parties for related company obligations. TC did not disclose that there were such guarantees, one of which was in favour of TC. Prior to agreeing to participate in the syndicate, NW enquired of TC whether there were any contingent liabilities, and was told that such contingent liabilities as there were, were nominal and that the financial statements in the information memorandum were correct. NW eventually became a member of the syndicate and provided its share of the facility to TC. PI subsequently experienced difficulties and was involved in a workout with banks not involved in the syndicate. TC disclosed the existence of the guarantees at a subsequent syndicate members' meeting, and said it would have the guarantees discharged, which it did.

NW sued TC, arguing that, whilst the guarantees were discharged and most of the losses were due to PI's unprofitable trading activities, it would not have entered into the syndicate if it had known about them beforehand, and that the loss was a risk relating

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may be liability under Hedley Byrne, but that it "might be difficult [to establish] unless it could be shown that the lead manager ought to have known that the participants were relying on the lead manager to check the information."

226 Which itself collapsed, and caused great financial problems for the Australian State of Victoria.

to the syndicate. TC had a disclaimer in the IM which read as follows:

> " . . . The information herein has been obtained from the borrower and other sources considered reliable. No representation or warranty expressed or implied is made with respect to this information."[227]

It was held by MacDonald J., in the Victorian Supreme Court, amongst other things, that:[228]

(i) A prudent banker in TC's position, with its knowledge of PI, seeking another participant in a syndicate, ought to have realised that if the third party guarantees were disclosed, it was probable NW would not have entered into the syndicate.

(ii) The circumstances of the case - especially in view of the question asked by NW concerning contingent liabilities and the answer given - were such that TC was under a duty to disclose the existence of the contingent liabilities; their existence was a material fact for NW to consider as to whether it would join the syndicate.

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227 Reproduced in Battacharyya, G., supra, at p.174, and at p.261, respectively.

228 See [1993] 11 J.I.B.L. N-203. A successful claim was also brought under s.52 of the Australian Trade Practices Act 1974 (as amended) (of which there is no United Kingdom equivalent) for deceptive and misleading conduct. There is no equivalent of UCTA in Australia, although, as Battacharyya, supra, at p.174, and p.261, respectively, argues, because TC knew about the guarantees, it is unlikely that the disclaimer would be regarded as reasonable, in the circumstances.

(iii) The failure by TC, in answer to NW's question about contingent liabilities, to disclose the guarantees (which were considered "salient and material facts"[229]) amounted to a breach of its duty of care to NW.

(iv) If the guarantees had been disclosed, NW, "as a probability"[230], would not have participated in the syndicate or provided the advance.

(v) The breach by TC of its duty to NW was a cause of the loss that NW suffered, due to its being unable to recoup its advances.

(vi) There was no act or omission by NW, between advancing the loan and seeking its repayment, which broke the causal chain, and neither was there any contributory negligence.

Avoidance of Such Liability - Due Diligence.

In order to reduce its liability, a lead manager will usually place the onus on the other syndicate participants of satisfying themselves as to the true position regarding the borrower's financial position, by requiring them to undertake their own due diligence of the borrower, so that it cannot be said that they relied on the information supplied to them by the lead manager *vis-a-vis* their decision to join the syndicate.[231] Also, a syndicated loan agreement

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[229] [1993] 11 J.I.B.L. N-203, at N-205.

[230] [1993] 11 J.I.B.L. N-203, at N-204.

[231] Ibid. See also Bhattacharyya, G., "The Duties and Liabilities of Lead Managers In Syndicated Loans" (1995) B.J.I.B.F.L. 172, at pp.174-175, (1995) 16

and the information memorandum, will normally contain provisions which seek to limit the lead bank's liability, such as, requirements for an independent investigation, exoneration clauses and an indemnity in favour of the lead manager for liabilities, costs and loss that it may incur or sustain relating to the transaction.[232] This indicates that there is no assumption of responsibility by the lead manager.

To avoid liability under s.10 of the 1985 Act, or s.2(1) of the 1967 Act, the lead bank will need to show that the contract was entered into by the other syndicate member as a result of their own independent enquiries, and not because of any statement of the lead bank. The due diligence requirement seeks to prevent the other syndicate member from claiming that it relied on the lead bank, by setting up a personal bar or estoppel, i.e., the lead manager is trying to make the other syndicate member say that it entered into the syndicate on the basis of its own enquiries. If the other syndicate member can show it entered into the loan on the basis of the negligent information memorandum, then, as the lead

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The Company Lawyer 259, at pp.261-262. See also Wood, P.R., International Loans, Bonds and Security Regulations (1995), at para.17-25, on p.319.

[232] Ibid. For an example of such a memorandum: see Tennekoon, The Law Relating to International Finance (1991), at p.51; and Cresswell, Blair, Hill and Wood, Encyclopaedia of Banking Law, at paras.F5250 (information memorandum) and F5251 (the express provision in a loan agreement). See also the discussion of this in: Penn, Shea and Arora, The Law and Practice of International Banking (1987), at paras.7.08-7.10, and Wood, P., International Loans, Bonds and Securities Regulations (1995), at paras.17-26 - 17-27.

manager is another party to the contract, and it is due to its negligent misrepresentation that the other syndicate member has entered into the contract, that other member may recover the loss suffered under the 1985 Act, in Scotland,[233] or the Misrepresentation Act 1967, in England.

Duties Of An Agent Bank During The Life Of The Loan

During the duration of a syndicated loan, the agent bank owes duties of care to the other members of the syndicate, to whom the agent assumes responsibility.[234] So where, for example, the agent bank negligently failed to fulfil the disclosure obligations under mortgage indemnity guarantee insurance policies,[235] this failure invalidated the policies, and the agent bank was liable in negligence to the syndicate members for the losses sustained when the

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233 Unlike the 1967 English Act, the 1985 Scottish Act does not appear to contemplate more than a bilateral contract, as it refers to another party to the contract, but then speaks of damages from the other party to the contract, when it should be another party to the contract. It would seem that this was not what was intended, and a court would apply the section against such a lead bank.

234 The Sumitomo Bank Ltd. v. Banque Bruxelles Lambert S.A. [1997] 1 Lloyd's Rep. 487, noted (1996) (Banking and Insolvency Law Section), B.J.I.B.F.L. 502. The lead bank (or agent bank) will also have fiduciary duties to the other banks.

235 The loan related to the purchase of property, but the property market collapsed, leaving large losses for the syndicate.

borrowers defaulted and the security did not cover the debt. The syndicate members were not insured because that responsibility lay with the agent. The nature of the relationship between the agent and the other banks was a "classic example" of a relationship where a duty of care arose *vis-a-vis*, the agent's carrying out the disclosure obligations under the policies.[236] The agent had assumed responsibility to the other banks for carrying out the disclosure requirements, and the other banks had expected and relied on the agent to do so.[237] The agent knew that the policies' validity depended on it performing its obligations properly; and that the policies were critical to its own interests, and those of the other banks, who were dependent on the agent to comply with the disclosure requirements which had been entrusted to the agent in all the banks' interests.[238]

[E] CONCLUSION

If a lender makes a negligent mis-statement or misrepresentation to a borrower or a third party, which the latter relies on, and which, as a consequence, results in loss to the borrower or third party, then the lender can be liable in negligence under the Hedley Byrne principle, based on assumption of responsibility and reliance, for the loss suffered. The courts have shown a willingness to impose

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[236] Sumitomo Bank Ltd. v. Banque Bruxelles Lambert S.A. [1997] 1 Lloyd's Rep. 487, at p.514, col. 1.

[237] Ibid.

[238] Ibid.

liability on lenders where they have given wrongful advice, particularly where the lender, through promotional material, has indicated it is competent to advise. In such cases, the degree of reliance on the part of the borrower, who has sought out, or been sought out by, the lender will be strong.

From the lender's perspective, with UCTA making the protection of a disclaimer an uncertain thing, it will have to argue, depending on the circumstances, that: (i) it did not assume any responsibility to the borrower or third party; or (ii) there was no reliance, or that it was not reasonable, to rely, on its advice, as, for example, where a borrower or third party exercises their own judgement on the matter, or the enquiry to the lender was not a serious one, or the lender merely passed on information and did not give advice. It seems clear, though, that the more sophisticated the borrower or third party, the less likely it is that he will be regarded as having reasonably relied totally on the lender. A strong indication that a lender is being relied on is the lack of other advisers, such as lawyers or accountants.

The other important questions, after the duty of care issue, are whether the duty of care has been breached and/or whether the cause of the loss was the lender's conduct. The lender will need to show, that, in all the circumstances, its conduct or statements were reasonable, i.e., that it had acted in the way that a reasonable banker would act; also, it will need to show that, even if it was negligent, the borrower's or third party's loss was not caused by the lender's conduct - rather, that the loss suffered was due to

something else. Cases like Galoo[239] and Alexander v. Cambridge Credit Corporation Ltd.[240], which identified the cause of the losses as the plaintiff's trading activities, rather than professional negligence, give some hope to lenders that they may not have to compensate a borrower, where it, or a company it invests in, collapses.

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239 [1994] 1 W.L.R. 1360.

240 (1987) 9 N.S.W.L.R. 310 (C.A.).

CHAPTER 7.

INTENTIONAL DELICTS/TORTS

In this chapter, delicts/torts other than negligence will be looked at. A common feature of these delicts/torts is an intention to cause harm - usually economic harm - to the borrower.[1] The first such delict/tort considered will be deceit or fraud, which will be followed by a consideration of the "economic delicts": (i) conspiracy; (ii) interference with contractual relations, including the liability of a lender for causing a borrower to breach a negative pledge clause in a loan agreement with another lender, and (iii) interference with a business.

(1) FRAUD/DECEIT

The difference between a fraudulent misrepresentation (or misstatement) and a negligent one, is the intention of the statement's maker. For the former, the statement is deliberately false, or is made recklessly, without caring whether it is true or false[2]; in the latter, the maker believes the statement to be true,

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[1] But not always: there may be a desire by the wrongdoer to benefit from his actions. This may be an alternative or additional motive.

[2] Derry v. Peek (1889) 14 App. Cas. 337, at p.374, per Lord Herschell (H.L.(E.)). See too Boyd & Forrest v. Glasgow & South-Western Rly 1912 S.C. (H.L.) 93, [1913] A.C. 404, where an honest mistake was held not to be fraudulent. The position in the United States is similar to the position in the Britain: see

although it is not, but this inaccuracy is due to a lack of reasonable care on his part, rather than an intention to deceive. For example, the credit reference by the bank in Hedley Byrne[3] to the enquirer about the bank's customer was false, but this was due to a lack of reasonable care on the bank's part, rather than an intention to deceive; however, if the credit reference had been deliberately false, because, for example, the bank was hoping the transaction would reduce any indebtedness of the customer, or it was made by the bank without checking the customer's account details (i.e., recklessly), then this would be fraud.

This difference of intention is reflected in the extent of civil liability to pay damages for deceit and negligence. The law is stricter in the former, where the maker is liable for all loss suffered by the victim of the deceit which flows directly "from the fraudulently induced *transaction*"[4]; whereas, in negligence, there is a narrower rule, with the loss recoverable not extending "beyond the consequences flowing from the negligent *misrepresentation*".[5] The rationale for

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National Bank of El Paso v. Farah Manufacturing Company Inc. 678 S.W. 2d. 661, at p.681 (Tex. App. 1984) - a case with unusual facts.

[3] Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465 (H.L.(E.)).

[4] Per Lord Steyn in Smith New Court Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1997] A.C. 254, at p.283C-D (Lords Keith of Kinkel, Mustill, and Slynn of Hadley agreeing); see the comment on this case by Alcock, A., "Limiting Contractual and Tortious damages" [1997] L.M.C.L.Q. 26, at pp.27-29.

