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Same Bank, Different Capacities: Knowledge, Remoteness and Measure of Damages

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Same Bank, Different Capacities: Knowledge, Remoteness and Measure of Damages

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Abstract

What damages, for example, is the customer entitled to if the paying bank breaches its duty of care in regard to the customer's cheques? The face value of the cheques? The face value of the cheques plus the interest that could have been earned if there was no breach? The face value of the cheques plus damages for business loss?

As the true owner of a cheque, what damages is the plaintiff entitled to in conversion if a bank collects the cheques for a rogue? Just the face value of the cheques? Or damages for the face value of the cheques plus damages for business losses?

These are some of the issues raised in *Nemur Varsity Pty Ltd v NAB* and the appeal case *National Australia Bank Ltd v Nemur Varsity Pty Ltd* decided on 1 March 2002, both being unreported judgements. Other important issues raised are whether the banker-customer relation is subject to concurrent duties in contract and tort and whether consequential damages can be claimed for conversion of a chattel.

KEYWORDS: damages, banking, *Nemur Varsity Pty Ltd v NAB*, *National Australia Bank Ltd v Nemur Varsity Pty Ltd*

SAME BANK, DIFFERENT CAPACITIES: KNOWLEDGE, RE MOTENESS AND MEASURE OF DAMAGES

*Robin Edwards**

Introduction

The measure of damages is always a difficult matter to assess and brings to mind the story *The Jar* by the Italian author Pirandello. A wealthy olive farmer had a five-foot high terracotta jar. Unfortunately it had a crack in it; so he sought the services of a repairer, paying him in advance. The repairer mended the jar but in the process imprisoned himself in the jar. The farmer's lawyer told him that he would have to break the jar or run the risk of an action against him by the repairer for false imprisonment. The farmer wanted to know what he could charge the repairer before he broke the jar and released him: the cost of a new jar? the worth of the jar when it was cracked? the worth of the jar when it was repaired? The lawyer devised a practical solution: ask the repairer to nominate a price before witnesses. But would such a nomination be obtained under duress? An impasse was arrived at. Meanwhile the repairer had taken a liking to life in the jar, having been furnished with wine, food and tobacco by friends and family. Frustrated and furious, the farmer smashed open the jar. This sense of frustration is often felt by litigants and not in the least in regard to damages awarded for conversion of cheques and non-payment of cheques.

What damages, for example, is the customer entitled to if the paying bank breaches its duty of care in regard to the customer's cheques? The face value of the cheques? The face value of the cheques plus the interest that could have been earned if there was no breach? The face value of the cheques plus damages for business loss?

As the true owner of a cheque, what damages is the plaintiff entitled to in conversion if a bank collects the cheques for a rogue? Just the face value of the cheques? Or damages for the face value of the cheques plus damages for business losses?

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These are some of the issues raised in *Nemur Varsity Pty Ltd v NAB*¹ and the appeal case *National Australia Bank Ltd v Nemur Varsity Pty Ltd*² decided on 1 March 2002, both being unreported judgements. Other important issues raised are whether the banker-customer relation is subject to concurrent duties in contract and tort and whether consequential damages can be claimed for conversion of a chattel.

It is not often that a plaintiff brings an action in regard to a cheque against both the paying bank and the collecting bank. In the *Nemur* case the plaintiff was both the customer and the true owner of the cheques. It was the latter because the cheques had not come into the hands of the payees: there had been no delivery of possession to the payees. Section 25 of the *Cheques Act 1986* (Cth) provides that a contract arising out of the drawing or the indorsement of a cheque is incomplete and revocable until delivery of the cheque. Here there was no delivery to the payee. Thus the drawer is the true owner of a cheque until possession is parted with.³ As the customer Nemur could sue the bank in its paying capacity and, as the true owner, it could sue the bank in its collecting capacity even though it was the same bank.

Background facts of the *Nemur* case

Nemur Varsity Pty Ltd (Nemur) was an insurance broker. The moving force behind Nemur was a man by the name of Jarman. Nemur had been approached by Australian National Intermediaries Pty Ltd (ANI) which led Nemur to believe that ANI could facilitate insurance with an insurer by the name of Reinsurance Co of America (RCA). Nemur wanted to transact business on behalf of its clients with RCA and ANI was to act as a non-brokering intermediary. The men behind ANI were James Charge and Richardson. There were five cheques written out by Nemur and they took the following form. The name of the payee was Reinsurance Company of America followed by the words 'or bearer'. Nemur signed the cheques and they were crossed and marked 'Not negotiable'. Essentially the case involved these cheques.

The cheques totalled about \$202,000. Nemur posted four of the cheques to ANI's office in Melbourne.

They were in envelopes addressed to RCA. These cheques were collected by NAB in Melbourne for an account entitled 'International Insurance Exchange Pty Ltd Premium Trust Account' (IIE).

1 [1999] VSC 342.

2 [2002] VSCA 18.

3 *Hunter B N Z Finance v ANZ Banking Group* [1990] VR 41, affirmed on appeal [1991] 2 VR 407.

Nemur took one of the cheques to NAB at Shepparton and the funds were telegraphed (TT), so Nemur thought, to RCA but the account number of the recipient was that of IIE. No insurance was effected with any of the above cheques.

