3VB'S FINANCE COLUMN: PAYMENT FRAUD: WHOSE LIABILITY?

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Anthony Pavlovich of 3VB considers the risk to banks in cases of payment fraud. The customer cannot usually recover most or all of the money that has been paid away. Since the fraudster will have vanished, the customer will look for wrongdoing on the part of its own bank or the recipient bank. What do banks need to know?

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WHO PAYS: THE CUSTOMER, THE PAYING BANK OR THE RECIPIENT BANK?

Payment fraud is an active area. Sometimes a bank's customer is tricked into directing a payment to a fraudster (authorised push payment (APP) fraud). Levels of APP fraud rose by 29% to £455.8 million in the UK in 2019 (*UK Finance: Fraud: The Facts 2020 (June 2020)*). Alternatively, an agent of the customer (such as a company director) may misappropriate funds.

The customer cannot usually recover most or all of the money that has been paid away. Then the question arises of who should bear the loss. Since the fraudster will have vanished, the customer will look for wrongdoing on the part of its own bank or the recipient bank.

It is generally easier for the customer to sue its own bank. The customer has a contract with its bank, and a mass of regulation governs the dealings between banks and their customers.

If the paying bank is not at fault, the customer might look to the recipient bank. Grounds may exist for alleging liability, provided the customer can argue that the bank should have prevented the fraud.

THE PAYING BANK'S LIABILITY

The customer's contract with the paying bank will normally impose a duty of care on the bank, which includes the "Quincecare duty" requiring the bank to investigate when it is put on notice of a possible fraud. For example, in one case a bank was found liable for a clear failure to stop a customer's director misappropriating money (*Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd [2019] UKSC 50*). But the Quincecare duty does not extend to APP fraud, since the customer cannot misappropriate her own money (*Philipp v Barclays Bank UK plc [2021] EWHC 10 (Comm)*).

The UK banking industry has introduced measures to combat payment fraud, such as "confirmation of payee" and "mule insights tactical solution". On 28 May 2019, the *Contingent Reimbursement Model Code for Authorised Push Payment Scams* was launched. This voluntary code provides full refunds to consumers, micro-enterprises and charities who are victims of domestic APP fraud. The exceptions include cases of "gross negligence" by the customer. The bigger UK banks have signed up.

The customer will also benefit from a number of regulations. The Payment Services Regulations 2017 (*SI 2017/752*) (PSR) are designed to protect the payer. Importantly, they require the paying bank (or other payment services

provider) to refund unauthorised payments promptly (*regulation 76(1)(a)*). But equally importantly, business customers have no direct ability to enforce the PSR, except in limited cases through the Financial Ombudsman Service or through a direct claim under regulation 148. It has been argued that this restriction is legally ineffective (*Hamblin v World First Ltd [2020] EWHC 2383 (Comm)*). Otherwise, the effect is that a breach of the PSR will usually only be indirectly relevant, perhaps as an instance of negligence.

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (*SI 2017/692*) set detailed requirements for customer due diligence (*regulations 27 and 28*). Again, these Regulations are hard to enforce directly but they can be indirectly relevant. There is also industry guidance from the Joint Money Laundering Steering Group and in the FCA's Financial Crime Guide to expand on the requirements, – but it is just guidance!

Conversely, the bank can seek to reduce its liability for negligence. It can allege contributory negligence by the customer in failing to stop the fraud. There can also be questions of mitigation, and it can be unclear who is responsible for trying to recover the funds.

For more information, see *Liability of banks and building societies to customers for authorised and non-authorised payment transactions*

THE RECIPIENT BANK'S LIABILITY

It is generally hard to establish liability against the recipient bank. But a customer can still try. For example, in one case a customer was permitted to use disclosed documents to bring a claim relating to APP fraud (*IFT SAL Offshore v Barclays Bank Plc [2020] EWHC 3125 (Comm)*).

A negligence claim faces a preliminary hurdle of establishing a duty of care, since the payer will not usually have any relationship with the recipient bank to create the required proximity or assumption of responsibility on the part of the bank (*Abou-Rahmah v Abacha [2005] EWHC 2662 (QB)*). If there is such a duty, breach can be easier to establish. For example, there may be breaches of the regulations discussed above (where applicable to the recipient bank). Again, there is a risk of contributory negligence and mitigation arguments.

A claim in unjust enrichment may be more attractive because it would not suffer that risk, but would instead put the focus on the bank's conduct. The main difficulty is that the bank will rely on a change of position (or on ministerial receipt), on the basis that it has paid away the money in good faith. Showing bad faith is harder than showing negligence, since it requires something approaching dishonesty (including "commercially unacceptable conduct", according to *Niru Battery Manufacturing Co v Milestone Trading Ltd [2003] EWCA Civ 1446, [2004] QB 985* at paragraph 164). Another difficulty concerns enrichment: why should the payment be treated as received by the bank rather than by the fraudster? Overall, this is a developing area of law.

A claim in knowing receipt may also be available. In many ways, it is the equitable version of the unjust enrichment claim. A preliminary hurdle is showing that the bank held the stolen funds subject to a constructive trust (*Halley v The Law Society [2003] EWCA Civ 97* at paragraph 45). The focus should be on the bank's "conscience" and of any knowledge it had or should have had of the fraud. The defences of change of position and ministerial receipt apply here, too, with the consequent analysis of bad faith. And there will be a question of whether the relevant "receipt" was by bank, rather than the fraudster.

CONCLUSION

Absent clear evidence of wrongdoing, customers have struggled to pin liability for payment fraud on their own bank, let alone the recipient bank. Nonetheless, the law, regulation and industry practices develop continuously and claims are now easier to bring, particularly for individuals and micro-enterprises suing their own banks.