Jumbo Foam Mattresses Industries Limited v First Community Bank & 2 others (Civil Appeal 62 of 2019) [2022] KEHC 16950 (KLR) (28 December 2022) (Judgment)

Neutral citation: [2022] KEHC 16950 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT KISUMU

CIVIL APPEAL 62 OF 2019

RE ABURILI, J

DECEMBER 28, 2022

BETWEEN

JUMBO FOAM MATTRESSES INDUSTRIES LIMITED ..... APPELLANT

AND

FIRST COMMUNITY BANK & 2 OTHERS ..... RESPONDENT

(An appeal from the judgement and decree of Hon W.K Onkunya S.R.M in Kisumu CMCC No. 36 of 2017 delivered on 5th April, 2019)

JUDGMENT

1. The plaintiff in the lower court was the appellant herein Jumbo Foam Mattresses Limited. It is a limited liability Company. The plaintiff sued the Defendants First Community Bank, Philip Owala Odera Odero and Simon Okumu Majimbo in the subordinate court claiming Kshs 1,225, 398/- and costs of the suit together with interest until payment in full.

2. The appellant's case was that the above said individuals opened a bank account in the appellant's name and banked several cheques drawn in its name at the 1st appellant Bank-First Community Bank. That upon reporting the issue to the Banking Fraud Investigating Unit, the appellant found that the individuals had colluded with the 1st respondent's agents and caused cheques amounting to Kshs 1,225,398/- drawn in the appellant's name to be banked into the said account and soon thereafter, Kshs 715,595/- was withdrawn from the said account.

3. The appellant averred that the respondent was reckless in allowing the said account to be opened and operated in the appellant's name. The particulars of such negligence have been provided under paragraph 8 of the plaint dated February 2, 2017.

4. The 1st defendant is the Respondent herein, First Community Bank. It filed its statement of defence denying negligence attributed to it. It averred that in facilitating the opening and the operation of

the bank account, it acted prudently, diligently and reasonably as expected of a banker. The fact of abrogation of duty by the respondent was also denied.

5. Jayeshkumar Trikambhai Patel the Appellant's Director testified as PW-1. He stated that an account in the appellant's name by unknown individuals where cheques stolen from its account's office would be deposited and withdrawals made therefrom. Upon realizing this, the appellant reported to the police and unearthed that cheques worth Kshs 1,225, 398/= had been banked and Kshs 715,595/= withdrawn. He stated that the documents and details used to open the account were not authentic. He accused the appellant of being negligent and facilitating the fraud leading to the loss of money.

6. Hawo Bora Godana, the 1st Respondent's Customer Service Representative testified as DW-1, and her testimony was that she received an application from the 2nd and 3rd defendants to open a bank account at the Respondent's Kimathi street. Upon conducting due diligence and verification of the documents submitted, she was satisfied of their authenticity and allocated an account number operated by the individuals. She was involved in opening the account.

7. The trial magistrate upon considering the evidence adduced by both parties dismissed the appellant's suit prompting the instant appeal which is premised on the grounds that:

    1. The learned magistrate erred in law in holding that the appellant had failed to prove negligence and or recklessness against the respondent.
    2. The learned magistrate erred in law and in fact in holding that there was no proof of fraud on the part of the respondent.
    3. The learned trial magistrate erred in law and in fact in holding that the respondent did not owe the appellant a duty of care and in holding that in the circumstances, the 1st respondent was not liable to the appellant for the loss and damage it had suffered.
    4. The decision of the trial court was illegal, unreasonable and allowed the respondent to unjustly enrich itself from its own mistakes.
    5. The learned magistrate miscomprehended the case before her, failed to analyse the evidence as a whole and reached a conclusion that was against the weight of evidence.

8. The appeal was canvassed by way of written submissions. Only the appellant complied and filed submissions reiterating the evidence adduced in the trial court.

9. On the 3rd ground of appeal, the appellant submitted that the trial magistrate erred by giving the term duty of care a very narrow definition. That the proper definition of the term was stated in *Equity Bank (kenya) Limited v Don Ogalloh Riaro & another* [2019] eKLR.

10. It was submitted that given the circumstances of the case, the bank colluded with the fraudsters to facilitate the opening, operation and the withdrawals of the money from the account. That the respondent failed to carry out due diligence and also violated the law and rules of banking.

11. It was further submitted that had the trial magistrate carefully considered the evidence before her, she could have allowed the claim as presented.

Analysis and Determination

12. The guiding principles in a first appeal were stated in *Gitobu Imanyara & 2 others v Attorney General* [2016] eKLR, where it was stated that:

> "... Briefly put, they are that this court must reconsider the evidence, evaluate it itself and draw its own conclusions though it should always bear in mind that it has neither seen nor heard the witnesses and should make due allowances in this respect."

13. Having considered the evidence adduced by both parties before the trial court as well as the grounds of appeal and the detailed submissions which reiterate the said testimonies, I am of the view that the issues for determination in this appeal are:

    a. whether the respondent owed a duty of care to the appellant in the manner in which the account was opened and operated

    b. whether the respondent was complicit in the fraud and

    c. whether the appellant proved negligence against the respondent to the required standards.

    d. What orders should this court make

14. On the first issue, the duty of care is usually owed by the bank to its customer as a matter of contract existing between that particular customer and the bank as has been established in several decisions. In *Equity Bank of Kenya & Another v Robert Chesang* [2016] eKLR, it was held that:

> "A bank has a duty under its contract with its customer to exercise reasonable care and skill in carrying out its part with regard to operations with its contracts with its customers. The duty to exercise reasonable care and skill extends over the whole range of banking business within the contract with the customer. Thus the duty applies to interpreting, ascertaining and acting in accordance with the instructions of the customer...The bank/customer relationship is based on utmost good faith. ...Any deviation from that understanding without justifiable reasons which should be communicated to the customer well in advance or immediately, the bank is in breach of a contract with the customer and is liable in damages."

