ESTOPPEL IN THE LAW OF BANKING AND NEGOTIABLE INSTRUMENTS

The area covered by the subject of 'estoppel in the law of banking and negotiable instruments' is a wide and diverse one. In this paper the discussion will be confined to two areas:

(i) forgery of drawer's signature; and
(ii) payment made under a mistake of fact.

(i) Forgery of Drawer's Signature

Section 24 of the Bills of Exchange Act 1949[1] provides:

> "Subject to the provisions of this Act, where a signature on a bill is forged or placed thereon without the authority of the person whose signature it purports to be, the forged or unauthorized signature is wholly inoperative, and no right to retain the bill or to give a discharge therefore or to enforce payment thereof against any party thereto can be acquired through or under that signature, *unless the party against whom it is sought to retain or enforce payment of the bill is precluded from setting up the forgery or want of authority.*[2]
>
> Provided that nothing in this section shall affect the ratification of an unauthorized signature not amounting to a forgery."

Section 24 of BEA renders a forged or unauthorized signature (subject to the provisions of the Act) wholly inoperative. Thus a banker who

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[1]Act 204. Hereinafter referred to as 'BEA'.

[2]Emphasis added.

pays on such a forged instrument is unable to debit the customer's account with the amount of the forged cheque.[3] The rationale underlying the liability is the absence of the customer's mandate on the forged cheque.[4] However, the banker is afforded a defence if the circumstances are such as to raise an estoppel.

Estoppel arises where a person either by his words or conduct induces another person to a course of action and that other person, in reliance on the words or conduct suffers some detriment. The person is estopped, that is, precluded from making any claim that is inconsistent with what he has said or done.

In the context of the forgery of the drawer's signature, estoppel may arise by representation or by negligence.

Estoppel by Representation

The essential features of estoppel by representation were enunciated by Lord Tomlin in the House of Lords decision of *Greenwood v Martins Bank Ltd.*[5] These are:

(i) a representation[6] or conduct amounting to a representation intended to induce a course of conduct on the part of the person to whom the representation is made;
(ii) an act or omission resulting from the representation, whether actual or by conduct, by the person to whom the representation is made; and
(iii) detriment[7] to such person as a consequence of the act or omission.

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[3]*Re Indian Overseas Bank Ltd., American International Assn. Co. Ltd. v Ho Chooi Soon* [1962] M.L.J. 134.

[4]*London Joint Stock Bank v Macmillan and Arthur* [1918] A.C. 777.

[5][1933] A.C. 51.

[6]In *Greenwood v Martins Bank Ltd* (*ibid*), Lord Tomlin stated, "Mere silence cannot amount to a representation, but when there is a duty to disclose deliberate silence may become significant and amount to a representation", at page 57.

[7]The detriment suffered may be a material loss or prejudice to the representee.

In that case the drawer was aware that his wife had forged his signature on several cheques but failed to inform the bank promptly of his wife's forgeries. On his wife's death, he subsequently brought an action against the bank for wrongfully debiting his account with the forged cheques. The House of Lords dismissed the action. It was held that a customer is under a duty to inform the bank of forgeries and a deliberate failure to do so amounted to a representation that the cheques were genuine and so deprived the bank of the opportunity to sue his wife before her death.[8]

In *Brown v Westminster Bank Ltd*,[9] the plaintiffs' signature had been forged on a number of cheques that had been stolen from her. When the branch manager drew her attention to a number of these cheques, she represented them to be genuine. Thus she was estopped from setting up the forgeries.

In *Tina Motors Pty Ltd v Australia & New Zealand Banking Group Ltdi*,[10] the bank had relied upon the oral representations made by the director of the plaintiff company that the signature on any cheques presented by an employee was in order. The cheques were in fact forgeries. An action by the plaintiff company for a declaration that the bank had improperly debited its account failed. The banker had successfully relied on estoppel.

In such cases of forgeries, detriment to the representee is constituted by the loss of opportunity to sue the forger because of his death[11] or by the banks paying out money to the forger.[12]

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[8]As the law then stood (prior to the Law Reform (Married Women and Tortfeasors) Act 1935, section 3) a husband is liable for his wife's torts. Thus even if he had informed the bank promptly of his wife forgeries, he would still have been liable for her tort.

