STANFORD, SEQUANA AND THE SUPREME COURT

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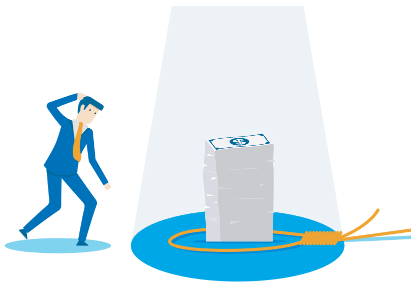
At the end of last year, the Supreme Court handed down its ruling in Stanford International Bank Ltd v HSBC Bank PLC [2022] UKSC 34, examining loss in the context of a Ponzi scheme and insolvency. This was preceded by another notable ruling by the same court, BTI 2014 LLC v Sequana SA [2022] UKSC 25, which considered, amongst other things, when directors should consider the interests of creditors in insolvency. How the two rulings interact in practice is yet to be seen but the Stanford decision raises issues which touch upon the creditor considerations arising from the ruling in Sequana.



The Stanford Ponzi Scheme

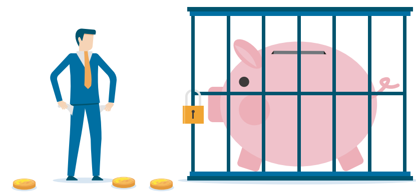
Stanford v HSBC stems from a fraud perpetrated by the bank's former chairman, Robert Allen Stanford.

The fraud was uncovered following an investigation by the US Securities and Exchange Commission. It was discovered that Stanford International Bank (SIB), an Antiguan based bank, had been used for years as vehicle for a multi-billion-dollar Ponzi scheme and impacted thousands of investors from multiple jurisdictions.

The fraudulent scheme involved the sale of Certificates of Deposit to investors by SIB. Investors were falsely promised that the Certificates Deposit were high-yielding and would achieve high returns for investors. "Early customers", who withdrew their funds in full before the scheme collapsed, escaped without loss. But, "late customers", who did not withdraw their funds before the scheme collapsed, risked losing almost all their money.

SIB went into insolvent liquidation in April 2009. Following that, in 2012, Mr Stanford was convicted for his role in the fraud and is currently serving a 110-year prison sentence in the US.

SIB's liquidators are currently trying to recover funds for investors and have brought claims in multiple jurisdictions against a range of parties who had dealings with SIB. One such party is HSBC, with whom SIB held accounts and which were operated by HSBC until it froze them in February 2009.

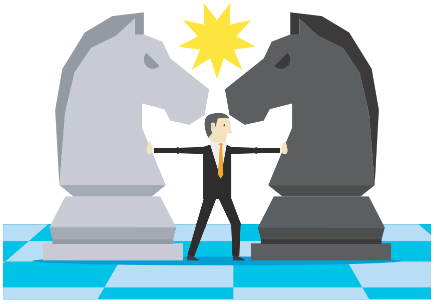


Sib's Claim Against Hsbc

In 2018, SIB's liquidators brought a claim against HSBC in respect of £116 million which had been paid to the "early customers" out of its accounts between August 2008 (when the liquidators considered that the HSBC should have frozen the accounts) and February 2009 (when it did freeze them following the US SEC's action against Mr Stanford).

SIB's liquidators alleged, amongst other things, that HSBC had breached the so-called Quincecare duty. This is the duty that banks have to their customers to refrain from executing an order where the bank has reasonable grounds to believe that the order is an attempt to misappropriate customer's funds, as defined in Barclays Bank Plc v Quincecare Ltd [1992] 4 All E.R. 363.

SIB's liquidators argued that HSBC had breached this duty because it was on notice of the fraud and had not recognised the signs, when it should have done, that SIB was being used as a vehicle for a Ponzi scheme. Their position was that, if HSBC had recognised those signs earlier, the HSBC accounts would (and, should) have been frozen earlier and money held in those accounts would not have been paid out to the "early customers". In turn, SIB would have held more in its accounts when it went into insolvent liquidation and so would have had more assets available to pay out to investors who had been defrauded.



