STANFORD INTERNATIONAL BANK V HSBC BANK PLC [2022] UKSC 34.

SUPREME COURT SIDES WITH BANKS IN LATEST QUINCECARE DUTY JUDGMENT - BUT WHAT IS THE COST FOR CREDITORS AND THE PARI PASSU PRINCIPLE?

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Introduction

The close of 2022 will have brought more than the usual dose of festive cheer for the banks, following the decision of the Supreme Court in the case of Stanford International Bank ("SIB") v HSBC Bank plc ("HSBC Bank"). For those representing creditors in distressed companies, the decision will place a significant hurdle to future attempts to collect in funds dissipated in the run up to a corporate collapse.

Executive Summary

The Supreme Court upheld the Court of Appeal decision by a majority of 4:1, thereby striking out a claim worth £116 million against HSBC Bank. The Appeal had asserted that there had been an alleged breach of Quincecare Duty by HSBC Bank when certain payments were authorised to a group of creditors shortly before SIB went into liquidation.

The Court held that of the £116 million of claimed losses, none was recoverable on the basis of SIB's pleaded case. The payment of due and valid debts did not reduce SIB's assets available to its creditors. This decision was reached on the basis that where monies had been paid to creditors of SIB to discharge validly owed debts, SIB had suffered no loss of a chance that had any monetary value to SIB. In essence, SIB's balance sheet was in the same "net" position it would have been had those payments not been made, since those benefitting creditors would have had equivalent claims for the totality of the sums paid out.

In this article we will examine the background to this Supreme Court decision and some of the points arising for future Claimants.

Background to the Ponzi Scheme

SIB is an Antiguan-Barbuda registered company that went into liquidation in 2009 whilst holdings bank accounts with HSBC Bank. At the time, SIB was controlled and owned by Robert Allen Stanford (Mr Stanford). SIB's business concerned the sale of Certificates of Deposit, sold as investment products offering an attractive rate of return. Investors in the certificates were led to believe that the funds they deposited would be invested by SIB in a diversified low risk portfolio of assets and securities. However, for a number of years in the run up to the demise of SIB, Mr Stanford had run the company as a Ponzi scheme whereby the proceeds of investments from one set of clients were used to provide notional profits to another set of clients. All payments were essentially directed by Mr Stanford and his cronies.

Following enforcement action taken by the SEC in the US, the HSBC accounts were frozen in 2009. However, in 2008 in the run up to the accounts being frozen, a number of transfers out of the bank accounts were authorised by Mr Stanford who had been orchestrating the fraud. These payments adversely impacted on all creditors who were unpaid at the time the monies became frozen as the company was deprived of those funds to pay creditors. These payments, before the liquidation crystallised, were estimated to be for c. £116 million.

SIB through its liquidator brought the litigation and claimed that HSBC had been on notice that the payments that had been made in 2008 were part of a fraud. SIB claimed HSBC was subject to the Quincecare duty at the time and should have refused the payments orchestrated by Mr Stanford.

It should be noted that under the Antiguan insolvency regime, the liquidators were unable to claim back money from those customers who received payments prior to the date of liquidation. There was no legal basis under common law or under Antiguan statutory insolvency laws for the avoidance of wrongful preferential payments.

What is a Quincecare Duty?

The Quincecare duty was established in 1992. At that time, it was regarded as an extension of the duty of care that banks are said to owe to their customers (including compliance with their instructions), which was established in the preceding case of Lipkin Gorman v Karpnale. In the Quincecare case, Mr Justice Steyn (as he then was) described the duty as one whereby:

"a banker must refrain from executing an order if and for as long as the banker is 'put on inquiry' in the sense that he has reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of the company."

Having been dormant for a number of years following the decision in Barclays v Quincecare , there has been a renaissance of these claims, starting with the Singularis decision in 2017. These decisions have helped to clarify (and refine) the scope of the duty of care owed by banks.

In Singularis, the Court of Appeal had held that the purpose of the duty was to (i) "protect a bank's customers from the harm caused by people for whom the customer is, one way or another, responsible" and (ii) to protect companies against misappropriation by fraudulent agents.