[5] Smith New Court, supra, at p.283, per Lord Steyn, citing Banque Bruxelles Lambert S.A. v. Eagle Star Insurance Co. [1997] A.C. 191 (H.L.(E.)).

this is difference is that an intentional wrongdoer should face wider liability.[6] This more stringent policy for intentional wrongdoers serves two purposes.[7] First, it has a deterrent function in trying to discourage fraud.[8] In this respect, civil remedies can have "a useful and beneficial role".[9] Secondly, there are moral considerations that require "the fraudster to bear the risk of misfortunes directly caused by his fraud"; the law and morality being inextricably linked.[10]

Proving Fraud

For there to be fraud, there needs to be "a misstatement of an existing fact", rather than a statement of opinion or intention, because ascertaining what is in a person's mind at a particular time is "very difficult to prove".[11] But, if the state of a person's mind can be ascertained, and it shows an intention to make a false statement (or

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6 Per Lord Steyn in Smith New Court Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1997] A.C. 254, at p.279F-G.

7 Per Lord Steyn in Smith New Court Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1997] A.C. 254, at p.279G-H.

8 Per Lord Steyn in Smith New Court Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1997] A.C. 254, at p.279H.

9 Per Lord Steyn in Smith New Court, supra, at p.280B-C

10 Ibid.

11 Edgington v. Fitzmaurice (1885) 29 Ch. D. 459, at p.483, per Bowen L.J.

give a false opinion), then it may be possible to prove fraud.[12] Because of the seriousness with which the law views allegations of fraud, which should not be pleaded lightly, the court will require greater proof of the allegation in order to be satisfied.[13]

In addition to an intention to deceive, the misrepresentation or misstatement must have been material, and it must have been relied on by the recipient, i.e., it must have induced a contract or a course of action where there is no contract.[14] For example, where a banker deliberately made false statements to a mortgagor and his wife that a major loan to a consortium (which the mortgagor was involved with) was assured, and that the mortgage would be used to support the major loan application, it was held that, because of these statements, the mortgagor and his wife signed the mortgage when they would not have done so otherwise, i.e., the false

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12 Ibid.

13 See Lord Steyn in Smith New Court Ltd. v. Scrimgeour Vickers,(asset Management) Ltd., supra, at p.274D, citing Lord Nicholls of Birkenhead in Re H (Minors) Sexual Abuse: Standard of Proof [1996] A.C. 583, at pp.586C-587F.

14 See Lord Selbourne in Smith v. Chadwick (1884) 9 App. Cas. 187, at p.190; Oliver J. (as he then was) in Nautamix BV v. Jenkins of Retford Ltd. [1975] F.S.R. 385, at p.394, citing Spencer Bower and Turner's Actionable Misrepresentation (1974) 3rd. Edn., at paras.99 and 115, on pp.118 and 132; Millett J. (as he then was) in London plc v. Fayed (No. 2) [1992] 1 W.L.R. 1, at p.6C-E; and District Judge Muir in Banco Urquijo (Banco De Progresso S.A.) v. Signet Bank/Maryland [1995] 4 Banking Law Reports 281, at p.300, col. 1 (United States District Court MD Pennsylvania).

statements induced the mortgage, and, consequently, the mortgage was set aside;[15] the banker's purpose in seeking the mortgage was to replace three promissory notes from the consortium with the mortgage, as the notes, which were a form of interim finance, were unauthorised, and, under Canadian law[16], the banker could have been personally liable.

And where a merchant bank made deliberately false statements to certain members of a company involved in a takeover (which was financed partly by contributions from the members (i.e., promoters) and partly by contributions from the bank): (i) that one of the promoters (PQ) had complied with one of the terms of the takeover, i.e., a deposit of £200,000 with the bank when he had not, and (ii) that PQ was not indebted to the bank, when he had borrowed money, and had failed to mention earlier that PQ's deposit had been reduced to £25,000[17], it was found that these statements and the omission had been made with the purpose of inducing the members of the predator to proceed with the takeover, and that they had this

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15 Fraser Valley Credit Union v. Canorama Development Corp. (1984) 56 B.C.L.R. 145, at pp.1158-159, per Finch J.

16 Credit Union Act, R.S.B.C. 179, c.79 (Canada).

17 To have done so, in the absence of consent, would have amounted to a breach of the bank's duty of confidence.

effect.[18] The target proved to be a bad investment, and damages were awarded in lieu of rescission, because there could not be restitution in full.[19]

If a person honestly makes a statement which he believes is correct, but which he later discovers is incorrect, or which subsequently becomes incorrect, and the recipient is under the impression that the original statement is still correct, then, the original maker should correct the false impression, otherwise that amounts to fraud. Similarly, a failure to inform someone of a situation when they are relying on you may amount to fraud, i.e., fraud by silence or by a negative misrepresentation. Thus, where a bank knew that the accounts receivables of a debtor company of the bank that was being sold by a receiver appointed by the bank were false, and the bank failed to tell either the receiver or the purchaser of the company[20], it was held the bank was liable for

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[18] Northern Finance Corpn. Ltd. v. Charlton [1979] European Commercial Cases 7 (Irish Supreme Court). These findings of the trial judge were upheld by a majority of the Appeal Court.

[19] Northern Finance Corporation Corpn. Ltd. v. Charlton [1979] European Commercial Cases 7 (Irish Supreme Court). Cf. Smith New Court Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1997] A.C. 254 (H.L.(E.)).

[20] The actual purchaser was another company ("Newco."), which was a vehicle for its owner, a Mrs Sugar (one of the plaintiffs), who wished to invest in the debtor company Mrs Sugar's husband, an experienced business man and a chartered accountant, was investigating the debtor company, on his wife's behalf.

fraud. The lender had been aware of the problem, and by remaining silent and not informing either the receiver or the purchaser of the situation, the lender was guilty of fraud, as the purchaser had relied on the documents from the receiver and the lender, concerning the validity of the accounts receivables, when deciding to purchase the company. The lender knew that the documents provided and the oral statements made by the receiver, although accurate as far as they went, did not disclose the full position; hence, the lender made a representation of fact, which it was intended the purchaser would act on, which it did[21]. Accordingly, the purchaser's initial investment could be recovered, but not a subsequent investment made after the fraud was discovered, but before the bank was confronted.[22]

Moreover, where a party has failed to disclose a material fact it is not a defence to an action for fraud for the fraudster to claim that,

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21 See Hood, P., "Lender Liability Under English Law" : Ch. 2 in Banks, Liability and Risk (1995) (R. Cranston, ed.) 2nd edn., at p.52.

22 Part of the problem that the purchaser faced was that the original owners of the debtor company in receivership were still working with the company, and their help was needed. An argument by the bank that breaches of a loan agreement entered into by Newco, in pursuance of the takeover of the debtor company, provided a defence, were dismissed on the basis that if there had been no fraud, then, the loan agreement would not have been entered into, and its provisions could not be relied on. Southey J concluded that the breaches of the covenants had no material effect on Newco's financial position, or the extent of the bank's loan to it.

if the victim had investigated the matter more fully he should have discovered the real position.[23]

Vicarious Liability Of A Bank For The Actions Of Its Employees

The victim of the fraud, assuming all the elements are made out, has a cause of action against the fraudster (i.e, the employee of the bank), but, as the employee may not be worth pursuing, the victim will wish to vicariously sue the bank for the acts or omissions of its employee (i.e., the fraud). In order to do so, the victim must show that the acts of an employee, acting within the course of his employment, were within his actual or ostensible authority; it is not enough that the employee's employment provided an opportunity to facilitate fraud.[24]

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[23] Redgrave v. Hurd (1881) 20 Ch. D. 1; see too Nocton v. Lord. Ashburton [1914] A.C. 932, at p.962, and in a banking context: see Sugar v. Peat Marwick Ltd. (1984) 66 O.R. (2d.) 766.

[24] Generale Bank Nederland NV (formerly Credit Lyonnais Bank Nederland NV) v. Export Credits Guarantee Department [1998] 1 Lloyd's Rep. 19 (C.A.), upholding Longmore J: [1996] 1 Lloyd's Rep. 200. A banking case, involving an employee of E.C.G.D., who assisted a fraudster by underwriting E.C.G.D. guarantees, with the consequence that the plaintiff bank purchased forged and valueless bill of exchange. In Armagas Ltd. v. Mundogas S.A.; The Ocean Frost [1986] A.C. 717, the House of Lords made a distinction between the vicarious liability of an employer for: (i) the dishonest acts of its employee, and (ii) the negligent acts of its employee.

Statute Of Frauds Amendment Act 1828 : Misrepresentation As To Credit

Under English law, if a person (in this context, a banker) makes a fraudulent misrepresentation about the credit of a third person, then, for there to be liability, the misrepresentation must be in writing. This is because of s.6 of the Statute of Frauds Amendment Act 1828 ("Lord Tenterden's Act")[25], which provides:

> "No action shall be brought whereby to charge any person upon or by reason of any representation or assurance made or given concerning or relating to the character, conduct, credit, ability, trade, or dealings of any other person, to the intent or purpose that such other person may obtain credit, money, or goods upon, unless such representation or assurance be made in writing, signed by the party to be charged therewith."

The section has been narrowly construed. It applies only to fraudulent misrepresentations[26], in writing, concerning a person's credit or credit worthiness.[27] The section does not apply to

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25 There is no Scottish equivalent of this Act.

26 Banbury v. Bank of Montreal [1918] A.C. 626 (H.L.(E.)), and UBAF Ltd. v. European American Banking Corp. [1984] Q.B. 713, at p.718H, per Ackner L.J. (as he then was), giving the judgement of the court.

27 Diamond v. Bank of London and Montreal Ltd. [1979] Q.B. 333, at p.347B-C, per Lord Denning M.R., and UBAF Ltd v. European American banking Corpn, supra, at p.719B, per Ackner L.J.

negligent misrepresentations or breaches of contract.[28] Nor does s.6 of Lord Tenterden's Act apply to false statements, outside the ambit of the section, which induce the recipients to enter into transactions, e.g., a false statement about a business's value.[29] But the section can include misrepresentations giving rise to liability under s.2(1) of the Misrepresentation Act 1967, as the maker of the misrepresentation under the 1967 Act is only liable if he "would be liable to damages in respect thereof had the misrepresentation been made fraudulently".[30] Also, the reference to person can include a

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[28] Banbury v. Bank of Montreal [1918] A.C. 626 (H.L.(E.)), and UBAF Ltd. v. European American Banking Corpn. [1984] Q.B. 713, at p.718H, per Ackner L.J.

[29] Fleming, J.G., The Law of Torts (1992) 8th edn., at p.639. See the discussion in UBAF Ltd. v. European American Banking Corpn., supra, at pp.719-725A, per Ackner L.J.

[30] Per Ackner L.J. in UBAF Ltd. v. European American Banking Corpn. supra, at pp.718H-719A. S.2(1) of the Misrepresentation Act 1967 (which does not apply in Scotland), provides:

> "Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable in damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable grounds to

corporation[31], but, for the corporation to be liable, the representation in writing must be signed by a person having authority in the company[32], e.g., a director, or the company secretary; the branch manager of a bank has been held not to be such a person[33].

The section is not infrequently used in disputes between members of a syndicate of banks and the agent bank.[34] This is because[35]:

(i) where an allegedly negligent misrepresentation has induced a syndicate member to enter into a syndicated loan agreement, the member may sue under s.2(1) of the Misrepresentation Act 1967, with its fiction of fraud. The effect of this is that a claim under

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believe and did believe up to the time the contract was made that the facts misrepresented were true."

See the discussion of this oddly drafted section in Chapter 5, "Lender Liability For Negligence".

31 Hirst v. West Riding Union Banking Co. Ltd. [1901] 2 K.B. 560, approved in Banbury v. Bank of Montreal [1918] A.C. 626, at p.714, per Lord Westbury; see also Lord Parker of Waddington, at p.708.