The Decisions

High Court

HSBC applied to strike out SIB's claim on the basis that SIB had suffered no loss and so had no claim for damages and argued that certain elements of SIB's claim were not sufficiently pleaded. At first instance, the High Court, struck out certain elements of SIB's claim but not the claim for breach of the Quincecare duty. Both sides appealed.

Court of Appeal

The Court of Appeal held that the claim relating to the Quincecare duty should be struck out: where a company was trading, even insolvently, then money paid to a creditor reduced its assets but that was offset by a corresponding reduction to its liabilities, meaning that the payments made by HSBC to "early customers" had caused SIB no loss.

SIB's liquidators appealed, contending that SIB had suffered the loss of a chance. When the payments were made, SIB had been hopelessly insolvent. In those circumstances, had the payments not been made, the relevant debts would still be owed. The "early customers" would, in that case, then have to prove their debts in the liquidation and were likely to receive only a few pence in the pound (rather than the amount that had been paid out to them). SIB, it followed, had lost the chance of discharging those debts for a few pence in the pound.

Supreme Court

The question for the Supreme Court was whether payments made out of HSBC's accounts to "early customers" could be caught by the Quincecare duty. That hinged on whether SIB had suffered loss. (In order to determine the question of loss, it was assumed for the purpose of the hearing that there had been a breach of the duty.)

The Supreme Court dismissed SIB's appeal and upheld the Court of Appeal's decision to strike out the majority of SIB's claim against HSBC in relation to alleged breach of the Quincecare duty.

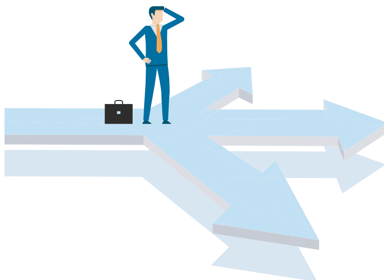
The Supreme Court held that SIB did not sustain loss where, while it was still trading, HSBC had paid money out of its accounts (in alleged breach of duty) and SIB had later entered an insolvency process. Although SIB argued that it had suffered the loss of a chance in that the payments had discharged certain of its debts in full when they could have been discharged for far less in the liquidation, that chance was matched by the risk of it having to increase the payments in liquidation to other creditors who had not received any payment before liquidation. Thus, SIB had not suffered the loss of a chance that had any pecuniary value to it.

In the Stanford decision, Lord Leggatt and Lord Sale also considered the nature of the fiduciary duty owed by a director to a company when it is about to go into insolvent liquidation. That follows the Supreme Court decision in Sequana which confirmed that once insolvent liquidation becomes inevitable the creditors interests become paramount. In both cases, a change happens to the responsibilities of the company when it is about to go into insolvent liquidation.

In his dissenting judgment, Lord Sales noted that in Sequana "the fiduciary duty owed by directors to the company itself would become a duty to protect the interests of creditors of the company at the point when the company entered into liquidation or was on the verge of doing so".

On the question of loss, Lord Sales found that SIB had suffered loss. This was on the basis that, considering the decision in Sequana, when the "early customers" were paid SIB was hopelessly insolvent and so SIB's interests were equated with those of SIB's creditors (being the "early" and "late customers"). SIB's assets were reduced by paying the "early customers", which Lord Sales thought SIB would not have done but for HSBC's breach. That meant SIB suffered loss of the assets which ought to have been paid out to both the "early" and "late customers" during the insolvency process.

In his concurring judgment, Lord Leggatt noted that had the case been about SIB's directors breaching their fiduciary duties then Sequana would be relevant. But, determining what the director's fiduciary duties were at a given time had no bearing on whether a payment ordered by a director in breach of his duties gave rise to a loss to the company.



Comment

How the Stanford and Sequana decisions interact in practice will be of interest to practitioners going forward. The decisions are important in terms of recoverable loss and when, in the context of insolvency, the interests of creditors should be considered.

On the question of loss, the Stanford decision reconfirms that the recoverable damages for breach of contract or in tort are subject to the net loss rule (meaning that the losses and gains caused by the breach must be netted off and only net loss awarded as damages).

That is a helpful reminder for both banks and claimants in terms of the losses that can be recovered in claims for breach of the Quinecare duty particularly in the context of insolvency.