There was also another cheque (called the 'ANI' cheque at trial and in the appeal case) drawn by Nemur in December 1989 for \$74,293.21 payable to ANI or bearer which was crossed and marked 'Not Negotiable'. That cheque represented an additional premium payable in respect of the Roccisano insurances. It was collected by the ANZ Bank in favour of an account of ANI maintained at that bank. There was no conversion by the defendant bank of this cheque nor any breach of contractual duty in regard to this cheque but Nemur claimed consequential damages in regard to this cheque, the gist of the argument being that had there been no earlier fault on the part of the defendant bank it would have found out the real position and not written out the cheque (there was never any insurance effected with this cheque).

The role of International Insurance Exchange Pty Ltd (IIE)

At one stage it was proposed by Nemur and ANI that another entity be set up and that any broker (including Nemur) could place business with the entity. It was to be owned equally by Nemur and ANI and these shareholders were to share equally the fifteen per cent commission. Initially two bank accounts were opened in its name at Shepparton at the NAB. These were later shifted to the NAB at North Balwyn and by that time Richardson and Charge were in control of this entity.

The back of the cheques

Of the four cheques that ended up in the account of IIE one was indorsed 'ANI Intermediaries, Richardson'. Another was indorsed 'Pay International Insurance Exchange' and signed by Richardson. The other two cheques were not indorsed. As they were all bearer cheques there was strictly no need for any of them to have been indorsed.⁴

The case in conversion against the bank

It was argued by NAB at first instance that Nemur intended the proceeds of the cheques to be paid to IIE. Ashley J rejected this, saying there was no credible evidence that the IIE arrangement continued throughout the relevant period. At the time of the conversion IIE was under the control of Charge and Richardson

4 Ss 40(4), 95 *Cheques Act 1986* (Cth).

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from ANI. Ashley J accepted Nemur's arguments that there was no intention to make the monies payable to IIE. Some of the telling points were that

- the payee on all of the cheques was RCA
- none of the cheques were made payable to IIE or ANI

Ashley J accepted the proposition that a failure to question a third party bearer cheque where the name of the payee, RCA, is different from that of the customer, IIE, was in all the circumstances evidence of negligence.⁵

He also accepted that the nature of the indorsements on a bearer cheque should have invited queries by the collecting bank.⁶

NAB's banking manual also prescribed the use of the third party cheque register for staff. Three of the four cheques were not recorded in this register.⁷ This too was viewed as evidence of negligence.⁸

It was held that the bank converted each of the cheques and had not established it was not negligent and it was therefore liable for the full face value of the cheques as damages.

The case against the bank in its paying capacity

Part of Nemur's claim against NAB was that it was wooed over to NAB by representations that NAB was fully cognisant of the banking requirements of the *Agents and Brokers Act 1984* (Cth) under which Nemur had to operate. Under this Act Nemur had to make sure that premium moneys were payable only to insurers.

The judge was of the opinion that the payment of the cheques and the circumstances attending their presentation and acceptance for collection were unusual.

Ashley J accepted NAB's proposition that it was going too far to say that in every case a paying bank should inquire of its customer as to the intended destination of a cheque. Nevertheless, Ashley J suggested that in this case the moneys in the Nemur account were akin to 'trust moneys' and included premium moneys.⁹ He also seemed to accept that proposition that there was something of a special obligation on the bank because of the nature of the account. Ashley J stated:¹⁰

5 [1999] VSC 342 [84].

6 Ibid [86].

7 Ibid [89] and [143].

8 Ibid [138].

9 Ibid [151].

10 Ibid [146].

There were, however, other circumstances of which the bank, viewed only as the paying bank, was apprised. It knew that the plaintiff was an insurance broker. It knew that the cheques were drawn on an insurance broking account. It knew that the moneys in that account were (or were akin to) 'trust moneys', and included premium moneys. In a largely undefined way it intended that deposits in such accounts be protected (the Flexicard reference in the relevant manual is the only suggestion of such protection). Without going so far as to conclude that the bank knew or ought to have known that cheques drawn on the account should only be paid in favour of the named payee when that payee was an insurer, the circumstances to which I have adverted, particularly when added to the fact that each of the cheques was drawn in favour of an insurer but was sought to be collected by a third party in circumstances which required but did not get investigation, constitute, I consider, a strong case of failure by the bank to abide its duty of care to the plaintiff by making payment in each instance. I do not doubt, as I said earlier, that had the bank enquired of the plaintiff whether it should pay the cheques in favour of IIE, the plaintiff would have answered 'no'. Moreover, had such an enquiry been made in the case of any one of the cheques, the probability is that the fraud would have been revealed.

In relation to the tele-transfer of funds Ashley J could not say on the evidence whether it was the fault of the Shepparton branch or the North Balwyn branch but said there was a duty owed to the person on whose behalf funds were being transferred to take reasonable care to ensure that the funds were intended for the credit of the intended beneficiary.

It was also held that Nemur was entitled to damages for loss of business stemming from the wrongs and breach of duty by the bank.

The Plaintiff was awarded the amount of \$314, 510 for net loss of past and future business income and \$74, 293.21 in regard to the ANI cheque.

Nemur on appeal

There was no challenge on the issue of liability but the bank appealed to the Court of Appeal on the issue of damages relating in particular to business losses referred to above.

The Court of Appeal of the Supreme Court of Victoria handed down their unanimous decision on 1 March 2002.

Causation

The Court of Appeal first reviewed the issue of causation.