32 Fleming, J.G., The Law of Torts (1992) 8th edn., at p.639.

33 Hirst v. West Riding Union Banking Co. Ltd. [1901] 2 K.B. 560.

34 Paget's Law of Banking (1996) 11th edn. (by M. Hapgood Q.C.), at p.128. See too UBAF Ltd. v. European American Banking Corpn., supra.

35 Paget, supra, at p.128.

s.2(1) needs to satisfy s.6 of Lord Tenterden's Act "as much as a claim in fraud";[36]

(ii) the broad disclaimers in the documentation between the agent bank and the syndicate member excluding the agent from liability for negligence, can be defeated if there was fraud by the agent;[37]

(iii) a negligence claim may be statute-barred[38], whereas a fraud claim may not be because time does not start to run until the fraud has been discovered by the victim (or could have been discovered with "reasonable diligence").[39]

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[36] Ibid.

[37] Ibid. See also Boyd v. Glasgow Rly 1915 S.C. (H.L.) 20, at pp.35-36, per Lord Shaw of Dunfermline; Commercial Banking Co. of Sydney v. R.H. Brown (1972) C.L.R. 337, [1972] Lloyd's Rep. 360, (High Court of Aust.); and S. Pearson & Sons Ltd. v. Dublin Corpn. [1907] A.C. 351, at p.362, per Lord James, on the effect of fraud.

[38] S.2 of the Limitation Act 1980, provides:

> "An action founded on tort shall not be brought after the expiration of six years from the date of the cause of action."

This is determined by the circumstances of the case: see UBAF Ltd. v. European American Banking Corpn. [1984] 1 Q.B. 713, at pp.725-726, per Ackner L.J., and the cases referred to there.

[39] S.32(1) of the Limitation Act 1980.

Remedies For Fraud : Rescission and Damages

There are two main remedies for fraud: (i) rescission of an agreement induced by fraud and/or (ii) damages for deceit[40].

(i) Rescission

For there to be rescission, which is a discretionary remedy and is "moulded in accordance with the exigencies of the particular case"[41], the victim of the fraud must be able to make *restitution in integrum*[42], which means that the parties are put back in the position they would have been in had the contract not been made. Nonetheless, it is well established that this doctrine is not to be applied too literally.[43] The difficulty with rescission in many commercial contracts, is that the fraud is not discovered until later on, by which time it is too late to make restitution. Consequently,

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[40] Newbigging v. Adam (1887) 34 Ch. D. 582, at p.592, per Bowen L.J.; Archer v. Brown [1985] Q.B. 401, at p.415G, per Peter Pain J. (as he then was); Bryson & Co. Ltd. v. Bryson 1916 S.L.T. 361, at p.364, per Lord Anderson.

[41] Per Lord Wright in Spence v. Crawford 1939 S.C. (H.L.) 52, at p.76, [1939] 3 All E.R. 271, at p.288C-D.

[42] See, for example, Boyd & Forrest v. Glasgow & South-Western Rly 1915 S.C. (H.L.) 20, [1915] A.C. 526 (H.L.(Sc.).

[43] See Spence v. Crawford 1939 S.C. 52, at p.70 (H.L.), [1939] 3 All E.R. 271, at p.279G-H, per Lord Thankerton; and 1939 S.C. 52, at p.77, [1939] 3 All E.R. 271, at p.288E-F, per Lord Wright.

the victim of the fraud has a remedy in damages against the fraudster. It is this remedy that this chapter will focus on.

(ii) Damages

This remedy made be either a separate one without rescission (i.e., an action for deceit), or it may be cumulative with rescission. The measure of damages for fraud, is "reparation for all the actual damages directly flowing from the fraudulent inducement", not just damage that is reasonably foreseeable.[44]

The measure is delictual and not contractual (i.e., it is not a claim for loss of a bargain), and aims to put the victim in the position he would have been in had the fraud not occurred.[45]

A gloss has been placed on the general principle, set out above, by Lord Browne-Wilkinson, who outlined seven principles when assessing damages for deceit, where the victim has been induced to purchase property[46]:

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[44] Doyle v. Olby (Ironmongers) Ltd. [1969] 2 Q.B. 158, at p.167, per Lord Denning M.R., cited with approval by the House of Lords in Banque Bruxelles Lambert S.A. v. Eagle Star Insurance Co. [1997] A.C. 191, and in Smith New Court Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1997] A.C. 254, at p.265C, per Lord Browne-Wilkinson, and, at pp.281-282, per Lord Steyn.

[45] Smith New Court Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. supra, at p.281, per Lord Steyn.

[46] Smith New Court Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1997] A.C. 254, at pp.266H-267D, per Lord Browne-Wilkinson; Lords Keith of

(i) the fraudster "is bound to make reparation for all the damage directly flowing from the transaction";[47]

(ii) the damage does not have to be foreseeable, but must have been caused directly by the fraud;

(iii) the victim can recover the full price paid for the property by way of damages, but must give credit for any benefits he has received because of the transaction;

(iv) generally, the benefits received by the victim of the fraud include the market value of the property purchased at the date of

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Kinkel, Mustill and Slynn of Hadley expressly agreeing. To similar effect are the six principles outlined by Lord Steyn, at pp.282G-283E; Lords Keith of Kinkel, Mustill and Slynn of Hadley also agreed with Lord Steyn's speech. Lord Mustill felt Lord Browne-Wilkinson's seven principles should replace Doyle v. Olby (Ironmongers) Ltd., where the Court of Appeal did not speak in unison: see at p.269F-G.

[47] But this does not include losses that the victim "would have suffered had he not entered into the transaction or for losses attributable to causes which negative the causal effect of the misrepresentation": per Lord Hoffman, delivering the leading speech, in Barque Bruxelles Lambert S.A. v. Eagle Star Insurance Co. Ltd. [1997] A.C. 191, at p.216. Nor is it correct "to embark on a 'hypothetical reconstruction' of what the parties would have agreed had" there been no fraud: per Lord Steyn in Smith New Court, supra, at p.283F-G, rejecting the view of Hobhouse L.J. in Downs v. Chappell [1997] 1 W.L.R. 426, at p.443. (C.A.). See also Lord Browne-Wilkinson, at p.267D-F, who rejected this approach. Lords Keith of Kinkel, Mustill and Slynn of Hadley agreed with both speeches.

the purchase, but this rule is not to be inflexibly applied where its application means that the victim will be prevented from obtaining full compensation for the wrong suffered by him;[48]

(v) the general rule's application cannot be stated comprehensively, but it will not apply where:

> (a) the misrepresentation continues to operate after the purchase, thereby inducing the victim to continue to hold on to the property, or
>
> (b) the circumstances of the matter mean that the victim is "locked into the property" because of the fraud;[49]

(vii) once the victim has discovered the fraud, he must seek to mitigate his loss.

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[48] As was the case in Smith New Court itself, where the House of Lords rejected old cases, such as McConnel v. Wright [1903] 1 Ch. 546, to hold that where shares had been purchased, owing to fraud, the measure of damages was the difference between: (a) (i) the purchase price (82p) and (ii) the sale price (48p), rather than the difference between: (b) (i) the purchase price (82p) and (ii) the value of the shares at the date of the transaction (78p).

[49] Cf. Sugar v. Peat Marwick Ltd. (1989) 66 O.R. (2d.) 766.

Thus, the measure of damages[50] for fraud (i.e., "loss flowing directly from the transaction induced by the wrongdoer")[51]:

> ". . . is not tied to any process of valuation at the date of the transaction. It is squarely based on the overriding compensatory principle, widened in view of the fraud to cover all direct consequences. The legal measure is to compare the position of the plaintiff as it was before the fraudulent statement was made to him with his position as it became as a result of his reliance on the fraudulent statement."

Conclusion

Fraud by a bank, via its employees, is a comparatively rare occurrence. Where fraud does occur, it seems to relate to problems with a transaction, rather than systemic dishonesty. For example, (i) when an employee is under pressure to protect the bank and/or himself, or (ii) where an employee has been over zealous in his conduct and acted outside his authority with regard to recovering a loan. The difficulty for customers/borrowers is that they, justifiably, trust and rely on the integrity of banks. If, for example, a customer starts to find delays occurring when things seemed settled, with little, or no adequate, explanation, the customer should start to be a little wary. It is easy to preach vigilance (which, when

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50 Smith New Court Ltd. v. Scrimgeour Vickers (Asset Management) Ltd., supra, at p.282D-E, per Lord Steyn.

51 Smith New Court Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. supra, at p.282C-D, per Lord Steyn.

dealing with a bank, one does not expect to have to), but often the fraud will not be discovered until after the business has been transacted, and too late to do anything to prevent it.

(2) CONSPIRACY

Civil conspiracy concerns an agreement between two or more persons to act in such a way as unlawfully to cause economic damage to another person or entity. There are two types of such a conspiracy[52]:

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[52] Lonrho Plc v. Fayed [1992] 1 A.C. 448 (H.L.(E.); noted by Mann, F.A., "The Single Speech" (1991) 107 L.Q.R. 519, Cohen, H., "Conspiracy, Intentional Harm and Economic Loss" [1991] J.I.B.L. 478, and Bentil, J.K., "Improper Interference with Another's Business of Trade Interest as a Tort" [1993] J.B.L. 519, at pp.533-535. This case sought to clarify the uncertainty created by the single speech of Lord Diplock in Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, which was a case of the second type of conspiracy, but one in which Lord Diplock spoke in terms of the first type of conspiracy, and gave the impression that the unlawfulness in the second type of conspiracy was not enough - that there had to be a predominant motive to injure the victim by the conspirators. The two Lonrho cases are hard to reconcile - a similar view is shared by Mann, supra, at p.519 - but, on principle, the 1991 decision of their Lordships' is correct.

(i) where the conspirators use a lawful means to harm the victim, but the aim is an unlawful end[53]; or

(ii) where the conspirators use unlawful means to harm the victim.[54]

(i) Conspiracy Using Lawful Means

This type of conspiracy has been described as anomalous[55], because it makes an act done by two or more persons in concert, which causes economic harm to another person, a delict/tort, whereas, if the act had been done by an individual, it would be lawful.[56] In the case of an individual, his motive (i.e., to cause harm to the victim) is irrelevant, provided his conduct is lawful[57], for example, one bank providing finance to a borrower at a lower interest rate than a

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53 See Lord Devlin in Rookes v. Barnard [1964] A.C. 1129, at p.1204, cited with approval by Lord Bridge of Harwich in Lonrho plc v. Fayed [1992] 1 A.C. 448, at p.464.

54 Ibid.

55 See Lord Diplock in Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, at p.189C-D.

56 See Lord Diplock in Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2), supra, at p.188G-H.

57 See Lord Herschell in Allen v. Flood [1898] A.C. 1, at p.123, cited with approval by Lord Wright in the Scottish case of Crofter Hand Woven Harris Tweed Co. Ltd. v. Veitch 1942 S.C. 1, at pp.27-28 (H.L.), [1942] A.C. 435, at p.467 (H.L.(Sc.).

competitor in order to undercut that rival. In the case of two or more persons, as will be seen below, motive or purpose is critical, even though their acts, by themselves, are not illegal. For example, if a group of two or more banks conspired to lower interest rates on loans dramatically to deliberately undercut a new rival bank that they disliked, then there is a case of conspiracy. There appears to be no logical rationale for this distinction between individuals and parties acting in concert. The view expressed last century that "a combination may make oppressive or dangerous" something which if an individual did it would not be[58], is no longer valid, as a multinational conglomerate is more likely to have a bigger economic impact than the actions of a few small businesses[59].

To prove this first type of conspiracy: (i) the act needs to be carried out - there can be no attempt to conspire under the civil law, unlike the criminal law - and (ii) there must be damage caused to the

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58 Per Bowen L.J. in Mogul Steamship Co. v. McGregor, Gow & Co. (1889) 23 Q.B.D. 598, at p.616, in the Court of Appeal.

