

MONEY LAUNDERING - THE COURT OF APPEAL OPENS THE FLOODGATES

In recent years a number of High Court decisions have assisted in clarifying the relationship between a banker's contractual obligations to its customer and its obligations under the Proceeds of Crime Act 2002 ("POCA").

POCA places banks in an invidious position where on the one hand they have a contractual obligation to their customer but on the other have a legal obligation to report suspicions of money laundering and to seek consent from the Serious Organised Crime Agency ("SOCA") before undertaking an act which might constitute money laundering. Until now the courts appear to have recognised the difficult position that the legislation places banks in. The Court of Appeal's decision in *Jayesh Shah and Another v HSBC Private Bank (UK) Limited* [2010] EWCA Civ 31 (handed down on 4 February 2010), however, places banks in the firing line, may very well undermine the purpose of the POCA regime and is likely to encourage expensive and vexatious claims.

In the appeal the Court considered:

- the nature of a bank's obligations when instructed to transfer funds which are suspected to be the proceeds of crime;
- what amounts to "suspicion" in these circumstances;
- what evidence may be adduced, for the purposes of a summary judgment application, to defeat a

claim for breach of contract for failing to comply with instructions;

- whether a bank which makes an authorised disclosure to the authorities seeking consent to transact is exempted from any breach of confidence; and
- whether a bank can be required to give information to its customer concerning its disclosures to the authorities when it believes that to do so would expose it to prosecution for tipping off.

FACTS

The facts of the case can be summarised as follows:

- The Claimants held an account with HSBC Private Bank (UK) Limited ("Bank").
- Between 20 September 2006 and 28 February 2007, the Bank delayed execution of four separate payment instructions given by the Claimants, including an instruction to transfer approximately US\$28million.

- In each case the Bank suspected that the funds in the Claimants' account were criminal property. Before the Bank proceeded with each transaction, it made an authorised disclosure to SOCA seeking consent. Once consent had been obtained, the Bank complied with the instructions except for one, which the Claimants cancelled.
- In each case, the Bank told the Claimants that it was complying with its statutory obligations but declined to provide any further information to the Claimants or their solicitors.

THE LAW: THE PROCEEDS OF CRIME ACT 2002

Section 328(1) of POCA provides that:

"A person commits an offence if he enters into or becomes concerned in an arrangement which he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person."

The relevant threshold is suspicion (as opposed to speculation) and a bank does not need to have actual evidence of money laundering. As soon as a bank suspects that monies on its customer's account may be the proceeds of crime then (whether or not they in fact are) the bank is prohibited from entering into any arrangement in relation to those funds without obtaining consent. This is achieved by making an authorised disclosure seeking consent under s335 of POCA.

Provided that certain conditions are met (including making the disclosure before the prohibited act is carried out) section 338 of POCA will exempt a bank from breaching any duty of confidentiality owed to its customer by making an authorised disclosure.

Once an authorised disclosure has been made, SOCA may consent or refuse to consent to the transaction.

1. If no notice refusing consent has been received from SOCA within seven working days, then consent is deemed to have been given.
2. If consent is refused within seven working days, SOCA has a further 31 calendar days (the moratorium period) to consider the matter and the transaction cannot proceed until such time as consent is given or, the moratorium period expires.

Unless and until consent is given (or is treated as having been given), the bank or financial institution may commit a criminal offence if it proceeds with the transaction in question. Further, it cannot inform the customer that a

disclosure has been made as this risks committing the offence of tipping off.

THE CLAIMS

The Claimants, who lived in Zimbabwe, alleged that the Zimbabwean authorities had become suspicious when they had learned of the Bank's delays and the Bank's refusal to explain the reasons for the delays and had seized the Claimants assets.

The Claimants claimed approximately US\$400 million of losses allegedly arising out of the seizure of their assets and the stigma caused to their reputation in Zimbabwe.