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The trial judge found that as a result of the bank's breach of duty Nemur was 'in each case left with the [erroneous] belief that the clients whose premiums had been represented by the cheques were insured with RCA'¹¹ and therefore Nemur could not tell they were not insured. Nemur learned of 'the true situation on 9 July 1990'¹² and told the clients they were uninsured. The trial judge considered it 'very reasonable to infer, as a generality, that the plaintiff's communication of the true situation was a cause of those clients abandoning dealings with the plaintiff'¹³ given that they knew they were uninsured and had paid a premium for nothing. The trial judge was of opinion that 'loss of business occurring in those circumstances was a loss caused by the default of the defendant, whether the matter be looked at in contract or tort'.¹⁴

In short the trial judge was of the view that the bank's failures misled Nemur whereas had the bank acted properly the fraud of ANI would have been discovered.¹⁵

On appeal Counsel for the bank argued successfully that had the bank in its collecting capacity made enquiries (as it should have done) as to why cheques made out to Reinsurance Company of America were going into ANI's account, such enquiries would have been directed to its customer ANI, the perpetrator of the fraud, or to the payee, Reinsurance Company of America, but not to the drawer, the plaintiff Nemur. Thus had this duty been fulfilled this would not have made the plaintiff any wiser as to what was going on. Moreover, Counsel for the bank argued that had Nemur been aware that the cheques were going into ANI's account it did not logically follow that Nemur would have become aware of the fraud since the trial judge had found that Jarman was gullible and would have been likely to accept facile explanations.

Batt JA delivering the main judgement of the Court of Appeal found that the trial judge had erred in his finding on the issue of causation. Essentially he found that the trial judge had mainly applied the 'but for' test of causation that had been rejected as the sole criterion of causation by the majority of the High Court in *March v E & MH Stramare Pty Ltd*.¹⁶ According to the Court of Appeal the trial judge should have applied common sense; the cause of Nemur's loss was fraud. Batt JA stated¹⁷

the cause of the relevant clients' lack of insurance and of the belief by Nemur Varity and its relevant clients that the latter had insurance cover was that Nemur Varity had

11 Ibid [202].

12 Ibid [203].

13 Ibid [204].

14 Ibid [206].

15 Ibid [208].

16 (1991) 171 CLR 506.

17 [2002] VSCA 18 [41].

chosen to deal with ANI as supposed agent for RCA and as able to bind it (or at any rate to deal with RCA through ANI).

Having found that the bank's conduct was not the cause of the loss, there was strictly no need to go into the issue of remoteness. However, he did so on the assumption that he might be wrong on the issue of causation. His findings on remoteness are therefore strictly speaking obiter dicta. Phillips JA agreed with Batt JA on the issue of causation but declined to comment on the issue of remoteness. Callaway JA found that the business losses were incidental rather than consequential and therefore found it was not necessary for him to decide whether Nemur's claim failed as a matter of causation or of remoteness.

Remoteness of damages in regard to breach of contract

The first problem Batt JA had to solve was whether the damages awarded against the bank in its paying capacity was on the basis of a breach of the banker-customer contract; or whether it was on the basis of a breach of some tortious duty of care. The judgement at first instance did not make this entirely clear, so Batt JA had to decide whether the damages flowed from breach of contract or from tort as there are different tests for remoteness according to whether the claim is in contract or in tort.¹⁸ Batt JA came to the conclusion that the bank's duties in its paying capacity had to be looked at solely in the light of contract law and approved of the following passage from Lord Scarman's judgement in *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd*¹⁹

Their Lordships 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. ... [T]heir Lordships believe it to be correct in principle and necessary for the avoidance of confusion in the law to adhere to the contractual analysis.

Callaway JA agreed with this approach to the paying bank's liability and said:²⁰

I agree with Batt, JA that, putting statute and equity to one side, the duties of a bank to its customer with respect to cheques and telegraphic transfers lie in contract and not in tort. The relationship is too complex, and affected by settled commercial expectations, to be subverted by negligence.

Comments on the basis of the paying bank's duty

Normally the action for damages brought by a plaintiff involves a breach by the bank of duties arising from the banker-customer contract. Many of these duties

18 Ibid [42].

19 [1986] AC 80,107.

20 [2002] VSCA 18 [9].

established by case law were codified in the English *Bills of Exchange Act 1882* and found their way via the Australian *Bills of Exchange Act 1909* into the *Cheques Act 1986* (Cth). For example, s 90(1)(a) of the *Cheques Act 1986* (Cth) provides that the drawee institution must obey a countermand of its customer;²¹ s 67 provides that the drawee institution must pay or dishonour a cheque as soon as possible;²² similarly, s 32 provides that if there is a forgery or an unauthorised signature on the instrument it is not a valid cheque.²³ Conversely, there are duties imposed on the customer that can be seen to stem from the banker-customer contract, for example, the so-called *MacMillan*²⁴ duty to draw cheques in a way so as not to facilitate fraud; likewise the customer owes the bank the so-called *Greenwood*²⁵ duty, that is, where the customer knows her signature has been forged, she owes a duty to report it to the paying bank and failing to do so, she may be estopped from denying liability on the forged signature on the cheque. If there is a forgery the drawee institution has no mandate to pay.²⁶ All these rights and duties described above arise from the banker-customer contract.