59 See Lord Diplock in Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, at p.189A-B; see also Lord Wright in Crofter Hand Woven Harris Tweed Co. Ltd. v. Veitch 1942 S.C. 1, at p.28 (H.L.), [1942] A.C. 435, at p.468, who found the various rationales unconvincing. The Crofter case remains the leading modern authority in Britain on this type of conspiracy. The report of the case in the Session Cases is a fuller one than that appearing in the Appeal Cases, and is to be preferred.

victim[60], although the damages recoverable will be damages at large, i.e., the damages "are not limited to a precise calculation of the amount of the actual loss actually proved"[61].

Self Interest/Mixed Motives

The key to this type of conspiracy is the intention of the conspirators.[62] This is because there is "a defence of self interest".[63] If the conspirators did their act solely to deliberately injure the victim, then, provided there has been damage to the victim, there is a delictual/tortious conspiracy. However, if the parties acting in concert did not intend to injure the victim, but to promote their own interests, there is no conspiracy.[64] Where there is a mixture of motives by the conspirators, then, provided the real and predominant purpose was to promote their interests, rather

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60 Crofter Hand Woven Harris Tweed Co. Ltd. v. Veitch 1942 S.C. 1, at p.5 (H.L.), [1942] A.C. 435, at p.439, per Viscount Simon L.C.; and Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, at p.189C-D, per Lord Diplock.

61 Lonrho Plc v. Fayed (No. 5) [1994] 1 All E.R. 188, at p.193j, per Dillon L.J.

62 The Crofter case, supra; and McKernan v. Fraser (1931) 46 C.L.R. 343, at p.398, per Evatt J.

63 Per Evans L.J. in Lonrho plc v. Fayed (No. 5) [1994] 1 All E.R. 188, at p.208j.

64 Sorrell v. Smith [1923] A.C. 700, at pp.771-712, per Lord Cave L.C.; see too the Crofter case, 1942 S.C.1, at p.7, [1942] A.C. 435, at p.442, per Viscount Simon L.C., citing it with approval, and Lord Wright, 1942 S.C.1, at p.25, [1942] A.C. 435, at p.464.

than harm the victim, no unlawful conspiracy is committed.[65] So, a mere dislike of someone is not sufficient to constitute a conspiracy[66] - there must be a predominant purpose to cause damage.[67]

(ii) Conspiracy Using Unlawful Means

In this second type of conspiracy, it is not necessary to show a predominant purpose of intending to cause damage to the victim: as the means used, being illegal, found the cause of action, i.e., the unlawful conduct itself used to harm the victim is enough; the conspiracy element is "of secondary importance".[68] Where,

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65 The Crofter case, 1942 S.C. 1, at pp.10-11, [1942] A.C. 435, at pp.445-446, per Viscount Simon L.C., and 1942 S.C. 1, at p.36, [1942] A.C. 435, at p.478, per Lord Wright. Lord Wright goes on to state that there does not have to be "a complete identity of interest between the parties to a combination": it is enough if there is a "sufficient identity of object", although different advantages may be derived from the same object: see 1942 S.C. 1, at p.37, [1942] A.C. 435, at p.479.

66 Per Evatt J. in McKernan v. Fraser (1931) 46 C.L.R. 343, at p.402. For an excellent analysis of the case law up to that time: see his Honour's judgement at pp.390-403.

67 The Crofter case, supra; and Lonrho plc v. Fayed (No.5) [1994] 1 All E.R. 188 (C.A.).

68 See Lord Devlin in Rookes v. Barnard [1964] A.C. 1129, at p.1204, cited with approval by Lord Bridge in Lonrho Plc v. Fayed [1992] 1 A.C. 448, at p.464. See also the Crofter case, supra.

however, the unlawful acts of the conspirators are not actionable by the victim[69], to succeed in a claim for this second type of conspiracy, it is still necessary to show an intention to harm the victim of the act, although this does not have to be the predominant purpose[70]; it is enough that it was reasonably foreseeable that the act may injure the victim, and did injure him[71].

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69 As in Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173 (H.L.(E.), where Shell and B.P. breached the Southern Rhodesia (Petroleum) Order 1965 (S.I. 1965 No. 2140), made under the Southern Rhodesia Act 1965. This order prevented United Kingdom companies supplying oil to (what was then) Rhodesia. However, Shell and BP had no intention to harm Lonrho. It was held that: (i) the breach of the Order, which was penal, and not a civil wrong, did not create a civil claim for breach of statutory duty; and (ii) as there was no intent to harm Lonrho, Lonrho's claim failed.

70 Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173 (H.L.(E.). See too Parker J., at first instance, and Lord Denning M.R., in the Court of Appeal, in Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2), both unreported, whose views were approved by Lord Diplock in the House of Lords: [1982] A.C. 173, at p.189; these views were cited by Lord Bridge in Lonrho Plc v. Fayed [1992] 1 A.C. 448, at pp.466-467.

71 Lord Denning M.R. in Lonrho Ltd v. Shell Petroleum Co. Ltd. (No. 2), unreported decision of the Court of Appeal, delivered on 6th March, 1981, cited with approval by Lord Bridge in Lonrho Plc v. Fayed [1992] 1 A.C. 488, at p.467A-F.

Unlawful Means

What is meant by "unlawful means", and when is something that is unlawful, under the criminal law, actionable under the civil law?[72] If the conspirators commit a civil wrong, this would be actionable. It is likely that "unlawful means" would include all common law crimes and all delicts/torts.[73] A more difficult question arises where there is a breach of a statute, and, in particular, a penal statute. Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No.2)[74] indicates that not every criminal offence will be regarded as "unlawful means" for the purposes of compensation under the civil law. It is a question of construction whether legislation which makes an act a criminal offence also permits the victim of that act to claim damages for loss suffered because of it.[75] The general rule is "that 'where an Act [of Parliament] creates an obligation, and enforces the performance in a specified manner . . . that performance cannot be

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72 For a discussion of "Unlawful Means"; see Carty, H., "International Violation of Economic Interests: The limits of Common Law Liability" (1988) 104 L.Q.R. 250, at pp.265-273 and 279-280.

73 Fleming, J.G., The Law of Torts (1992) 8th edn., at p.699.

74 [1982] A.C. 173, (H.L.(E.)).

75 Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, at pp.183F-H, per Lord Diplock, referring to Cutler v. Wandsworth Stadium Ltd. [1949] A.C. 398 (H.L.(E.)).

enforced in any other manner'."[76] To this general rule, there are two exceptions[77]:

(i) where the obligation or prohibition in the Act, on its construction, "is for the benefit or protection of a particular class of individuals"[78]; or

(ii) where a public right is created by the statute (i.e., a right enjoyed by all of Her Majesty's subjects)[79], and a member of the public suffers "particular, direct and substantial damage".[80]

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[76] A.C. 398. Doe d. Murray v. Bridges (1831) 1 B. & Ad. 847, at p.859, [1824-1834] All E.R. Rep. 167, at p.170, cited with approval by Lord Diplock in Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, at p.185.B-C (H.L.(E.)).

[77] Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, at p.185C-D, per Lord Diplock.

[78] Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, at p.185D, per Lord Diplock.

[79] Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, at p.185F-G, per Lord Diplock.

[80] Per Brett J. (as he then was) in Benjamin v. Storr (1874) L.R. 9, C.P. 400, at p.407, cited with approval by Lord Diplock, in Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, at p.185G.

A wider principle of liability, not dependant on the statute's language and scope, has been rejected.[81]

Consequently, the nature of the statute will need to be looked in determining whether an act attracting a criminal sanction, e.g., a fine, will also attract a civil sanction, e.g., damages.

Conspiracy By Bankers

It is unlikely that a banker is going to engage in conduct, with others, that will amount to either a type one or type two conspiracy. This is because the banker's main aim is to be repaid by a borrower, rather than seeking to injure it (and, hence, reduce the borrower's chances of repaying its loan to the bank)[82]. In 1991 (when there was an economic recession), accusations were levelled at banks, by small businesses, that the banks were "ganging up" on them, concerning interest rates; however, an inquiry by the Treasury and the Bank of England "found no evidence of collusion among the clearing banks in setting lending rates to business."[83] An accusation of conspiracy was made against certain clearing banks in the highly publicised Sir Freddie Laker litigation, but the Court of Appeal, in England, refused to allow an English liquidator to

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81 Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173, at p.187E-F, per Lord Diplock.

82 See Hood, P., "Lender Liability Under English Law" : Ch. 2 in Banks, Liability and Risk (1995) 2nd edn., at p.63.

83 Wood, N., "Main banks cleared of ganging up on firms", *The Times*, 2nd July, 1991.

institute proceedings, in the United States, under that country's anti-trust laws, because to have done so would have been unconscionable.

One possible problem area for lenders is if they become associated with so-called "Napoleonic" business figures, who misappropriate moneys from (public) companies they are major shareholders in, and divert it to their own private companies, which harms the (public) company, and has the consequence that the lender is regarded as having conspired with the "tycoon" to this end.[84] Such a situation arose in the Canadian case of Claiborne Industries Ltd. v. National Bank of Canada.[85] There, a lender ("NBC") was found to have conspired with a customer ("B") to approve transfers of funds from Claiborne Industries Ltd. ("Claiborne"), a public company, which had several subsidiaries, to B's private companies, without Claiborne's proper authority. These transfers were for the benefit of B and were to Claiborne's detriment. There were two other acts of NBC which became entwined with the general conspiracy: (i) NBC's releasing security to Claiborne, which B later took, via B's private companies, and (ii) the subsequent acquisition of under-valued security by NBC in Claiborne, which gave NBC a controlling interest in Claiborne.

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[84] See Hood, P., "Lender Liability Under English Law" : Ch. 2 in Banks, Liability and Risk (1995) 2nd edn., at p.63.

[85] (1989) 59 D.L.R. (4th) 533. After NBC was found liable for conspiracy, the possible liability of NBC as a constructive trustee was not considered.

The test for conspiracy in Canada is somewhat different from the test in Britain. In Canada, a person can be guilty of conspiracy where that person, in combination with another or others: (i) uses either lawful or unlawful means with the predominant purpose of causing injury to the victim; or (ii) engages in unlawful conduct directed towards the victim (either by himself or together with other persons), and the conspirators should know that, in the circumstances, the victim is likely to suffer injury, and, in fact, does so.[86] In the second situation, there does not have to be a predominant intention to cause injury, but there must be a constructive intent. In both situations, the victim must have suffered damage.

A further situation where a lender may, potentially, be the subject of an action for conspiracy is if a group of lenders decided together that they would accelerate their loans to a borrower, who has defaulted, not for the purpose of seeking repayment, but with the predominant motive to cause harm to the borrower, who had caused them difficulties, and with whom relations were strained. This is an unlikely scenario, and would involve considerable proof problems.

Alternatively, a powerful corporation, could put pressure on some banks, by threatening to take its business elsewhere, if they lent money to a rival (of lesser financial status). If the banks agreed to

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86 Canada Cement La Farge Ltd. v. British Columbia Lightweight Aggregate Ltd. [1983] S.C.R. 452, at pp.471-472, (1983) D.L.R. (3d.) 385, at pp.398-399, per Estey J., in the Supreme Court of Canada.

this, and, as a consequence, the rival was not able to obtain finance, or could only obtain it elsewhere at uneconomic rates, the first corporation and the banks have acted together, with severe economic consequences for the rival. The difficulty, though, for the rival is motive: the large corporation has acted to harm its rival, but the lenders have acted to preserve their own business relationship with the corporation: they have not had a predominant motive to harm the rival.