In Fiona Lorraine Philipp v Barclays Bank UK Plc, it had been thought that the scope of the Quincecare Duty had been slightly widened to include a duty to a bank's individual (as opposed to corporate only) customers. This case involved an APP fraud. The facts of the case (and indeed whether the duty did arise in respect of Mrs Philipp and was breached) are yet to be tested at trial. The case (at the time of writing this article) is also subject to an appeal to the Supreme Court.

In RBS v JP SPC the Privy Council confirmed a key limitation on the duty, namely that a bank owes a duty of care to its client (or the account holder) alone. It does not owe a duty of care to third party beneficiaries of funds held in an account.

So the history of recent cases, suggested that banks had a duty to protect their customers alone.

This decision affirms the line of reasoning (and indeed, the confinements) adopted in RBS v JP SPC.

The Claim against HSBC

In this case, SIB had pleaded that HSBC had been reckless in how it had allowed a culture in its relationship with SIB to develop, where ignoring red flags and due diligence in the day-to-day operations as the norm. This sloppy due diligence, it was argued, meant that payments were allowed and by doing so HSBC had facilitated the operation of the dishonest Ponzi scheme. The HSBC accounts enabled the Ponzi scheme in particular the dishonesty of Mr Stanford in the lead up to the collapse and arguably helped the collapse to crystallise.

The issue before the Supreme Court was whether the Court of Appeal had been correct in its approach by striking out the £116 million Quincecare claim. But that required the court to consider the scope of the duty and when it was engaged.

Damages for Breach of Contract and the "no net loss" hurdle

The Judgment is a reminder that damages for breach of contract and breach of duty in tort are essentially compensatory and follow the "net loss" rule which takes a holistic approach taking into account the pluses and minuses of a breach including any potential recovery or gain.

The majority in the Supreme Court Judgment considered whether the payment to earlier customers created a loss or not. The payments authorised by Mr Stanford to customers before the liquidation made no difference to the company as those customers would have had claims in the same sum after a liquidation. The balance sheet of debts had therefore not been adversely impacted. SIB would not have been £116 million better off, as it would have claims against it in the same amount.

The Supreme Court followed the Court of Appeal and held that the Quincecare claim should be struck out: "SIB has not suffered the loss of a chance that has any pecuniary value to it and hence there is nothing recoverable on its pleaded case." (paragraph 31 of the SC Judgment).

It is worth noting the dissenting opinion of Lord Justice Sales. He took a different view because he focussed on the distinct corporate personality of SIB which he felt should not be confused with the claims of creditors as a class rather than as individuals. At paragraph 128 he states that:

> "In my view this reflects the point that in the eyes of the law the interests of a company which is hopelessly insolvent are fully aligned with those of its creditors as a general body. In those circumstances the purpose of the company, and the function to be served by its having corporate personality as the vehicle by means of which it holds assets so that they can be used for fulfilling that purpose, is to protect the interests of the creditors as a general body, ie according to the pari passu principle applicable in an insolvent liquidation, subject to any security rights creditors might have."

Lord Justice Sales dismissed the focus of the majority on whether a loss had been suffered or not as essentially out with the Quinceare Duty. At paragraph 132 he notes,

> "The Quincecare Duty should be kept within narrow bounds, lest it interfere unduly with the conduct of commerce…..However the very existence of the Quincecare duty qualifies that position and, in my respectful opinion, the solution to keeping its effect within proper bounds lies in analysis of the duty itself, not in distorting (as I see it) the question whether the company has suffered loss".

Concluding Remarks

However attractive the reasoning applied by Lord Justice Sales, the majority prevailed, and the Appeal dismissed meaning that the claims were struck out. If one looks at this purely as a loss analysis of SIB balance sheet, then of course the decision makes sense. But if you are an unpaid creditor who has been subject to fraudulent conduct and would like a proper investigation to understand how the banks enabled these payments, then you will be disappointed.

The impact of this decision means that those with claims are now deprived of being investigated further in these proceedings. The Bank no longer has any obligation to provide disclosure on the issues in the case. Of course, had Antigua had similar statutory insolvency protections on preferential payments to the UK, then that problem may have been mitigated. Other regulatory investigations may of course shed more light on the conduct that transpired and the relationships between the bank and SIB. However it is unfortunate that those investigations won't enable an unpaid creditor to be paid pari passu.