Initially, the Claimants claimed damages for breach of contract arising out of the Bank's failure to comply with their instructions and the Bank's refusal to provide any information about the reasons for the delay. The Bank's defence was that, because of its suspicion, complying with their instructions without consent or explaining the reasons for the delay would expose the Bank to criminal liability under POCA.

In their draft amended claim the Claimants also alleged that the Bank had a duty to take reasonable care in operating the account, which had been breached by the Bank's alleged failure to make a disclosure to the authorities seeking consent "*as soon as it was practicable to do so*" when there were no "*rational grounds*" to suspect money laundering and by the Bank's alleged failure to refer to "criminal property" in its disclosures to the authorities. The Claimants alleged that the Bank's disclosures to the authorities were not protected by POCA and were therefore made in breach of confidence.

The Bank objected to the amendments. It applied to strike out the claims and also applied for summary judgment on the basis that the claims did not have any real prospect of succeeding at trial. The Bank succeeded at first instance and the claim was struck out. The judgment of Mr Justice Hamblen was that:

- **There was evidence of suspicion:** the Court accepted the Bank's evidence that it held a suspicion and in each case had made an authorised disclosure seeking consent.
- **Suspicion is a subjective fact:** the Court held that, following the decision of the Court of Appeal in *K Ltd v NatWest* [2008] 1 WLR 311, suspicion of money laundering is a purely subjective matter and there is no requirement of reasonableness or rationality.
- **Duty of care to report suspicion without unreasonable delay:** the Court accepted that, in general terms, a banker owes a duty of care to its customer. The Court thought that a banker who

unreasonably delays seeking consent once it has decided to do so, or who unreasonably delays complying with instructions once consent has been obtained, might be in breach of that duty. However, the Court found that the Bank's disclosures had all been made within two days of payment instructions, which was not an unreasonable delay.

- **Breach of confidence when seeking consent:** the Court found that the making of an authorised disclosure was exempted from any breach of confidence irrespective of whether the suspected criminal property in fact turned out to be criminal property.
- **Tipping off:** the Bank supplied evidence from the Metropolitan Police to the effect that the confidentiality of the existence of an investigation was of great importance and that, in this case, the Metropolitan Police had specifically asked the Bank not to disclose the existence of its investigation into the Claimants' affairs to the Claimants. The Court agreed that disclosure of the information requested by the Claimants would have involved the Bank committing the offence of tipping off under s333 of POCA (or at least a serious risk of such an offence being committed) and that, accordingly, the claim for failing to provide information had no real prospect of success.

GROUND OF APPEAL

The Shahs appealed on the following grounds.

- A relevant suspicion, for the purposes of Part 7 of POCA, did not include the following bases for suspicion:
 - an irrational suspicion or a suspicion which was fanciful or not of a settled nature (Ground 1);
 - a negligently self-induced suspicion (Ground 2);
 - a suspicion based on a false and fundamental mistake of fact (Ground 3); and
 - a suspicion which was induced by a mechanical or computerised reaction to the customers' instructions (Ground 4).
- The Judge in the Court below had been wrong to conclude that there was no reasonable prospect of

the Claimants challenging at trial assertions made as to the existence of suspicions on the part of relevant bank employees and or the disclosure of "*criminal property*" (Ground 5).

The bank had failed to make its disclosures to SOCA as soon as reasonably practicable (Ground 6).

- The Claimants' claim for breach of confidence could not be excluded by s338(4) of POCA as the disclosures could not have been authorised disclosures under s338(1) of POCA (Ground 7).
- The bank had breached its duty as agent by failing to keep its customer informed about the state of his affairs (Grounds 8 and 9).

THE COURT OF APPEAL'S JUDGMENT

Basis of suspicion: the Bank was successful in relation to Grounds 1-4. The Court re-affirmed that the relevant suspicion need not be based on reasonable or rational grounds and that a negligently self-induced suspicion can be a relevant suspicion for the purposes of POCA Part 7. The Court found that no evidence had been put forward to justify an assertion of mistake on the Bank's part and that, with regard to mechanically generated suspicion, it would be "*almost impossible*" to suppose that a report could be made to SOCA or another authority without any human input.