Conclusion

The above circumstances indicate the problems of trying to appease charismatic borrowers, who place lenders under pressure, and also of becoming too involved in such a borrower's affairs. This is another example of lenders having difficulties when they step out of the normal debtor/creditor relationship, and lose their objectivity. The problem, though, for any borrower that claims it is the victim of a conspiracy by a bank and another party, or by a group of banks, is proving it. In the absence of a bank, or group of banks, acting unlawfully - which, with the large numbers of legal advisers that banks have, and the (generally) cautious approach they take to transactions by getting the details of the transaction checked by their lawyers is unlikely - it will be difficult to show that a bank, or group of banks, had a predominant motive to harm the borrower, rather than protect its, or their, economic interests.

(3) TORTIOUS INTERFERENCE WITH CONTRACT

Where B (a banker) interferes with a contract between C (a customer) and A (another person), by, for example, inducing A to

breach its contract with C[87], or by hindering the performance by A of the contract[88], B commits a delict/tort[89], and can be liable to C, if C suffers loss as a result. This delict/tort was originally concerned with industrial matters, but has been used by the courts to encompass commercial matters, and has been broadened to include an interference with a contract, as well as inducing a breach.[90] The interference may be direct, where B interferes himself, or indirect, where B uses a third party to interfere with A and C's contract - the most common example of this was a secondary boycott in the industrial relations field. The reason for interference by B might be that B has a contract with C and is seeking to promote its contract at the expense of the contract between A and C; or it might be that there is no contract between B and C, but B is hoping that, by disrupting the contract between A and C, there will be a contract between himself and C.

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87 See, for example, Edwin Hill & Partners v. First National Corporation [1989] 1 W.L.R. 225 (C.A.).

88 See Torquay Hotel Co. Ltd. v. Cousins [1969] 2 Ch. 106, at p.138, per Lord Denning M.R., cited with approval by Lord Diplock in Merkur Island Shipping Corp. v. Laughton; The Hoegh Apapa [1983] 2 A.C. 570, at p.607.

89 This delict/tort originated from Lumley v. Gye (1853) E & B. 216, 118 E.R. 749, but is known in Scots law: see British Motor Trade Association v. Gray 1951 S.C. 586.

90 Fleming, J.G., The Law of Torts (1992) 8th edn., at p.689.

Elements of the Delict/Tort

(a) English Law

In Edwin Hill & Partners v. First National Corporation Plc[91], Stuart-Smith L.J. outlined the following five elements of this tort[92]:

(i) a direct interference with a contract between C and A by B;

(ii) a sufficient knowledge on B's part that B's conduct will interfere with the contract between C and A;

(iii) an intention to bring that contract to an end;

(iv) B's interference caused damage to C (or A)[93]; and

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91 [1989] 1 W.L.R. 225 (C.A.). For a discussion of this case and the defence of justification: see O'Dair, R., "Justifying an Interference with Contractual Rights" (1991) 11 O.J.L.S. 227.

92 [1989] 1 W.L.R. 225, at pp.227-228. See also Jenkins L.J. (as he then was) in D.C. Thomson Ltd. v. Deakin [1952] 1 Ch. 646, at p.696; and Slade J. (as he then was) in Greig v. Insole [1978] 1 W.L.R. 302, at p.332. Cf. the position in the United States, where: (i) a valid contract known to the defendant, and (ii) an unjustified and intentional interference with that contract (iii) resulting in damage to the plaintiff need to be shown: see In re Quality Processing Inc. 9 F. 3d. 1360 (8th Cir. 1993).

93 There needs to be a causal link between the interference and the damage, so that if the plaintiff's loss is not due to the defendant's interference, but arose, e.g., because the plaintiff was impecunious, then there is no liability:

(v) the interference was not justified.

(b) Scots Law

The Scottish position, is set out in the judgement of Lord Russell in British Motor Trade Association v. Gray[94], who said that B's actings had to:

(i) be intentional;

(ii) without lawful justification;

(iii) productive of damage to the pursuer (here, C or A); and

(iv) procure or induce a breach of the contract between A and C.

This test omits to refer to the question of knowledge, but it is clear later from the judgement of Lord Russell[95], and from the judgement of Lord President Cooper in the same case, that knowledge is a requirement. The Lord President said that the essence of the delict was "to be found in knowing and unjustifiable interference".[96]

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see Lord Strathcona Steamship Co. Ltd. v. Dominion Coal Co. Ltd.; The Strathcona [1926] A.C. 108 (P.C.).

94 1951 S.C. 586, at p.603.

95 Ibid.

96 1951 S.C. 586, at p.600, citing Lord MacNaughten in Quinn v. Leatham [1901] A.C. 495, at p.510.

Knowledge

The key elements are knowledge of the contract between A and C by B, and an intention by B to interfere with that contract.[97] The level of knowledge has to be actual, rather than constructive, knowledge.[98] This accords with the general prohibition against constructive notice in commercial matters. But this requirement is not rigidly enforced by the courts: it is enough if B must have almost certainly known of the existence of the contract between A and C.[99] As Sir Raymond Evershed M.R. said[100]:

> "If all else were satisfactorily proved, it might well be (having regard to common knowledge about the way business is conducted) that absence of such strict proof [of knowledge] would not suffice to prevent the grant of relief."

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[97] D.C. Thomson & Co. Ltd. v. Deakin [1952] 1 Ch. 646, at p.660, per Upjohn J. (as he then was), whose decision was upheld on appeal.

[98] See D.C. Thomson & Co. Ltd. v. Deakin [1952] 1 Ch. 646, at p.686, per Lord Evershed M.R.; and Browne-Wilkinson J. (as he then was) in Swiss Banking Corp. v. Lloyds Bank Ltd. [1979] 1 Ch. 548; this latter case was reversed on other grounds by the Court of Appeal and the House of Lords: [1982] A.C. 584, but this point was not affected.

[99] Per Sir John Donaldson M.R. (as he then was), in the Court of Appeal, in Merkur Island Shipping Corpn. v. Laughton; The Hoegh Apapa [1982] 2 W.L.R. 45, at p.63, cited with approval by Lord Diplock in the House of Lords: see [1983] 2 A.C. 570, at pp.608H-609A.

[100] D.C. Thomson & Co. Ltd. v. Deakin [1952] 1 Ch. 646, at p.686.

Moreover, B does not have to have detailed knowledge of the provisions of the contract between A and C; it is sufficient if B could infer knowledge of contractual relations.[101]

Intention

A person's intention is usually discovered by referring to their "overt acts and to the circumstances in which they are done".[102] One difference between English law and Scots law, is that, under Scots law, recklessness or "turning a blind eye", is not sufficient to found an intention, it has to be "tantamount to enable the court to conclude that such actings were in effect intentional".[103] In England, a strong Court of Appeal has held that recklessness or indifference as to whether an act causes a breach of contract, is sufficient to found an intention to procure a breach.[104] It is suggested that this is the better view, and makes this delict/tort

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[101] Emerald Construction Co. Ltd. v. Lowthian [1966] 1 W.L.R. 691, at p.701, per Lord Denning M.R.; see also Diplock L.J. (as he then was), at p.704 (who speaks of this in terms of intent); see too Lord Penrose in Mercedes-Benz Finance Ltd. v. Clydesdale Bank Plc 1996 S.C.L.R 1005, at p.1014A-B.

[102] Per Lord Wright in Crofter Hand Woven Harris Tweed Co. v. Veitch 1942 S.C. 1, at pp.28-29, [1942] A.C. 435, at p.468, speaking in the context of conspiracy, but his Lordship's comments are apposite, nonetheless.

[103] See Lord Mayfield in Rossleigh Ltd. v. Leader Cars Ltd. 1987 S.L.T. 355, at p.360H-I.

[104] Emerald Construction Co. Ltd. v. Lowthian [1966] 1 W.L.R. 691, at p.701, per Lord Denning M.R.; see also Diplock L.J. (as he then was), at p.704.

analogous with another intentional delict/tort: fraud. It is further suggested that, as is the case with interference with a business, the intention here does not have to be the predominant intention - it can be a secondary motive. Nonetheless, it has been held, in England, that a presumed intent may not be enough.[105]

The question of intention by a banker, in relation to the operation of a bank account, was considered in the Scottish case of Mercedes-Benz Finance Ltd. v. Clydesdale Bank plc[106], which would be equally applicable to England. S was a member of the GH group, which had motor car dealerships for M-B, and banked with the Clydesdale Bank ("CB"). Under the dealership arrangement, amongst other things, the sums received from customers by S were paid from the dealer's account by direct debit to M-B. The group ran into financial difficulties. Three group members (including S) were allowed to continue trading by CB using a joint account. M-B applied for a payment by direct debit from S, but there were insufficient funds in the account. It was agreed that, provided the account was within its overdraft limit, CB would replace the direct debit with a telegraphic transfer to M-B. Funds were lodged by S. CB could now have paid out the sum sought by M-B and kept the account within the overdraft limit, but CB did not do so. Four days later, a receiver was appointed.

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[105] Per Upjohn J. (as he then was) in D.C. Thomson & Co. Ltd. v. Deakin [1952] 1 Ch. 646, at p.663.

[106] 1996 S.C.L.R. 1005 (O.H.).

M-B alleged that by refusing to make the telegraphic transfer, CB had wrongfully interfered with the contract between M-B and S; M-B sought damages. Lord Penrose dismissed this aspect of the case. His lordship said:

(i) That a banker might be liable for this delict to a third party because of the way he operated a customer's account, and that "[p]ure self-interest in preventing a movement of funds at a time when that might be critical to the banker's prospects of recovering from one or other party the full amount of his indebtedness would not be a sufficient defence to a claim."[107]

(ii) What was required was "an averment and proof of intentional inducement of the breach of a contract which is res inter alios acta by conduct for which there is no lawful justification".[108] There were no allegations that the bank acted with a view to inducing GH to breach its obligations to M-B, nor that what CB did amounted to a breach of the general current account contract.[109]

(iii) CB was under no obligation to continue the overdraft indefinitely (an overdraft being repayable on demand), or for a particular period.[110] The bank was entitled, "in its own interests",

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[107] 1996 S.C.L.R. 1005, at p.1014D-E. Cf. Griffiths v. Commonwealth Bank of Australia (1994) 123 A.L.R. 111 (Federal Court of Australia).

[108] 1996 S.C.L.R. 1005, at p.1014E-F.

[109] Ibid.

[110] At p.1014F.

under its contract with its customer, to "legitimately . . . refuse payment in a wide range of circumstances."[111] A banker would not be liable to a third party on stopping a cheque or refusing to honour a payment instruction from its customer because this might stop the customer from fulfilling a contractual obligation owed to a third party,[112] and the same reasoning applied here - there being no difference, in effect, between payment by cheque and payment by a direct debit.[113]

Interference

For there to be liability, the interference does not have to be by an unlawful act, although it could be, e.g., fraud; the interfering with the contract is sufficient to constitute illegality itself.[114]

Justification

Justification is a controversial area. The difficulty is that there are no precise criteria setting out what is required for this defence. It is clear that interfering with a contract because it is in your own self (or commercial) interests, without more, is not sufficient, e.g.,

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[111] At p.1015A-B.

[112] Ibid.

[113] At p.1011C-D; see also the Court of Appeal in Esso Petroleum Co. Ltd. v. Milton [1997] 1 W.L.R. 938, [1997] 2 All E.R. 593, on direct debits.

[114] Per Viscount Radcliffe in J.T. Stratford & Son Ltd. v. Lindley [1965] 269, at p.328.

an attempt merely to increase profits may not be justified,[115] and where the interference with the contract is by unlawful means, e.g., fraud, the defence of justification cannot apply,[116] because fraud cannot be justified.[117] But beyond this, the position will depend very much on the circumstances of the matter, with the case law providing some limited guidance.

Although justification is stated as being an element of the claim, in both English and Scots law, the better view is that justification is a

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115 Per Nourse L. J. in Edwin Hill, supra, at p.235. In British Motor Trade Association v. Gray 1951 S.C. 586, at p.600, Lord President Cooper said: "The suggestion that 'sufficient justification' for the respondent's conduct can be found in his own self-interest seems to me to be manifestly untenable, for such an exception would empty the rule of all intelligible content". See also Lord Russell, in the same case, at p.603.