However, it is not always entirely clear that the rights and duties of the paying bank and those of the customer stem solely from the banker-customer contract. Much of the discussion in the *Greenwood* case, for example, was in terms of estoppel rather than in terms of contract law and several subsequent cases to *Greenwood* seem to have been mainly in terms of estoppel.²⁷

It is worthwhile pointing out that the paying bank's liability may sometimes be tortious. Apart from liability under s 93 (liability to the true owner for paying contrary to the crossing on the cheque) of the *Cheques Act 1986*, can a true owner of a cheque bring an action against the drawee institution in conversion? This is not, of course, an action brought by the customer unless the customer is the true owner, which is possible if the drawer-customer has not delivered the cheque to the payee. The action in conversion is based upon the idea of misappropriation of the chattel (the cheque). How can this be said of the drawee institution when it is just obeying the instructions for payment written on the cheque? It could be argued that the conversion is the wrongful payment of the cheque: it has the effect of destroying the cheque as a piece of property. This would seem to be the idea

21 AL Tyree, *Banking Law in Australia* (3rd ed, 1998) [5.58]-[5.63]; WS Weerasoria, *Banking Law and the Financial System in Australia* (4th ed) (1996) [13.38]-[13.59].

22 Tyree, *ibid* [5.65]-[5.67]; Weerasoria *ibid* 11.23].

23 See also Part II, Division 5 of the Act dealing with signature: ss 31-34 of the *Cheques Act 1986*; see also Tyree, *ibid* [6.69]-[6.70] and [10.39]-[10.44]; Weerasoria, *ibid* [23.34] and [23.40]-[23.52].

24 See Tyree, *ibid* [5.22]-[5.26], see also Weerasoria, *ibid* [23.5]-[23.33].

25 *Greenwood v Martins Bank Ltd* [1933] AC 51; *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] AC 80, [1985] 2 All ER 947.

26 *National Westminster Bank v Barclays Bank International Ltd* [1975] QB 654.

27 See, for example, *Brown v Westminster Bank Ltd* [1964] 2 Lloyd's Rep 187; *Tina Motors Pty Ltd v Australian and New Zealand Banking Group Ltd* [1977] VR 205.

behind s 93 of the *Cheques Act*. It has been suggested that conversion will only lie against the drawee institution when payment is made to a holder who cannot be a holder in due course.²⁸

The Selangor duty

Another instance of the duties of the paying bank is the so-called *Selangor* duty, that is, if the bank has knowledge or suspicions that the monies are being paid for uses other than those contemplated by the customer, then the bank owes a duty, at the very least, to make enquiries to clarify the customer's wishes.²⁹ The *Nemur* case at trial suggests that when there is a distinct possibility that the funds are not going to the right person then the bank in its paying capacity should not pay the cheque even though the signature of the drawer is valid and even though the proceeds are paid according to the crossing on the cheque. The basis for this duty is not particularly well articulated in the trial judgement. The trial judge did not expressly refer to the *Selangor* case but said that the monies were akin to trust monies.³⁰ But had the monies of *Nemur* actually been trust monies, then a case against the bank on the basis of 'knowing assistance' would have had to be brought by the beneficiary against *Nemur* as the trustee acting wrongfully. But, there was no dishonest intent on *Nemur's* part.³¹

Then, why the reference by the trial judge to the monies being like 'trust monies'? Perhaps it was an attempt to explain the *Selangor* duty. If it were this then it is something of a misconception. In this well known case the bank acting on behalf of one of the parties in a fraudulent and illegal misapplication of the company's funds to purchase its own shares was held liable as a constructive trustee. However, the real ratio decidendi of the case is arguably that the bank owed its customer a duty of care in paying cheques and this duty is not necessarily discharged by paying the cheques according to their tenor and according to the

28 Ellinger and Lomnicka, *Modern Banking Law* (2nd ed, 1994) 361.

29 *Selangor United Rubber Estates v Craddock* (no 3) [1968] 2 All ER 1073.

30 [1999] VSC 342 [146].

31 Where a bank is a party to a breach of trust by the trustee customer there are two sorts of cases: 'knowing receipt' and 'knowing assistance'. The characteristics of 'knowing receipt' are: first, the bank obtains a benefit; secondly, it knows that the monies beneficially belong to someone else: *Westpac Banking Corporation v Savin* [1985] 2 NZLR. With 'knowing assistance' the bank does not obtain a benefit but assists the trustee in breaching the trust. To succeed the beneficiaries must demonstrate that the bank had actual knowledge of trustee's dishonest intent: *DPC Estates Pty Ltd v Greg Consul Developments Pty Ltd* [1974] NSWLR 443. The decision by the Privy Council in *Royal Brunei Airlines v Tan* [1995] 2 AC 378 has narrowed the applicability of 'knowing assistance' to banks since it held that the accessory's liability is founded upon dishonesty. This would seem to suggest some dishonest involvement in the breach of trust. It could, however, be argued that actual knowledge by the bank of the trustee's breach of trust could be viewed as acting dishonestly.

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mandate lodged at the bank. The constructive trustee aspect of the case stemmed from the breach of contract.

In *Lipkin Gorman (a Firm) v Karpnale Ltd*³² it was held that a bank could not be held liable as a constructive trustee of its customer's money unless it was in breach of its contractual duty of care. But the reverse is not true. In *Ryan v Bank of New South Wales*,³³ a case decided by McGarvie J of the Supreme Court of Victoria who approved of the principle in *Selangor*, the plaintiff argued that the paying bank should not have paid out on its cheques against uncleared effects lodged in its account. (The uncleared effects were solicitor's trust account cheques but this had nothing to do with the decision on the duty of the paying bank.) McGarvie J found that there was a duty of care based on an implied term of the banker customer contract that the bank should not pay out on a cheque if circumstances were shown in which a reasonable banker properly applying his mind to the situation would know that, if the plaintiff knew the circumstances known to the banker, the customer would not want his cheque to be paid.³⁴ McGarvie J also made it clear in his judgement that the duty was based in contract law when he stated:³⁵

I have indicated that in my opinion *the proper implication from the contract* in this case is that the defendant bank is in breach of its duty of care if it pays a cheque drawn by a plaintiff, where, from circumstances known to the bank a reasonable banker properly applying his mind to the situation would have known that the plaintiff, if aware, of those circumstances would not have desired it to be paid. (author's italics)

On the facts in the *Ryan* case the plaintiff failed.