[9][1964] 2 Lloyds' Rep. 187.

[10][1977] VR 205.

[11]*Greenwood v Martins Bank, supra*, note 6

[12]*Tina Motors Pty Ltd, supra*, note 10.

Estoppel by Negligence

A banker who pays on a forged instrument may escape liability if the negligence of the customer in drawing the cheque facilitated the fraud or forgery.

In *London Joint Stock Bank Ltd. v Macmillan*,[13] a clerk prepared a cheque for £2 payable to bearer. The space for the sum in words was left blank. The employer signed the cheque. Thereafter the clerk altered the figure to £120 and inserted the words 'one hundred and twenty pounds' in the space provided. The House of Lords held that a duty of care is owed by the customer to his banker to take reasonable care in the drawing of cheques so as not to facilitate fraud or forgery. If in breach of the duty, he negligently draws the cheque that enables a third party to commit fraud or forgery, the banker is entitled to debit the customer's account with the amount paid out.[14]

In determining the conduct that would amount to negligence, Lord Finlay in *McMillan*'s case said:[15]

> "... the negligence must be in the transaction itself, that is, in the manner in which the cheque is drawn".[16]

Negligence which is not connected with the actual drawing of a cheque does not usually afford a defence to a bank who has wrongfully honoured a cheque.[17] Thus it appears that a customer who loses his cheque book or fails to keep it locked up with the result that it is stolen by a stranger or employee who forges the customer's signature, is not estopped from setting up the forgery. Cases abound with examples of

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[13][1918] A.C. 777.

[14]Although the principle in *McMillan*'s case was followed by the local court in the case of *Barbour (E.A.) v The Ho Hong Bank Ltd* [1929] S.S.L.R. 116 the judgement in the case raises the interesting point that what may be considered to "facilitate fraud" in the drawing of the cheque may differ. As a finding of fact two of the judges held against the customer but the dissenting judge found that the spaces left were barely sufficient to enable fraudulent alteration.

[15][1929] S.S.L.R. 116.

[16]*Supra*, note 11, at page 795.

[17]*Tai Hing Cotton Mill Ltd. V Liu Chong Hing Bank Ltd.* [1998] A.C. 80.

customers who neglected to take sufficient care, resulting in substantial losses which had to be shouldered by banks.

In the well-known Privy Council division of *Tai Hing Cotton Mills Ltd v Liu Chong Hing*,[18] an accounts clerk of a textile company forged the signature of the company's managing director on some 300 cheques totalling approximately HK$5.5 million. The forgeries extended over a period of three and a half years and were undiscovered because of inadequate internal control practiced by the customer.

The banks contended that the customer was precluded from setting up the forgeries by the breach of a 'wider duty' of care to take reasonable precautions to prevent the fraud. They also relied on a 'narrower duty' of the customer to check his bank statement and to verify or notify the bank of any discrepancies or inaccuracies within a prescribed period.

The Privy Council held that there was no 'wider duty' to take precautions beyond the duty to draw cheques carefully. Thus the customer has no further duty to take precautions in the general course of his business to prevent forgeries.

Malaysian decisions, as illustrated by the cases *of Syarikat Islamiyah v Bank Bumiputra Malaysia Bhd*[19] and *United Asian Bank Bhd v Tai Soon Heng Construction Sdn. Bhd.*[20] have recognised and applied the common law position.

Nevertheless it is noteworthy that the above decisions preceded section 73A of BEA which reads:

> "Notwithstanding section 24, where a signature on a cheque is forged or placed thereon without the authority of the person whose signature it purports to be, *and that person whose signature it purports to be knowingly or negligently contributes to the forgery or the making of the unauthorized*[21] signature, the signature shall operate and shall be deemed to be the signature of the person it purports to be in favour of any person who in good faith pays the cheque or takes the cheque for value."

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[18] *Ibid.*

[19] [1988] 3 MLJ 218.

[20] [1993] 1 MLJ 182 (Supreme Court).

[21] Emphasis added.

The following question that may be asked: what is meant by the words, 'knowingly or negligently contributes to the forgery'? Does it merely restate the common law position on estoppel in this matter, or does it go further than the common law?