Delay: this ground was dismissed as the Court thought there was no reasonable prospect of such a claim succeeding and Grounds 5 and 7 were abandoned by the Appellants shortly before the hearing began.

Informing the customer about the fact of suspicion: the Appellants were successful in relation to Grounds 8 and 9. The Court ruled that on the facts a point must have come where the bank would no longer fall foul of the tipping off provisions and so, because it was arguable that an agent is obliged to keep his principal informed about his own affairs (especially if the principal requests such information), the Court thought that this issue should be allowed to proceed to trial.

Proof of the existence of a suspicion: during the course of the two-day appeal hearing another ground of appeal was developed by Counsel for the Appellants. The Appellants argued that, whatever the test for a relevant suspicion, a bank should have to prove the existence of such a suspicion - customers should not be required to simply accept the assertion by the bank of a suspicion in its lawyer's witness statement (the so-called "*Wall of Silence*" Ground).

This new ground of appeal resulted in a significant finding by the Court of Appeal in the Appellants' favour. The Court was of the opinion that to allow the bank to assert a relevant suspicion, without ever being put to

proof of the same, would be to give every bank carte blanche to decline to execute its customers' instructions without court investigation. The Court, therefore, held that a bank must prove any relevant suspicion that it asserts. In doing so, the bank may be obliged to disclose relevant documents and call witnesses. The Court dismissed the bank's arguments that to do so would put bank employees in a dangerous position stating that the court could be informed of such dangerous circumstances so as to proceed in a manner which would ensure protection for the witnesses or otherwise ensure that their evidence is available. As to parts of documents which banks may not wish to disclose, the Court stated that a judge in chambers could be made aware of any such issues and take an appropriate view.

The Court did not think that, at the point of a trial, there would still in all likelihood be a risk of the bank engaging the tipping off provisions under POCA but stated that, if this was possible, the court could be informed of any ongoing investigations in an "admissible manner". Therefore, regardless of the Bank's arguments against being put to proof of its suspicion the Court thought that it would not be right to allow a bank to dismiss proper litigation without "*any appropriate inquiry of any kind*".

PRACTICAL EFFECTS

The effect of the Court of Appeal's judgment is to require a bank defending a claim for breach of the banking contract arising out of disclosures made under POCA to prove the fact of that suspicion in the ordinary way at trial. If the suspicion can be proved then this will still be a good defence to a claim for breach of contract for failing to comply with payment instructions, providing there is no evidence of bad faith (or possibly delay). The judgment has also confirmed that, providing the suspicion exists and is genuinely held, it does not matter if it was unreasonable or irrational.

Banks will be required to disclose documents in the ordinary way (which could, subject to grounds of objection such as public interest immunity, include any suspicious activity reports) and then call evidence from

witnesses (including potentially those people who reported the suspicion).

It seems therefore that there is little or no means for banks to dismiss claims which have no real prospect of success or which are frivolous or vexatious or embarked upon as a way to obtain disclosure of the bank's suspicion. Aggrieved, vindictive or even criminal customers might therefore attempt to explore the basis on which the bank suspects money launderers or reports suspicions.

Finally, banks should be aware that even if they can assert that the tipping off provisions under POCA are a bar to their being able to give the customer further information about the state of his affairs, there will almost certainly come a point (in the court's eyes) where these provisions will no longer be engaged. In such circumstances, a continuing refusal to provide the customer with the information requested could lead to the bank being held liable.

Banks should, going forward, consider carefully the content of suspicious activity reports as well as the training given to staff in relation to both their reporting obligations to the authorities and the risks of tipping off the customer.

Daren Allen and Nick Marsh acted for HSBC Private Bank in this case, and also acted for NatWest Bank in K Ltd v NatWest.

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