On appeal in the *Nemur* case it was found that the duty of the bank in its paying capacity was based solely on contract law and the Court of Appeal set its face against the possibility of any duty based on negligence.³⁶

Remoteness in contract law

Having decided that the real basis of the paying bank's liability was contractual, Batt JA went on to examine the issue of remoteness on the basis of contract law.

Interestingly, both the trial and the appeal proceeded on the basis that the paying and the collecting branch were not to be treated as distinct as regards knowledge

32 [1989] 1 WLR 1340, [1992] 4 All ER 409.

33 [1978] VR 579.

34 Ibid 581.

35 Ibid 582.

36 [2002] VSCA 18 [45].

and conduct.³⁷ This seems at odds with cases that in this context have treated knowledge and conduct of branches of the same bank differently for the purposes of liability and defences of the bank in its paying and collecting capacities.³⁸

Batt JA said:³⁹

Not only on liability but also on damages the appeal must proceed, as the trial had proceeded, on the basis that *the two branches of the Bank were not to be treated as distinct as regards knowledge and conduct*. However, the Bank did not know that the account into which, it was to assume, the cheques would through its default be paid was that of or associated with a fraudster. On the whole, I am not satisfied that the Bank should reasonably have contemplated that loss of the kind in question would probably (in the sense in which I have been using that word) result from a breach of its contractual duty of care in relation to the payment of cheques of Nemur Varity. That conclusion, I consider, is supported by the remarks of McHugh, J in *Kenny & Good*⁴⁰ set out earlier. To arrive at the contrary conclusion would, I think, be to impose liability upon the Bank exceeding that which it could be fairly regarded as having contemplated and been willing to accept, to adopt the words of Walsh, J. in *Wenham v. Ella*,⁴¹ applied by McHugh, JA in *Alexander v Cambridge Credit Corporation*.⁴² (italics added)

Treating both the branches as the same in terms of knowledge and conduct creates something of a tension. At trial in its collecting capacity the bank did not even try to establish that it had acted without negligence but the trial judge accepted evidence adduced by the plaintiff that the collecting bank had been negligent. Strictly speaking this was not necessary since the plaintiff's claim was in conversion. But had the bank in its collecting capacity made submissions that it had not been negligent, these would not have succeeded according to the trial judge.⁴³ Some of the matters raised in regard to the issue of negligence for the purposes of a defence for conversion under s 95 of the *Cheques Act* included failure to query the deposit of a third party cheque, failure by the staff to comply with the bank's procedures, and failure to query unusual indorsements on bearer cheques. These were matters within the collecting bank's knowledge and on appeal it was accepted that this knowledge was also to be attributed to the paying bank. Although this sort of knowledge is relevant to the issue of the defence of acting without negligence, it is also arguably relevant to the issue of whether the bank in its paying capacity should have reasonably contemplated the losses arising from

37 Ibid [53].

38 *Carpenter's Co v British Mutual Banking Co Ltd* [1938] 1 KB 501; see also *Chalmers and Guest on Bills of Exchange* (14th ed) (1991) 734

39 [2002] VSCA 18 at [53].

40 (1999) 199 CLR 413 at 437-8.

41 (1972) 127 CLR 454 at 466.

42 (1987) 9 NSWLR 310, 363-368 per McHugh, JA (obiter).

43 [1999] VSC 342 [138].

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the breach of its contractual duty, given that the two branches of the Bank were not to be treated as distinct as regards knowledge and conduct. Yet Batt JA said that the bank in its paying capacity 'did not know that the account into which, it was to assume, the cheques would through its default be paid was that of or associated with a fraudster'.⁴⁴ It is a matter of degree, surely, as to what the bank must know before it can be positively said to know that the money was going into a fraudster's account. However, the knowledge it had in its collecting capacity was adjudged not to be enough for the bank to be viewed in a paying capacity as knowing the monies were going into a fraudster's account. Nevertheless, attributing knowledge that the bank has in its collecting capacity to its state of knowledge as a paying bank is fraught with the danger that the bank in its paying capacity may be lumbered with all sorts of knowledge acquired in its collecting capacity that may be quite damning.

Curiously the *Cheques Act 1986* has no provision that deals explicitly with the problem of a bank that is both the paying bank and the collecting bank. This is a situation that is quite common in Australia.

Not treating the branches as distinct as regards knowledge and conduct can also create problems that did not arise in the *Nemur* case. For example, the plaintiff and a rogue employee of the plaintiff have accounts at the same bank but at different branches. The rogue steals a cheque with the plaintiff's name as payee and, forging the plaintiff's indorsement, puts it into his account. Some English cases suggest that if the bank in its paying capacity can use s 94 of the *Cheques Act 1986* then it cannot be liable for conversion.⁴⁵ This seems illogical. It is submitted that it is conceptually better and fairer to allow the defendant that is being sued in both capacities to avail itself of both defences and for the different branches to be treated as separately as far as conduct and knowledge is concerned and this means, of course, that it should act with care in both capacities.⁴⁶

Although bank branches are not separate legal entities and the bank is one single corporation, there are enough exceptions to this rule to justify treating different branches of the same bank as separate. It has been, for example, accepted that notice to stop payment to one branch does not constitute notice to stop payment to another branch of the same bank.⁴⁷ In the context of bankruptcy it is not permissible to aggregate the knowledge of one person (an agent) from one branch

⁴⁴ [2002] VSCA 18 [53].