116 Read v. Friendly Society of Operative Stonemasons [1902] 2 K.B. 732, at p.738, per Collins M.R.; Ansett Transport Industries (Operations) Pty. Ltd. v. Australian Federation of Air Pilots (No. 1) [1991] 1 V.R. 635, at p.677, per Brooking J; and also Building Workers' Industrial Union of Australia v. Odco Pty. Ltd. (1991) A.L.R. 735, at p.771, per the Full Court of the Federal Court of Australia.

117 Fleming, J.G., The Law of Torts (1992) 8th edn., at p.695.

defence to a claim for interference with contract.[118] This is because B has to justify his action to avoid liability.[119]

Whether conduct is justified, will depend on "the nature of the actionable acts and the circumstances in which they were committed."[120] The sorts of factors (which are not exhaustive) that may be relevant to a defence of justification are[121]:

(i) the nature of the contract broken;

(ii) the position of the contractual parties;

(iii) the grounds for the breach;

(iv) what was used to procure the breach[122];

(v) the relationship of the wrongdoer to the contract breaker; and

(vi) the aim of the wrongdoer in procuring the breach.

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[118] Per Lee J., in the Federal Court of Australia, in Griffiths v. Commonwealth Bank of Australia (1994) 123 A.L.R. 111, at p.119, lines 25-27.

[119] But C (the plaintiff) has to rebut it: see Greig v. Insole [1978] 1 W.L.R. 302, at p.332, per Slade J. (as he then was).

[120] Per Lee J., in Griffiths v. Commonwealth Bank of Australia (1994) 123 A.L.R. 111, at p.119, lines 35-36.

[121] Per Romer L.J. (as he then was) in Glamorgan Coal Co. Ltd. v. South Wales Miners Federation [1903] 2 K.B. 545, at pp.573-574.

[122] Unlawful means cannot be justified: see Collins M.R. in Read v. Friendly Society of Operative Stonemasons [1902] 2 K.B. 732, at p.738.

So, where a contract between B and C was not consistent with an earlier contract between B and A, A could induce B to break his contract with C, and could seek the court's assistance to do so.[123]

Equal or Superior Right as Justification

Where the interference by B with a contract between A and C is "to advance a private commercial interest or right, to the detriment of the contractual rights of [C], justification for that conduct will depend upon whether the interferor [B] has sought, bona fide, to protect an equal or superior right to that of the interferee."[124] The list of what constitutes an equal or superior right is not exhaustive, but it has been held that a mortgagee who lent new money to a borrower (a property developer), and who required the borrower to dismiss his architect, had an equal or superior right to the architect; there being no difference between the mortgagee enforcing its

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[123] Per Buckley L.J. in Smithies v. National Association of Operative Plasterers [1909] 1 K.B. 310, at p.337.

[124] Per Lee J. in Griffiths v. Commonwealth Bank of Australia (1994) 123 A.L.R. 111, at p.119, lines 37-41 (Federal Court of Aust.). See also Read v. Friendly Society of Operative Stonemasons of England, Ireland and Wales [1902] 2 K.B. 732; and Smithies v. National Association of Operative Plasterers [1909] 1 K.B. 310, on this point. And see too: Dellabarca v. Northern Storeman and Packers Union [1989] 2 N.Z.L.R. 734, at p.753, per Smellie J.

security and entering into an arrangement with the borrower[125]; here, a real right prevailed over a personal right[126]. But a bank was not justified in refusing to issue a draft requested by a customer, when the bank knew this would prevent the customer performing a contract with a third party, because the bank wished to apply these funds to reduce the customer's indebtedness[127]; thus, there was no equal or superior right - the bank was merely acting in its own interests. And where a bank released a security deposit to a customer, who had a loan, when requested, without first exercising its (the bank's) rights of contractual set-off, the bank was not justified in requesting another bank of the customer, in a different country, with whom the sum had been deposited, to repay an equivalent sum to the first bank against an indemnity (which the overseas bank did); it being held there was no equal or superior right - a claim in unjustified enrichment was rejected, as the

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125 Edwin Hill & Partners v. First National Finance Corporation plc [1989] 1 W.L.R. 225 (C.A.). See the commentary on this case by O'Dair, R., "Justifying an Interference with Contractual Rights" (1991) 11 O.J.L.S. 227.

126 The secured property was not subject to the architect's contract, as the architects were not licensees: see O'Dair, supra, at p.233. Cf. De Mattos v. Gibson (1858) 4 De G. & J. 276.

127 Thermo King Corporation v. Provincial Bank of Canada (1981) 130 D.L.R. (3d.) 256.

customer was legally entitled to the money; the problem was the bank's failure to exercise its rights of contractual set-off.[128]

In the last case, the trial judge said that one test of the right the bank (as the interfering party) was seeking to promote was whether the right was capable of supporting an injunction to restrain the other party from exercising their contractual rights, which had been the subject of the interference.[129] In that case, it did not.

De Mattos v. Gibson Principle Under English Law

A similar principle to the delict/tort of interference with a contract arises, in equity, under English law.[130] In De Mattos v. Gibson[131], Knight Bruce L.J. outlined the following rule, concerning use of personal property (i.e., a chattel) by a third party:

> "Reason and justice seem to prescribe that, at least as a general rule, where a man, by gift or purchase, acquires property from another, with knowledge of a previous contract, lawfully and for valuable

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[128] Griffiths v. Commonwealth Bank of Australia (1994) 123 A.L.R. 111. See Lord Penrose in Mercedes Benz Finance Ltd. v. Clydesdale Bank Plc 1996 S.C.L.R. 1005, at p.1014D-E. A claim for equitable set-off, in the Griffiths case, was rejected, as the bank's right was in the nature of a cross-claim and not a defence to the customer's claim.

[129] (1994) 123 A.L.R. 111, at p.119, lines 42-44, per Lee J.

[130] See Browne-Wilkinson J. (as he then was) in Swiss Bank Corpn. v. Lloyd's Bank Ltd. [1979] 1 Ch. 548, at p.575C-D.

[131] (1858) 4 De G. & J. 276, at p.282.

consideration made by him with a third person, to use and employ the property for a particular purpose in a specified manner, the acquirer shall not to the material damage of the third person, in opposition to the contract and inconsistently with it, use and employ the property in a manner not allowable to the giver or seller."

Thus, the new owner takes the property subject to the contractual interest of the third party, but that contractual interest must relate to a specific asset[132]. The principle has been applied to grant injunctive relief to prevent the mortgagee of a ship, whose interest was acquired with knowledge of a previously existing charter party of the ship in favour of a third party, from exercising his (the mortgagee's) rights in security.[133]

It was also applied by Browne-Wilkinson J. (as he then was) in Swiss Bank Corpn. v. Lloyds Bank Ltd.[134] In that case, SBC made a loan in

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[132] Mac-Jordan Construction Ltd. v. Brookmount Erostin Ltd. (in receivership) [1992] B.C.L.C. 350, at p.357e-g, per Scott L.J. (as he then was); Farquharson and Parker L.J.J., agreeing.

[133] De Mattos v. Gibson (1858) 4 De G. & J. 276. See also Lord Strathcona Steamship Co. Ltd. v. Dominion Coal Co Ltd.; The Strathcona [1926] A.C. 108 (P.C.), and The Myrto [1977] 2 Lloyd's Rep. 243. Cf. Port Line Ltd. v. Benline Steamers Ltd. [1958] 2 Q.B. 146.

[134] [1979] 1 Ch. 548. The decision was over-turned on another point by the Court of Appeal and the House of Lords: see [1982] A.C. 584. Cf. Mac-Jordan Construction Ltd. v. Brookmount Erostin Ltd. (in receivership) [1992] B.C.L.C. 350 (C.A.), where Scott L.J. (who was the unsuccessful Senior Counsel in the

Swiss Francs to IFT, to allow IFT to acquire shares in a new Israeli bank ("FIBI"). As exchange controls were still in force, consents were needed from the Bank of England. Compliance with these consents was made a condition of the loan. One such consent was that the loan was to be used to purchase FIBI securities. These were to be held in a separate account by an authorised depository. Interest on the loan and its repayment were to be paid from these securities or the proceeds of their sale. Subsequently, the group of which IFT was a member suffered financial difficulties, and were granted a £27.5 million line of credit by Lloyds Bank. As security for this loan, Lloyd's Bank took an equitable charge, amongst other things, over the FIBI shares. This was done without Bank of England consent, as Lloyds Bank did not have actual notice of the Bank of England consents, at the time. Later, Lloyds Bank obtained actual knowledge of SBC's claims. Lloyds then sold, or agreed to the selling of, the FIBI shares, without SBC's consent, for U.S. $1.937 million; these proceeds of sale were converted into approximately £821,000. SBC claimed, amongst other things: (i) that Lloyds Bank took its charge with notice of the loan contract between SBC and IFT, which required that the FIBI securities be used to service and repay the loan by SBC to IFT, and consequently, Lloyds Bank could be restrained from acting in a way that would cause a breach of the SBC loan with IFT; and (ii) damages from Lloyds Bank for wrongfully interfering with the SBC

Swiss Bank case) distinguished the judgement of Browne-Wilkinson J. (as he then was), in the Swiss Bank case, on the basis that, in the former case, there was no specific asset to which the allegedly infringed contractual right could relate: see at p.357e-g; Parker and Farquharson L.JJ. agreeing.

loan by selling the U.S. dollar proceeds of the sale of the FIBI shares, rather than applying the proceeds in repayment of the SBC loan.

It was held by Browne-Wilkinson J. that:

(i) as Lloyds Bank did not have actual notice of the SBC loan - only constructive notice, which was not sufficient to found liability for interfering with contractual rights - Lloyds Bank was "entitled to rely on its rights under the charge as justification . . . for applying the proceeds of the FIBI securities in paying its own secured debt"[135]. In any event, it was too late to restrain Lloyd's Bank; and

(ii) De Mattos v. Gibson was a binding authority, which said "that a person taking a charge on property which he knows to be subject to a contractual obligation can be restrained from exercising his rights under the charge in such a way as to interfere with the performance of that contractual obligation".[136] That case is "the equitable counterpart of the tort" of interference with contractual rights,[137] and as actual knowledge of the contract is the requirement for the tort, it is the same for the equitable equivalent.[138]

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135 [1979] 1 Ch. 548, at p.572D-E.

136 At p.573B-C.

137 At pp.573C and 575C-D.

138 At p.575D-E.

Remedies For Interference With Contract

(a) Damages

Where the elements of the delict/tort have been established, the damages recoverable are the same as for unlawful interference with business and conspiracy - being damages at large, i.e., the damages "are not limited to a precise calculation of the amount of the loss actually proved"[139]. But the measure of damages in interference with contract cases is not always the amount which the victim "might have recovered for breach of contract", although, in many cases, "the plaintiff can be compensated properly by giving him the amount he might have recovered from the contract breaker".[140]

(b) Interdict/Injunction

If the party whose contractual rights are to be infringed knows of a potential infringement before it is due to happen, and can act quickly enough, it may be possible to protect itself with an interdict or injunction: prevention being better than a subsequent damages claim.

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[139] Per Dillon, L.J. in Lonrho plc v. Fayed (No. 5) [1994] 1 All E.R. 188, at p.193j; see also Brooking J. in Ansett Transport Industries (Operations) Pty Ltd. v. Australian Federation of Air Pilots (No. 2) [1991] 2 V.R. 636, at p.645, and the cases cited there, who said that where damages were at large, it meant that no proof of special damage was required.

[140] Ansett Transport Industries Operations Pty. Ltd. v. Australian Federation of Air Pilots (No. 2), supra, at p.646, per Brooking J.