In the absence of decided cases, it is arguable that section 73A may incorporate a 'wider' duty of care than that imposed by common law. The problem lies with defining what conduct may be construed as 'contributing to a forgery'. Would the imposition of this wider duty be too onerous on the customer (drawer) since he not only has take precautions to draw cheques carefully; he need also to take precautions in the custody of his cheque books as well as in the conduct of his business affairs.

(ii) Payment Made Under a Mistake of Fact

A banker having paid money by mistake may desire to rectify the error and recover the money paid. Common instances are when a banker pays on a countermanded or forged cheque or over credits a customer's account.

At common law, actions which are brought are usually termed actions to recover money paid under a mistake of fact or actions for money had and received.

The early view adopted by the courts was that this action is based on the equitable principle of unjust enrichment. In *Moses v Macfarland*[22] the court treated the defendant who had been unjustly enriched as being in the same position as if he had incurred a debt. Another principle that has been advanced is that the action is based on the doctrine of quasi-contract or an implied promise to repay.[23] The recovery of money paid under a mistake is subject to equitable principles, *inter alia*, the principles of estoppel.

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[22](1760) 2 Burr 1005.

[23]*Holt v Markham* [1923] 1 K.B. 504.

On a review of the cases, some of which are irreconcilable,[24] the following principles may be deduced. Money paid under a mistake is recoverable on the following conditions:[25]

(1) the mistake must be one of fact and not law;[26]
(2) the mistake must be fundamental, that is, instrumental in causing the payment; and[27]
(3) however, the recovery may be barred if the payee can prove -
    (a) that the payment was made voluntarily; or
    (b) estoppel.

To successfully raise the defence of estoppel, the defendant must prove the following:

(1) the plaintiff had made a representation to the defendant;
(2) the defendant had relied on the representation;
(3) the defendant had suffered a detriment or prejudice as a result of the reliance; and
(4) the defendant acted in good faith.

In *Holt v Markham*,[28] the defendant had mistakenly been paid more gratuity than he was entitled to because of the plaintiffs misconstruction of certain regulations. The defence raised was that the defendant had relied on the representation of the plaintiff to his detriment. In the case of *National Westminster Bank Ltd. v Barclays Bank*,[29] Kerr J. decided that payment on a forged cheque cannot be construed as a representation

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[24]Scrutton L.J. in *Holt v Markham* [1923] 1 K.B. 504, at page 513 said, "This is a troublesome instance of a particularly troublesome class of action. It is an action for money had and received to the plaintiffs' use, and is based upon the ground that the payment was made under a mistake of fact".

[25]Refer to *Barclays Bank Ltd v WJ Simms, Son & Cook Ltd* [1979] 3 All E.R. 522 for a comprehensive review of the law on this point by Robert Goff J.

[26]*Holt v Markham* [1923] 1 K.B. 504; *Kleiwort, Sons & Co. v Dunlop Rubber Co.* (1907) 97 L.T. 263.

[27]*Morgan v Ashcroft* [1938] 1 K.B. 49.

[28]*Supra*, note 8.

[29][1975] Q.B. 654.

of the genuineness of the cheque by the banker so as to give rise to estoppel by the defendant.

What constitutes 'detriment'? The decisions reveal varying interpretations. In some cases, the mere spending of money by the defendant has been held to be a detriment. This was successfully pleaded by the defendant in *Holt v Markham.*[30] Similarly in *Lloyds Bank v The Hon. Cecily Brooks,*[31] one of the issues raised was whether the defendant had spent more money than she would otherwise have spent, and if so had acted to her detriment. However in *United Overseas Bank v Jiwani,*[32] the defendant, Jiwani had used the money paid to him by mistake to purchase a hotel. The court allowed recovery of the amount, as the hotel was regarded as a 'continuing benefit' and no detriment was proven. In *Lipkin Gorman v Karpnale Ltd,*[33] the House of Lords emphasised that the mere fact that the payee had spent the money did not of itself involve a change in his position as 'the expenditure might have been incurred in the ordinary course of things'. Thus a change in the payee's position precludes recovery only if three conditions are fulfilled:

(1) the change must have been made in reliance on the payment of money in question;
(2) it must have been made in good faith; and
(3) it must have been a change to the payee's detriment.