⁴⁵ Section 94 of the *Cheques Act 1986* (Cth) provides the paying bank with protection if it pays a cheque with a forged indorsement on it if it acts in good faith and without negligence- it is deemed to have paid the cheque to the rightful owner: see *Bissell & Co v Fox Bros & Co* (1885) 53 LT 193; 1 TLR 542; *Gordon v London City and Midland Bank Ltd* [1902] 1 KB 242.

⁴⁶ EP Ellinger, *Modern Banking Law* (1987) 448.

⁴⁷ *London Provincial & South -Western Bank Ltd v Buszard* (1918) 35 TLR 142; *Bank of New South Wales v Ross* [1974] 2 Lloyd's Rep 110.

with the knowledge of another person (another agent) from another branch to establish that the bank has reason to suspect that the company is insolvent unless there is a duty and opportunity for such persons to communicate with one another.⁴⁸

Applying the second limb of the rules in *Hadley v Baxendale* on the issue of remoteness, namely, whether damages were within the actual contemplation of the parties when the contract was made, Batt JA encountered an immediate problem since the banker-customer contract was made in October 1986 while the breaches occurred in 1989. He therefore decided that the relevant time for the application of the test for contemplation was when the cheques were presented by the bank in its paying capacity and when the TT application was made.

As regards the TT transfer he found that it could not be said that the bank should have contemplated the business losses resulting from the breach. As to the payment of the cheques, Batt JA pointed out that the loss and remoteness of damages had to be looked at in the light of the fact that the bank did not know that through breach of its contractual duty the account into which the cheques would be paid was that of a company associated with a fraudster.⁴⁹ He was therefore of the opinion that this was not something that the bank could be said to have reasonably contemplated at the time of the breach of its contractual duty.

Remoteness of damages in regard to conversion

The bank in its collecting capacity was liable for conversion of the four cheques since it could not, indeed, did not even try to establish that it had acted without negligence which is a defence available to collecting banks under s 95 of the *Cheques Act 1986* (Cth).

The usual measure for damages is the face value of the goods converted: *Caxton Publishing Co Ltd v Sutherland Publishing Co*,⁵⁰ and with cheques it is their face value: *Morison v London County and Westminster Bank Ltd*.⁵¹ However, his Honour pointed out that cases and text books acknowledge that consequential losses may be recoverable;⁵² for instance, in *Harrisons Group Holdings Ltd v Westpac Banking Corporation*⁵³ consequential damages by way of interest were awarded for the loss of the proceeds of a cheque. But Batt JA was of the opinion that the application of the principles of remoteness of damages (reasonable

48 *Re Chisum Services Pty Ltd* (1982) 7 ACLR 641.

49 [2002] VSCA 18 [53].

50 [1939] AC 178, 192.

51 [1996] 1 VR 668.

52 [2002] VSCA 18 [56].

53 (1989) 51 SASR 36 at 40-41.

foreseeability) as established by *Wagon Mound No 1* and *Wagon Mound No 2* were not entirely clear in Australia as regards conversion of cheques.

Counsel for Nemur argued that all damages flowing naturally from the conversion were recoverable since conversion is a tort of strict liability. He also argued, in the alternative, that if the test for remoteness in regard to conversion was reasonable foreseeability, then this test was satisfied. Counsel for the bank, on the other hand, argued that the test for remoteness of damages in regard to conversion was whether the converter had special knowledge, that is, express notice or knowledge that loss beyond the face value of the cheques would be caused to Nemur.

First, Batt JA opined that a converter is not liable for all damages flowing naturally from the conversion.⁵⁴ His Honour seems to have been much taken with the idea of a sliding scale with strict liability being at the bottom, then negligence, and at the top intentional wrongdoing.⁵⁵ Batt JA thought that conversion was a tort of strict liability and that therefore it was to be found at the lower or less culpable end of the scale. In his opinion it was inappropriate that a converter be held liable for all damages flowing naturally from the conversion given that conversion can be innocent.⁵⁶

He also thought that reasonable foreseeability as a test for remoteness in regard to conversion was inappropriate and that a tougher test was required. He was of the view that the test for remoteness in regard to conversion of cheques should be whether the converter had special knowledge or notice. Batt JA approved obiter dictum from *France v Gaudet* where it was stated:⁵⁷

...in order to enable a plaintiff to recover special damage which cannot form part of the actual present value of the things converted, as in the case of the withholding of the tools of a man's trade, in which the damage arising from the deprivation of his property is not, and apparently cannot be fixed at the time of the conversion of the tools. In that case, however, we are inclined to think that either express notice must be given, or arise out of the circumstances of the case. This point was not determined in *Bodley v Reynolds*,⁵⁸ but we think that there must have been evidence of knowledge on the part of the defendant that in the nature of things inconvenience beyond the loss of the tools must have been occasioned to the plaintiff.

54 [2002] VSCA 18 [63].