Inducing a Breach of a Negative Pledge Clause

The Negative Pledge

The negative pledge clause is a well-known provision in a loan agreement or a floating charge/debenture. It is designed to protect the priority of a lender's loan (or security) against subsequent security of other lenders. The clause is very common in unsecured international lending, but is also present in domestic secured lending[141], and may take several forms. A common form seeks to prohibit the borrower from creating or permitting to subsist or extending "any mortgage, debenture, charge, pledge, lien or any other encumbrance or security whatsoever over any part of [its] present or future undertaking, property assets or revenues".[142] The negative pledge may also contain a requirement that if any security is granted by the borrower to a subsequent lender, then the borrower must grant security ranking equally and rateably

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[141] For a fuller discussion of the negative pledge: see Allan, D.E., Negative Pledge Lending - Dead or Alive? How to Re-invent the Mortgage" [1990] J.I.B.L. 330; Goode, R.M., Legal Problems of Credit and Security (1988) 2nd edn., at pp.17-23, and 85-86; Goode, R.M., Commercial Law (1995) 2nd edn., at pp.661-662; Hobbs, T., "The Negative Pledge: A Brief Guide" [1993] J.I.B.L. 269; Penn, Shea and Arora, The Law and Practice of International Banking (1987), at paras.6.36-6.45, on pp.110-116; and Wood, P.R., International Loans, Bonds and Securities Regulation (1995), at paras.3-10-3-28, on pp.34-41.

[142] See Lingard, J.R., Commercial Loan Agreements (1991), Appendix 2, "Specimen Facility Letter", Clause 10.01(a)(i), on p.114.

with it to the first lender.[143] Inaddition, there may be a "further assurance clause" in a secured loan, under which the borrower agrees to grant such further security and execute such further documents as the lender reasonably requires.

The negative pledge does not, by itself, create security - it merely provides a contractual right, which a lender can seek to enforce.[144] If a lender knows that a breach is about to occur, it may seek an interdict/injunction; otherwise, it will have a remedy of damages for breach of contact. Breach of a negative pledge clause is also an event of default under a loan agreement, which allows the loan to be accelerated; or, if the negative pledge is contained in a floating charge or debenture, it will allow a receiver of the borrower to be appointed, if breached. The problem with the negative pledge clause is that if it is breached by a borrower which is insolvent, the personal right against that borrower will be worth very little to the

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143 See Penn, Shea and Arora, The Law and Practice of International Banking (1987), at paras.6.37-6.38, on pp.110-111 who, amongst other things, point out that "it will be difficult to prescribe what is equal and rateable security", in a practical sense: see para.6.38, on p.111, fn.32; Wood, P. International Loans, Bonds and Securities Regulation (1995), at paras.3.18, on p.36; and Goode, R.M., Legal Problems of Credit and Security (1988) 2nd edn., at pp.19-20.

144 A similar view is taken by Goode, R.M., Legal Problems of Credit and Security (1988) 2nd edn., at p.19.

lender.[145] But if the breach of the negative pledge has been caused by a third party (such as another lender, which has the financial strength), then there may be a claim for interfering with contractual relations against that third party.

Affirmative Negative Pledge

In the United States, a form of negative pledge, called an "affirmative negative pledge", in which there is an automatic creation of security if the clause is breached, has become more popular.[146]

This form of negative pledge is unlikely to create valid equitable security, in England, for four reasons. First, the security is contingent on a future event which is uncertain.[147] Secondly, no new money is advanced in consideration of the security i.e., no value is given. For an agreement to take effect in equity, the

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[145] Hence, the comment of one Australian Court, in relation to negative pledges, that "recent experiences have shown lenders that all the convenants in the world are no substitute for good old fashioned security": Bond Brewing Pty Ltd. v. National Australia Bank [1990] A.C.L.C. 330 (Full Court of Victorian Supreme Court).

[146] See Stone, J., "The 'Affirmative' Negative Pledge" [1991] J.I.BL. 364; Wood P., International Loans, Bonds and Securities (1995), at paras.3-24-3-26, on pp.39-41.

[147] Goode, R.M., Legal Problems of Credit and Security (1988) 2nd edn., at p.20; and Penn, Shea and Arora, The Law and Practice of International Banking (1987), at para.6.41, on p.113.

consideration must be executed by advancing the money at or after (and in consideration of) the security.[148] Thirdly, there will be a problem of intention to create security.[149] Fourthly, the main problem, it is suggested, is one of identification of assets which the future security is to be taken over. A provision that the borrower is to give equal and rateable security on equivalent assets means that no specific assets have been identified.[150]

As Scots law does not recognise equitable interests in property[151], and requires identification of assets that security is being taken over, it would not be valid in Scotland.

Secured Lending

Floating Charges and Negative Pledge Clauses

(i) Scots Law

Under Scots law, a floating charge holder may include in his floating charge provisions which: (a) prohibit or restrict the creation of fixed or floating securities which either have priority over the floating charge, or which rank equally with the floating charge, or (b)

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[148] Goode, R.M., Legal Problems of Credit and Security (1988) 2nd edn., at p.20.

[149] Penn, Shea and Arora, The Law and Practice of International Banking (1987), at para.6.41, on p.113.

[150] Penn, Shea and Arora, Ibid; Wood, P., International Loans, Bonds and Securities Regulation (1995), para.3-24, on pp.39-40.

[151] Cf. Sharp v. Thomson 1997 S.C. 66 H.L.

regulate the ranking order of the floating charge in relation to existing or future floating charges or fixed security over the debtor's property.[152] If the floating charge does not contain these provisions, then a fixed security, even if later in time, will have priority over the floating charge, and any floating charges will rank according to their time of registration[153].

Therefore, if a floating charge prohibits the subsequent creation of fixed security "having priority over or ranking *pari passu* with the floating charge", and a floating charge and a standard security are executed for different lenders on the same day, this provision regulates the ranking of the two securities. As a floating charge is created when executed, and a standard security is created when it is recorded, the latter is created subsequent to the floating charge, which has priority.[154]

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[152] S.464(1) of the Companies Act 1985 (as amended) ("CA'85"). "Creation" in this section has the same meaning as in s.410 of the C.A.'85: see Allied Irish Bank Finance Ltd. v. Bank of Scotland 1995 S.L.T. 2, 1993 S.C.L.R. 85 (I.H.).

[153] Ss.464(3) and (4) of the C.A.'85. Unlike England, the floating charge is a statutory creation in Scotland, and so needs a statutory ranking (and negative pledge) clause.

[154] Allied Irish Bank Finance Ltd. v. Bank of Scotland 1995 S.L.T. 2, 1993 S.C.L.R. 85 (I.H.).

(ii) English Law

Under English law (which is not subject to the same statutory regime as Scots law[155]), a debenture holder may also insert a provision in a floating charge which prohibits the creation of subsequent security, with the consequence that a subsequent encumbrancer, having actual notice of this restriction, takes subject to the floating charge, which retains priority over the subsequent security.[156] The rationale for this is that, as a floating charge is not a mere contractual right, but an existing security (although it has yet to attach to the debtor's assets), the prohibition in the charge is an equity that binds those having notice of it.[157]

(iii) Details of Negative Pledges On Company Charges Register

The details of the negative pledge, as a matter of practice, will be included in the particulars of the floating charge in Form 410 (Scotland) and debenture in Form 395 (England and Wales). These particulars are placed on the companies charges register, when the floating charge/debenture is registered, so that notice of the

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155 The floating charge is a creature of equity (and now, to a limited extent, statute).

156 See Lord Esher M.R. in English & Scottish Mercantile Investment Co. Ltd. v. Brunton [1892] 2 Q.B. 700, at p.707 - in that case, it was held that constructive notice was not sufficient; and Cox v. Dublin City Distillery Co. [1906] 1 I.R. 446.

157 Goode, R.M., Legal Problems of Credit and Security (1988) 2nd edn., at p.85, and Goode, R.M., Commercial Law (1995) 2nd edn., at p.661.

negative pledge's existence is provided to any potential subsequent encumbrancer[158].

(iv) Result Of A Breach Of The Negative Pledge In A Floating Charge

The result of these restrictive provisions in floating charges, under both Scots law and English law, is that, even if a subsequent lender's actions interfere with the first lender's contractual rights *vis a vis* the negative pledge, the first lender's security will not lose its priority, and so the first lender will only be able to recover nominal damages from the second lender.

Unsecured Lending

A greater difficulty arises where the lending is unsecured.[159] For example, if lender A has a negative pledge clause in its loan agreement with a borrower (the loan being unsecured), but the borrower subsequently requires further finance from another lender (lender B), who requires the borrower to execute fixed and floating security, in breach of lender A's negative pledge clause, lender A has a problem if the borrower becomes insolvent, even if there is a *pari passu* provision (which is only a personal right). Although the borrower is in breach of its contract with lender A,

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158 This knowledge is constructive. But a lender will normally have solicitors acting for him who will, as a matter of course, conduct a search of the Companies' Charges Register, and will be very familiar with the negative pledge clause (as will the lender).

159 Such lending is common in international loans, but unsecured lending does occur in the domestic market too.

and lender B has procured this, lender B's security is still valid, and it will take priority over lender A's unsecured claim in a liquidation. Lender A may try to recover its loss from lender B. This loss will be the difference between: (i) the amount lender A would have recovered in the borrower's insolvency if the negative pledge had not been breached, and (ii) the amount it did recover.[160]

Two problems will arise for lender A in suing lender B for interfering with its contractual rights under the negative pledge: proving knowledge and intention.

Knowledge

With an unsecured loan, a lender cannot do a search of the charges register to see if there is a negative pledge. Instead, it will rely upon information from the borrower. So, if a borrower does not inform lender B of other loans and negative pledge clauses, that lender has no actual knowledge, and is unlikely to be liable to lender A (who has a negative pledge) for interference with contract. Whilst the borrower's conduct in deliberately not telling lender B of the negative pledge clause will be a breach of lender B's loan agreement, allowing the loan to be accelerated, this will not assist lender A.

Assuming the borrower is truthful about its financial affairs, lender B will have knowledge of the earlier negative pledge clause (or, based on experience, will be aware that it is very likely that any

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160 See Stone, J.B., "Negative Pledges and the Tort of Interference With Contractual Relations" [1991] J.I.B.L. 310, at p.319.

previous loan agreements will contain such a clause, and so will make enquiries).

As previously stated, the courts require actual knowledge, although they have not interpreted this requirement rigidly.

Intention

The second problem for lender A in bringing an action for inducing breach of contract, is that lender B will argue that, by inducing the breach of the negative pledge clause, it was not intending to harm lender A, but was merely attempting to buttress its own position.[161] Unlike conspiracy, and as with interference with a business, it is suggested that the intention to harm lender A does not have to be the predominant motive in breaching the negative pledge clause, a secondary intention is sufficient. This is a question of proof, which, except in the most obvious case, may be difficult. Under English law, where it can be shown that lender B was indifferent to the consequences of its actions, an intention may be inferred[162]; this will require proof, most probably in the witness box.

It is suggested, though, that in these circumstances, a court is going to be more sympathetic to lender A, and, in England, it will find that the action of lender B was indifferent. Where lender B has knowledge of lender A's negative pledge, lender B's causing that

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[161] See Stone, J.B., "Negative Pledges and the Tort of Interference with Contractual Relations" [1991] J.I.B.L. 310, at pp.314-315.

[162] See Emerald Construction Co. Ltd. v. Lowthian [1966] 1 W.L.R. 691, at p.701, per Lord Denning M.R., and, at p.704, per Diplock L.J. (as he then was).

negative pledge to be breached indicates that lender B intended the result that occurred, i.e., harm to lender A.[163]

Under Scots law, lender B would have to show that any "recklessness or turning a blind eye" was "tantamount to enable the court to conclude that such actings were in effect intentional".[164]

The Position in Practice

In practice, the negative pledge works because the parties to loan transactions will take legal advice, and their lawyers will do the necessary searches (if it is a secured loan) and make enquiries, and will seek consents from prior negative pledge holders to the creation of subsequent, or new, security. These lawyers will wish to act within the law, and see that contractual provisions are honoured,[165] i.e., it is their job to ensure that their clients act lawfully, and they not want to expose their clients to a possible action for interfering with contractual rights (with the result that they would be sued for professional negligence by their clients).

