SUSPICIOUS MINDS – COURT HOLDS BANK ENTITLED TO REFUSE TO EXECUTE A PAYMENT INSTRUCTION IF IT SUSPECTS MONEY LAUNDERING

THE LONDON LITIGATION LETTER

INTRODUCTION

In this transatlantic briefing we consider the recent case of *Shah v HSBC Private Bank (UK) Ltd [2012] EWHC 1283 (QB)*, in which the English High Court ruled that there is an implied term in the banker-customer contract which permits a bank to refuse to execute a payment instruction where it suspects the customer of involvement in money laundering. In so ruling, the Court dismissed the customers' claim for damages of more than $300m.

BACKGROUND

The Claimants, Mr and Mrs Shah (together the "Shahs") had been account holders with the Defendant bank, HSBC Private Bank (HSBC) in London, since 2002. Mr Shah conducts business in various countries (mainly in central Africa), including Zimbabwe, where he was based at the relevant time. In July 2006, he transferred over $28m from a bank account in Geneva to his London HSBC account, where it was held on a one month rolling deposit. He told his HSBC account manager that he needed to make the transfer because he believed that someone was trying gain access to his correspondence with the Geneva bank, probably to gain access to that account. After two months, Mr Shah instructed HSBC to return the money to the Geneva account. However, the following day, HSBC informed Mr Shah that it could not effect the transfer because it was "complying with its UK statutory obligations". HSBC did not provide Mr Shah with any further information in regard to his instruction.

SUSPICIOUS ACTIVITY REPORTS

HSBC suspected that the funds in Mr Shah's account were criminal property. Therefore, the bank had made a Suspicious Activity Report (SAR) to the Serious Organised Crime Agency (SOCA), asking for consent to proceed with the transaction. Before consent was granted (on 2 October 2006), HSBC failed to execute another money transfer request made by Mr Shah. The second request was for a small payment of $7,280 to a former employee of Mr Shah in Zimbabwe (Mr Kabra) to whom Mr Shah owed money. Again, HSBC made a SAR and informed Mr Shah that it was "complying with its statutory obligations".

When he was not paid, Mr Kabra told the Zimbabwean police that Mr Shah was suspected of being involved in money laundering. The Zimbabwean police then served a search warrant on Mr Shah and conducted searches at his home and office. Meanwhile, Mr Shah cancelled the payment instruction for the transfer to Mr Kabra. Subsequently, the Reserve Bank of Zimbabwe also asked him to explain what investigations into his affairs were being conducted. The Zimbabwean authorities subsequently froze and seized Mr Shah's investments held in certain private companies.

In due course, SOCA gave HSBC consent to proceed with two further transfers in February 2007.

THE CLAIM

The Shahs issued proceedings against HSBC alleging that, because Mr Shah was unable to provide a full explanation to the Zimbabwean authorities, their assets had been both frozen and seized; and as a result of the delay in the transfers they had suffered loss. They claimed more than $300m. The Shahs argued that HSBC was in breach of contract by failing to process their payment instructions promptly. They also contended that they should have been given the primary facts which caused HSBC to contact SOCA, together with the agency's reference numbers.

HSBC argued that, pursuant to its obligations under the Proceeds of Crime Act 2002 (POCA), there was an implied term in the banker-customer contract which permitted it to refuse to process a payment instruction, pending consent from SOCA where it suspected that the transaction constituted money laundering.

THE DECISION

Implied term in banker-customer relationship

Supperstone J dismissed the claim and gave judgment for HSBC. He held that under POCA, banks were at risk of criminal prosecution if they held suspicions about money laundering and did not report them; or if they reported them and then nonetheless carried out the customer's instructions without authorisation. It followed, therefore, that the POCA reporting regime had made inroads into the contractual duties of bankers to comply with a customer's payment instruction. He noted that it was plain that an intervention under POCA was potentially prejudicial to the customer. However, that was a price which Parliament had deemed worth paying in the fight against money laundering. The authorities showed that Parliament had struck a precise and workable balance between the conflicting interests of banker and customer under POCA. Therefore, he found that such balance required a term to be implied in the contract between a bank and its customer permitting the bank to refuse to execute payment instructions in the absence of "appropriate consent" from SOCA where it suspected the transaction(s) constituted money laundering.

The MLRO constitutes the bank

As to the question of who constitutes the bank for the purposes of the suspicion, Supperstone J found that it was HSBC's nominated Money Laundering Reporting Officer (MLRO), within the meaning of POCA. He did not think that it mattered that the MLRO had been appointed by HSBC's parent company because, as a matter of conduct and practice, the MLRO was the only person who reported suspicious activity.

The definition of suspicion

The judge held that, in the context, the test for suspicion was that set out in *R v De Silva [2007] 1 WLR 303*, namely that "the defendant must think that there is a possibility, which is more than fanciful, that the relevant facts exist. A vague feeling of unease would not suffice. But the statute does not require the suspicion to be clear or firmly grounded." The judge was in no doubt that HSBC's nominated MLRO had honestly and genuinely believed that the funds in Mr Shah's account were criminal property. He found that there was no issue as to whether the suspicion needed to be of a settled nature, although it was clear from the evidence that the MLRO's suspicions were of a settled nature.

The cause of the alleged losses

Supperstone J was unimpressed with the Shahs' argument that HSBC's delays had caused the loss. He found that there was no reference in the terms of the Zimbabwean search warrant to HSBC, money laundering, or Mr Shah's account being frozen. Instead he found that the losses had in fact been caused by actions of the Zimbabwean authorities which could not have been foreseen by HSBC. In fact, the predominant cause of the Zimbabwean authorities' actions were long standing concerns that they had about Mr Shah's activities.

No duty to provide information

Supperstone J held that there was no implied term in the contract between Mr Shah and HSBC under which the bank had a duty to provide Mr Shah with its communications with SOCA. The principal argument against disclosure of the information was that the bank would be unlikely to know whether its suspicions had triggered an investigation, or would do so in the future. Therefore, the provision of the information could constitute tipping off. Such an implied term would be unworkable because its practical effects would require banks to reveal regularly the factual basis of its suspicions. However, he did find that it was appropriate to imply a term permitting the bank to refuse to provide information to a customer when to do so might breach a legal or other duty.

COMMENT

This judgment will be welcomed by banks, as they are often placed in an invidious position when trying to reconcile their obligations to their customers with those that they have under POCA. Here, however, the judge was clear that when a bank suspects that a customer is involved in money laundering, and that suspicion is honestly held, it will not be in breach of contract if it delays the execution of a transaction instruction pending consent from SOCA. The case, therefore, offers banks considerable protection from claims for damages where a customer has suffered loss as a result of a delay in the execution of a transaction.

Banks will also welcome the rejection of the argument that they have a duty to inform a client when they make an SAR. Indeed, Supperstone J was unequivocal that banks should refuse to do so, as the provision of information would not only constitute tipping off, and could trigger a criminal prosecution, but would also cut across the statutory regime, act as a disincentive to report suspicions, and undermine the reporting regime.

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