55 Ibid [58].

56 Ibid.

57 (1871) LR 6 QB 199, 205.

58 8 QB 779.

Batt JA thought there was no evidence of any special knowledge of the bank in its collecting capacity and that there was therefore no justification for the consequential damages awarded by the court below. He stated:⁵⁹

There must be knowledge on the part of a defendant that *in the nature of things* inconvenience beyond the loss of the goods *must* have been occasioned to the plaintiff. The matters relied on did not show directly that loss of business income would occur nor did they show that indirectly, by showing that the chain of events which his Honour found occurred and resulted in loss of business income would occur.

He pointed out that it is not enough for this test for remoteness that certain events *might* happen. In effect, what was really absent was the bank's knowledge that a rogue was involved.

Conclusions

One of the issues decided at trial was that where the customer's account is for a special purpose an obligation is imposed on the paying bank not to pay cheques to parties who were not obviously in the contemplation of the drawer when the drawer wrote out the cheques. At trial whether this obligation depended upon tort or stemmed from the banker-customer contract was not made clear. The Court of Appeal has now clarified this and established that such a duty is contractual in nature and that therefore the appropriate measure for damages is the contractual one. Batt JA made the point that there has been a trend in courts of final appeal to stop the expansion of negligence into areas governed by contract, equity or statute⁶⁰ and cited numerous cases to support this trend: *CBS Songs Ltd v Amstrad Consumer Electronics Plc*,⁶¹ *Scally v Southern Health and Social Services Board*,⁶² *Downsview Nominees Ltd v First City Corporation Ltd*; ⁶³ *Hill v Van Erp*.⁶⁴ The only case mentioned in the judgement that supported the contention that a banker could be under coextensive duties in contract and tort was the case of *Barclays Bank plc v Quincecare Ltd* ⁶⁵ but Batt JA thought this was not good law.

Deane J of the High Court in *Hawkins v Clayton*⁶⁶ has spoken of the erroneous idea of a dichotomy between contract law and tort law and said:⁶⁷

59 [2002] VSCA 18 [69], Judge's italics.

60 [2002] VSCA 18 [47].

61 [1988] AC 1013, 1059-1060.

62 [1992] 1 AC 294, 302-304.

63 [1993] AC 295, 316-317.

64 (1997) 188 CLR 159, 179.

65 [1992] 4 All ER 363.

66 (1988) 164 CLR 539; (1988) 78 ALR 69; (1988) 62 ALJR 240; (1988) Aust Torts Reports 80-163.

67 (1988) Aust Torts Reports 80-163 ¶ 80-163.

SAME BANK DIFFERENT CAPACITIES: KNOWLEDGE, REMOTENESS AND
MEASURE OF DAMAGES

The law of contract and the law of tort are, in a modern context, properly to be seen as but two of a number of imprecise divisions, for the purpose of classification, of a general body of rules constituting one coherent system of law.

Some learned authors believe it is still open for the courts to find that the paying bank's duties are not founded in contract alone in an appropriate case.⁶⁸ Indeed, the High Court in *Astley v Austrust Limited*⁶⁹ has made it clear that professional service providers can owe concurrent and independent duties in contract and tort. Batt JA cited various passages from the *Astley v Austrust Limited* case to support his view that there was a trend away from the expansion of negligence governed by contract, equity or statute.⁷⁰ These passages could, however, be equally interpreted as just supporting the ratio decidendi of the case, namely, that providers of a professional service can owe concurrent duties in contract and negligence but that such duties may be restricted or excluded by agreement.⁷¹ However, Batt JA was of the view that in 'this area of discourse a banker is not a professional person'.⁷² He did not advance any reasons as to why he thought this to be so. Nevertheless the *Nemur* case is a powerful precedent that suggests that a banker is not in a paying capacity vis-à-vis its customer under concurrent duties in contract and negligence.

The rationale of the *Selangor* duty was not explored at trial or on the appeal. On the facts of the case it even seems difficult to understand its application. The damning evidence of lack of negligence in the bank's collecting capacity seems to have coloured the view of the bank in its paying capacity given that they were to be treated as the same. This seems an erroneous approach.

Moreover, it is submitted that the Court of Appeal missed an opportunity to set some realistic boundaries to the *Selangor* duty. Parker LJ in the *Lipkin Gorman* case set the duty at a more realistic level when he stated⁷³

The question must be whether if a reasonable and honest banker knew of the relevant facts he would have considered that there was a serious or real possibility albeit not amounting to a probability that his customer might be defrauded. If it is so established then in my view a reasonable banker would be in breach of duty if he continued to pay cheques without enquiry. He could not simply sit back and ignore the situation.

68 George A Weaver and PM Weaver, *The Laws of Australia*, Vol 18, 18.4 Chapter 18.4 [1].

69 (1999) 75 ALJR 403; (1999) 161 ALR 155.

70 [2002] VSCA 18 Para 47.

71 Brendan Sweeney and Jennifer O'Reilly, 'Service Providers' Breach of Duty of Care & Skill: Is there a Right to Apportionment for Contributory Negligence?' (2001) 7(1) *Current Commercial Law*, 56.

72 Para 47 of the appeal case.

73 [1992] 4 All ER 409 at 441.