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163 Stone, J.B., "Negative Pledges and the Tort of Interference with Contractual Relations" [1991] J.I.B.L. 310, at p.315.

164 See Lord Mayfield in Rossleigh Ltd. v. Leader Cars Ltd. 1987 S.L.T. 355, at p.360H-I.

165 See also Wood, P.R., International Loans, Bonds and Securities (1995), para.3-22, on p.38.

(4) UNLAWFUL INTERFERENCE WITH A TRADE OR BUSINESS

This is a comparatively new delict/tort, whose existence is recognised under British law[166], but whose ambit remains uncertain, as it is still developing.[167] In contrast, in the United States, the delict/tort is well recognised.[168]

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166 See J.T. Stratford & Son Ltd. v. Lindley [1965] A.C. 269, at p.324, per Lord Reid, and, at p.328, per Viscount Radcliffe; Merkur Island Shipping Corporation v. Laughton; The Hoegh Apapa [1983] 2 A.C. 570, at p.609G-H; and Lonrho plc v. Fayed [1990] 2 Q.B. 479 (C.A.). For a discussion of this delict/tort: see Bentil, J.K., "Improper Interference With Another's Business" [1993] J.B.L. 519.

167 See Dillon L.J. in Lonrho Plc v. Fayed [1990] 2 Q.B. 479, at p.489, who referred to the delict/tort as being "recognised, but the detailed limits of it have to be refined"; Ralph Gibson L.J. (at p.492), spoke of it as "a comparatively new tort of which the precise boundaries must be established from case to case"; and Woolf L.J. (as he then was) (at p.493), who said: "The tort is still of uncertain ambit, albeit that its existence is now beyond doubt and certain of its features are clearly defined."

168 See, for example, State National Bank of El Paso v. Farah Manufacturing Co. Inc. 678 S.W. 2d. 661 (Court of Appeals of Texas), decided in 1984, and the cases referred to in the judgement, at paras.[20]-[22], on pp.688-669, per Schulte J.; see also Norton, J., "Lender Liability in the United States: A Decade in Perspective" : Ch. 12 in Banks, Liability and Risk (1995) 2nd edn., at p.349.

The basis of the delict/tort of interference with a business - which has similarities with conspiracy[169] - is that the trade or business of another has been interfered with "by the doing of unlawful acts"[170]. In this context, trade or business appears to mean economic interests.[171] Three elements of the delict/tort have recently been elucidated, which point up differences with conspiracy:

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169 In Lonrho Plc v. Fayed [1992] 1 A.C. 448, at p.471, Lord Templeman (with whom Lords Brandon of Oakbrook, Goff of Chieveley and Jauncey of Tullichettle expressed agreement), said, "the ambit and ingredients of the torts of conspiracy and unlawful interference might . . . require further analysis and reconsideration by the courts". In that case, the issue of conspiracy (and the question of predominant motive), had been reserved in the Court of Appeal (Lonrho Plc v. Fayed [1990] 2 Q.B. 479) for consideration by the House of Lords, together with an appeal against the decision of the Court of Appeal on interference with a business. In the House of Lords, only the issue of conspiracy was considered, and Lord Bridge of Harwich, who delivered the leading speech (with which Lords Brandon of Oakbrook, Templeman, Goff of Chieveley and Jauncey of Tullichettle agreed) said that the issues of conspiracy and unlawful interference with business stood or fell together: see Lonrho Plc v. Fayed [1992] 1 A.C. 448, at p.470. It is to be regretted that the final appellate court did not deal with the second issue of interference with business.

170 Per Lord Diplock in Merkur Island Shipping Corpn. v. Laughton; The Hoegh Apapa [1983] 2 A.C. 570, at p.609H.

171 Fleming, J.G., The Law of Torts (1992) 8th edn., at p.703.

(i) a predominant purpose to injure the victim is not required where the delictual/tortious act relied on is injury by wrongful interference with a third party's contract, or there is intimidation, or the "wrongful interference has been by the practice of fraud on a third party, aimed specifically at the plaintiff"[172], i.e., these acts were done to injure.

(ii) the delict/tort does not have to be complete, in the sense that it is a requirement that the victim has suffered damage;[173]

(iii) the unlawful act has to be directed against the victim, or be intended to harm him.[174]

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172 Per Dillon L.J. in Lonrho Plc v. Fayed [1990] 2 Q.B. 479, at pp.488G-489F; Ralph Gibson and Woolf L.JJ., agreeing, at pp.492A and 494D-E, respectively. This is similar to the second category of conspiracy, where unlawful means are used: see Lonrho plc v. Fayed [1992] 1 A.C. 448 (H.L.(E.).

173 Per Dillon L.J. in Lonrho Plc v. Fayed [1990] 2 Q.B. 479, at p.489A-B; Ralph Gibson and Woolf L.JJ., agreeing, at pp.492C and 493, respectively. This is different from conspiracy: see Crofter Hand Woven Harris Tweed Co. Ltd. v. Veitch 1942 S.C. (H.L.) 1, [1942] A.C. 435 (H.L.(Sc.)).

174 Per Dillon L.J. in Lonrho Plc v. Fayed [1990] 2 Q.B. 479, at p.489D-E; Ralph Gibson and Woolf L.JJ., agreeing, at pp.491 and 493, respectively. In the United States, by comparison, the elements of the tort are:

(i) a valid business relationship, or the expectation of entering into such a relationship;

(ii) knowledge by the defendant of such a relationship or expectation;

What are "Unlawful Means"?

It is not clear what would be included in the term, "unlawful means". The case law indicates that intimidation[175], interfering with a contract[176], and making fraudulent statements about a rival[177] are included. Fleming is of the view that this term would

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(iii) an intentional interference by the defendant, so that the relationship is terminated, or the expectation is prevented from coming to fruition; and
(iv) damage to the victim because of the interference.

See Norton, J., "Lender Liability in the United States: A Decade in Perspective" : Ch. 12 in Banks, Liability and Risk (1995) 2nd edn., at p.349. Cf. State National Bank of El Paso v. Farah Manufacturing Co. Inc. 678 S.W. 2d. 661, at paras.[20]-[22], on p.688, where Schulte J. observed that interference with a business is only actionable when it is "motivated by malice and no useful purpose of the inducing party is subserved". Malice, in this situation, means "an unlawful act, done intentionally without just cause or excuse." The judgement also goes on to refer to the perpetrator having "knowledge of the plaintiff's interests or, at least, of facts that would lead a reasonable man to believe in their existence": see at para.[24], on p.689.

175 Rookes v. Barnard [1964] A.C. 1129 (H.L.(E.).

176 Lord Diplock in Merkur Island Shipping Corpn. v. Laughton; The Hoegh Apapa [1983] 2 A.C. 570, at p.609H, who indicated that the delict/tort, may be more than this.

177 Lonrho Plc v. Fayed [1990] 2 Q.B. 479 (C.A.).

include all common law crimes and all delicts/torts.[178] Difficulty arises with statutory offences as to whether they allow a civil claim for damages. The general view is that they do not, unless it is clear, as a matter of construction, that a class of persons is to be protected, or the statute provides a public right.[179] In Lonrho Plc v. Fayed[180], Dillon L.J. suggested that breaching a statutory prohibition might not be enough - the victim would have to establish that breach of the statute permitted a civil remedy to be sought.

In the United States, interference by a lender with corporate governance of a borrower by the false threat of using a change of management clause in a loan agreement to put a troubled borrower into insolvency, which allowed the lender to veto or make appointment to the board of the borrower[181], has been held to be an unlawful interference. Also, damaging or destroying the property of a business has been held, in the United States, to

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178 Fleming, J.G., The Law of Torts (1992) 8th edn., at p.699. See the discussion by Carty, H., "Intentional Violation of Economic Interests: The Limits of Common Law Liability" (1988) 104 L.Q.R. 250, at pp.265-273, and 279-280.

179 Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2) [1982] A.C. 173 (H.L.(E.).

180 [1990] 2 Q.B. 479, at p.488F.

181 See State National Bank of El Paso v. Farah Manufacturing Co. Inc. 678 S.W. 2d. 661. Under British law, these circumstances could give rise to liability for wrongful trading, as a shadow director, under ss.214 and 251 of the Insolvency Act 1986.

amount to interference with a business.[182] For example, the deliberate destruction of an important asset or piece of machinery could easily have a damaging financial impact on a business.

Boundaries of the Delict/Tort

When seeking to establish the boundaries of this delict/tort, the following factors (which are not exhaustive) need to be kept in mind:[183]

(i) the nature of the intention needed to fulfil the requirement that the conduct be directed against the victim. For example, if A makes a fraudulent misrepresentation about himself to B, in order to cause B to act in a way in which "A obtains or maintains a commercial advantage over C, or deprives C of a commercial advantage"[184]; then, if the fraud is about the merits of A, rather than the

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182 State National Bank of El Paso v. Farah Manufacturing Co. Inc. 678 S.W. 2d. 661, at para.[24], on p.689, per Schulte J., referring to Tippett v. Hart 497 S.W. 2d. 606 (Tex. Civ. App. - Amarillo).

183 Per Ralph Gibson L.J. in Lonrho plc v. Fayed [1990] Q.B. 479, at p.492D-G.

184 If the fraud had been about the deficiencies of C, rather than the virtues of A, the position would be clearer: see Ralph Gibson L.J. in Lonrho plc v. Fayed, supra, at p.492E-F; Bentil, supra, at p.531; and Hood, P., "Lender Liability Under English Law" : Ch. 2 in Banks, Liability and Risk (1995) 2nd edn., at p.62.

deficiencies of C, it is suggested that this may not be direct enough.[185]

(ii) the nature of the business interest, which the victim has to show he has suffered damage in respect of.[186]

(iii) whether a "sufficient nexus or directness of impact and consequence" exists "between the unlawful means employed and the alleged damage causing effect upon the" victim, i.e., a causal link[187]; and

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185 See Woolf L.J. (as he then was) in Lonrho Plc. v. Fayed [1990] 2 Q.B. 479, at p.493E-G.

186 See Woolf L.J. (as he then was), in the same case, at p.493G-H, who raised a similar point, and doubted whether an opportunity to bid for a company was a business asset. It is suggested it is not, as there is no certainty about obtaining the company by the bid - it is different if the bid is successful; nor is there necessarily any exclusivity about bidding for a company, as there can be competing bids - this makes it different from an option to purchase shares, which is an asset, as there there is certainty, if you exercise the option. There is no personal or real right in having an opportunity to bid - it is a loss of a chance.

187 Per Ralph Gibson L.J., at p.492E-F. A similar point is made by Dillon L.J., concerning the need for causation, supra, at p.489. See also Woolf L.J., supra, at p.493E-G.

(iv) whether there is sufficient damage for there to be a cause of action.[188]

Conclusion

In the absence of fraud, or vindictive personal animosity, a bank is unlikely to be found liable for unlawfully interfering with the business of a borrower, as to engage in such conduct would be counter-productive - the lender will want the business of a customer to flourish, as this will be a source of profit for the bank.[189] If a lender acts prudently, and in accordance with its loan and security documentation, there is little chance of an action based on this delict/tort being brought or succeeding.[190]

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188 Per Ralph Gibson L.J., supra, at p.492F-G.

189 Hood P., "Lender Liability under English Law": Ch. 2 in Bank's Liability and Risk (1995) 2nd edn., at p.62.

190 Ibid.