In cases where payment had been made on a forged instrument, 'detriment' has been construed as the loss of the defendant's right to sue on the instrument because of his failure to give prompt notice of dishonour.[34]

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[30]*Supra*, note 8.

[31](1950) 6 Legal Decisions Affecting Bankers 161.

[32][1926] 1 W.L.R. 964.

[33][1991] 2 AC 548.

[34]See *Cocks v Masterman* (1829) 9 B & C 902; *London and River Plate Bank of Liverpool* (1896) 1 QB 7. Compare with the position in *Imperial Bank of Canada v Bank of Hamilton* [1903] A.C. 49 (Privy Council).

The defendant's good faith is also essential to establish the defence of estoppel. This was stressed by Justice McKenna in the case of *United Overseas Bank v Jiwani*[35] where the plaintiff bank had mistakenly over credited the defendants bank account by a deposit of $11,000.00. The bank was allowed recovery of the money over credited, *inter alia*, on the grounds that the plaintiff was aware of the bank's mistake.

Under the Malaysia law, actions for recovery of money paid by mistake is provided by section 73 of the Contracts Act 1950 which reads:

> "A person to whom money has been paid, or anything delivered, by mistake or under coercion, must repay or return it."

Unlike the common law position the above section does not distinguish between a mistake of fact and a mistake of law. This position has been reaffirmed by the Privy Council in *Sri Sri Shiba Prasad Singh, Deceased v Maharaja Srish Chandran Nandhi*[36] which considered section 72 of the Indian Contract Act which is in *pari materia* with the Malaysian section 73. Also, unlike the position at common law, voluntariness of the payment by the payer does not bar recovery.[37]

Nevertheless, the Malaysian and Indian courts have accepted that estoppel is an available defence to an action under section 73 of the Contracts Act. Thus the common law cases on this point are instructive.

Similarly, the good faith of the defendant is essential to a successful defence. In the case of *Bank Bumiputra (M) Bhd v Hashbudin bin Hashim*,[38] the plaintiff bank brought an action to recover money from the defendant that had been paid on a countermanded cheque. The plaintiff succeeded in recovering the money, *inter alia*, because the defendant had not acted in good faith when presenting the cheque for payment when he had been requested not to do so.

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[35][1977] 1 All E.R. 733, at page 739.

[36](1949-50) LR 244.

[37]*Sales Tax Officer Banaras v Kan Hai Ya Lal Makund Lal Sarat* AIR 1959 SC 135.

[38][1998] 3 MLJ 262.

The Malaysian position is also similar to the common law one in that negligence of the plaintiff does not bar recovery.[39] In the *Bank Bumiputra* case the negligence of the bank in overlooking a valid countermand by the drawer was held to be irrelevant to the issue.

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[39]*Kelly v Solari* [1835-42] All E.R. Rep. 320; *Bank Bumiputra (M) Bhd v Hashbudin bin Hashim, supra*, note 29.

PENGURUSAN DANAHARTA NASIONAL BERHAD - A CASE FOR IMPOSING FIDUCIARY DUTIES ON THE SPECIAL ADMINISTRATOR

1. Introduction

As a result of the recenteconomic collapse - the Malaysian government has established two entities to help revitalise local financial institutions. One is Danamodal with the specific objective to recapitalise troubled financial institutions. The other entity is Pengurusan Danaharta Nasional Berhad ("Danaharta") to acquire selected non-performing loans of these financial institutions. In this paper I will focus on Danaharta.

Danaharta is incorporated pursuant to Pengurusan Danaharta Nasional Berhad Act 1998[1] ("the Act").

The objectives of the Act are to:[2]

(a) assist financial institutions by removing impaired assets;
(b) assist the business sector by dealing expeditiously with financially distressed enterprises; and
(c) promote the revitalisation of the nation's economy.

These objectives will be met by the establishment of Danaharta which is equipped with the powers to acquire, manage, finance and dispose assets and liabilities. Danaharta is also empowered to appoint a Special Administrator to administer and manage the companies[3] whose assets and liabilities have been acquired by it.[4]

The appointment of the Special Administrator as provided by the Act is can be compared to the appointment of receivers and/or managers,

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[1]Act 587.

[2]The Act, Preamble, paragraph 1.

[3]Defined in the Act as 'affected person' - section 21.

[4]The Act, part VI.