Bearing in mind that Batt JA found that the bank in its paying capacity did not know that the account into which the cheque monies were going was associated with a rogue, it is difficult to see how on the facts there could have been a finding that the bank was in breach of its contractual duty as a paying bank by the trial judge. In addition, the trial judge's explanation of the liability is not very convincing: the bank knew the customer was a broker; the bank knew that the account included premium monies; and the bank knew the monies in the account were akin to trust monies. None of these things in themselves or even combined would lead to a conclusion that there was a breach of duty in the bank's paying capacity in terms of the *Selangor* duty. Perhaps when combined with the knowledge and conduct of the bank in its collecting capacity, yes. But this merging of knowledge and conduct of two branches acting in different capacities seems wrong.

The *Selangor* duty seems excessive given the customers' duties are relatively light, namely, the *McMillan* duty and the *Greenwood* duty. An opportunity in the *Nemur* case to define or limit the *Selangor* duty has been missed.

As to remoteness of damage for conversion of cheques, Batt JA, made much of the idea of a sliding scale going from strict liability to intentional wrongdoing in determining the test for remoteness. Starting at the top of the scale with intentional wrongdoing, Lord Steyn said in the *Smith v Scrimgeour Vickers* 'it is a rational and defensible strategy to impose wider liability on an intentional wrong doer'.⁷⁴ Thus with intentional torts like deceit and injurious falsehood, there is no requirement of reasonable foreseeability: *Palmer Bruyn v Parker*.⁷⁵ As pointed out by one learned author 'an innocent plaintiff may, not without reason, call on a morally reprehensible defendant to pay the whole of the loss he caused'.⁷⁶ Hence, with intentional torts, there is no requirement of reasonable foreseeability, since it extends the defendant's liability.

Placing conversion in the strict liability category, Batt JA therefore argued that a 'more stringent test of remoteness, satisfied only by express notice or special knowledge is required for conversion...'.⁷⁷ Being at the lower end of the scale, a test that lessens the defendant's liability is appropriate.

However, some confusion arises as to Batt JA's idea of strict liability. In terms of the sliding scale referred to in *Smith's* case, strict liability would seem to be referring to liability without fault, that is, liability for accidental harm, independently of either wrongful intent or negligence. In order to justify his

74 [1997] AC 254 at 279.

75 (2001) 76 A.L.J.R. 163 at 166, 170 and 172-176, [13], [54] and [63]-[81].

76 Hart and Honore, *Causation in the Law*, (2nd ed, 1985) 304.

77 [2002] VSCA 18 [58].

classification Batt JA points out that conversion may be 'entirely innocent'.⁷⁸ However, the fact that conversion may be intentional, he explains away by saying that it is not part of the definition of the tort of conversion. Be that as it may, surely it is an argument against characterising the tort of conversion as strict liability. The tort of conversion is usually classified as an intentional wrong. Fleming, for example, covers conversion in the chapter dealing with intentional interference with chattels.⁷⁹ Batt JA concedes in a footnote that the act of conversion must be committed intentionally but persists that it is not part of the definition of conversion.⁸⁰

Setting aside for a moment the correctness of Batt JA's classification of conversion as a tort of strict liability, the problem with strict liability as epitomised by *Rylands v Fletcher* is that the doctrine seems on the retreat. In *Cambridge Water co v Eastern Counties Leather Plc*⁸¹ the House of Lords returned the strict liability principle to nuisance (injurious consequences must be foreseeable). This test of remoteness seems inconsistent with the rationale for strict liability.⁸² On the other hand, the High Court of Australia has declared the principle of *Rylands v Fletcher* to be subsumed into the law of negligence: *Burnie Port Authority v General Jones*.⁸³ Apart from strict liability imposed by statute, one has to query whether it still is a useful category for classification purposes.

The obvious problem with the tort of conversion is that it can encompass two extremes of behaviour, innocent conversion and culpable conversion. The former might logically require a test of remoteness that lessens the defendant's liability but the latter requires a test that increases the defendant's liability given that the defendant has a malicious intention.

It is respectfully submitted that Batt JA's selection of express notice or special knowledge as the appropriate test is somewhat strained since in *Harrison Group King CJ* used reasonable foreseeability as the test for remoteness in regard to conversion and it is not very convincing to say that in this case the 'point as to the test for remoteness did not command a reasoned expression of view by his Honour'.⁸⁴ Moreover, Batt JA's rejection of overseas precedents that put forward reasonable foreseeability as the test for conversion, rest on his view that 'none of the cases on conversion discussed above is binding on this Court and there is on analysis little authority directly supporting that test'.⁸⁵ Given that Batt JA's view

78 Ibid [63].

79 Fleming, *The Law of Torts* (9th ed) (1998) Chapter 4.

80 [2002] VSCA 18 footnote 115.

81 [1994] 2 AC 264.

82 See McHugh J, in his dissenting judgement in *Burnie Port Authority v General Jones* (1994) 179 CLR 520.

83 (1994) 179 CLR 520.

84 [2002] VSCA 18 [62].

85 Ibid [62].

that special knowledge or actual notice is the test for remoteness for the tort of conversion rests upon obiter dicta in *France v Gaudet*, one might equally say there is little authority for the test he advances.

Logically, given that the tort may cover innocent as well as culpable behaviour, it would make more sense to either choose a midway test (reasonable foreseeability) or use two different tests depending upon whether the conversion is innocent or wicked.

Most conversions by banks of cheques are innocent and this is plainly what worried Batt JA about remoteness test in regard to intentional torts. Nevertheless, his characterisation of the tort of conversion as one of strict liability, requiring as a test for remoteness of damage that the converter have special knowledge or express notice is too sweeping given that conversion can cover culpable behaviour.