15. The circumstances of the matter herein are that the account was opened by individuals who are not the appellant's directors, and or employees in the appellant's name. The appellant accuses the bank of reneging on its duty to exercise due care so that the account so opened was used to deposit cheques stolen from the appellant and thereafter withdrawn.

16. The duty of care comes into play when the relationship of a banker and customer exists. In the instant case, my finding from the analysis of the evidence on record is that the individuals who opened the account were indeed fraudsters who used forged documents to have the account opened in their favour. These individuals were unknown to both the appellant and the respondent.

17. The duty does not therefore extend to the appellant who was not a party to the entire transaction. Had the fraudsters been genuine people, the duty would be between them and the bank as opposed to the appellant.

18. The second issue relates to whether the respondent aided in the fraud. It is the appellant's further contention that the information given to the 1st respondent at the time of opening the account were a forgery and that the 1st respondent failed to take further steps to verify the authenticity of the documents so presented by the individuals.

19. It was the 1st respondent's evidence before the trial court that DW-1 received the application to open the account on 24/2/2014 and opened the account on 26/2/2014 after receiving original certificate of incorporation, original KRA PIN, original Memorandum of Association of the company, original sealed resolutions from the company, original identity cards of the directors, coloured passport size photographs and bank statements as a reference. It was her further testimony that before opening the account, she presented the documents to her supervisor for verification and that upon being satisfied, the account was opened.

20. In cross-examination, the witness stated that they did not write to the Registrar of Companies to verify the authenticity of the certificate of incorporation and as well as the Memorandum and Articles of Association. The 1st respondent further did not conduct a search at the Registrar of Companies. This was admitted by DW1.

21. It is now trite law that fraud must be specifically pleaded and proved. There is a plethora of cases on the subject from our courts. In *Vijay Morjaria v Nansingh Madhusingh Darbar & another* [2000] eKLR, Tunoi JA (as he then was) stated:

> "It is well established that fraud must be specifically pleaded and that particulars of the fraud alleged must be stated on the face of the pleading. The acts alleged to be fraudulent must of course be set out, and then it should be stated that these acts were done fraudulently. It is also settled law that fraudulent conduct must be distinctly alleged and as distinctly proved, and it is not allowable to leave fraud to be inferred from the facts."

22. The particulars of fraud have been pleaded under paragraph 9 of the plaint. I have carefully considered those particulars of fraud against the evidence adduced in the matter. It is my finding that in as much as the documents presented were a forgeries, the bank and or its agents did not aid in the fraud.

23. The allegations contained therein largely attach to the individuals as opposed to the bank and its agents.

24. In disposing the issue, I therefore hold that the respondent was not fraudulent and neither did it aid in perpetrating the fraud in the entire transaction.

25. As to whether the appellant proved negligence against the respondent. From the evidence on record, I find that the account was opened with the intention of advancing fraudulent activities on the appellant through theft of cheques. The element of negligence was discussed in *Standard Chartered Bank Limited v Intercom Services Limited & 4 Others* [2004] eKLR where it was held that:

> " The onus of establishing circumstances showing absence of negligence is on the banker. It is a matter of defence, does not give a substantive cause of action. The extent of inquiry must be measured by what in the circumstances, a fair minded banker paying due regard to the exigencies' of banking business in relation to the person depositing the cheque would consider it prudent to do in order to protect the interest of the true owner and each case must depend on its own circumstances."

26. Further on the subject, Justice Havelock in *Kenya Grange Vehicle Industries Ltd v Southern Credit Banking Corporation Limited* [2014] eKLR citing with approval JA Moldaver in *A & A Jewellers Limited v Royal Bank of Canada* [2001] Can LII 24012 (ON CA) observed that:

> "In cases such as this, where the Bank is under a duty to make inquiries of its customer regarding a possible breach of trust, the Bank will be found to be in constructive knowledge of the breach of trust if it 'fails to make the appropriate inquiries."

27. The appellant pleaded instances of negligence it attributes to the 1st respondent to *inter alia* include failing to adhere to standard account-opening and operation procedures and guidelines. The appellants produced as evidence the Central Bank of Kenya Prudential Guidelines for institutions licensed under the *Banking Act* CBK/PG/08 as Exhibit 6 which came into effect on January 1, 2006. Under Clause 4(3) thereof, the on customer identification and verification procedures, the 1st Respondent , it is provided inter alia, that "the Institution- Bank should establish to its satisfaction that it is dealing with a person that actually exists, and identify those persons who are empowered to undertake the transactions, whether on their own behalf or on behalf of others."

28. The said guidelines further provide that "in order to judge whether a transaction is or is not suspicious, an institution needs to have a clear understanding of the pattern of its customer's business as its relationship with the customer develops. Suspicious transactions may arise at any stage and frequently occur within an established business relationship rather than at the outset."

29. DW1 admitted that the 2nd and 3rd Respondents were depositing and withdrawing the cheques once the cheques were paid and that under the guidelines, this amounted to suspicious dealings which the Bank could have arrested in time.

30. Having considered the evidence in the matter, I am satisfied that the respondent failed to exercise due diligence expected of a banker when it opened and allowed the operation of the account in the manner it was operated leading to loss of money on the appellant's part.

31. In *Equity Bank (Kenya) Limited v Don Ogalloh Riaro & another* [2019] eKLR, the Court of Appeal held, *inter alia*, that:

> "In the instant matter, the liability and obligation of the appellant bank to the 1st respondent does not arise from the Advocates Act. It is an obligation arising from circumstances under which the common law imposes a duty of care that a bank owes to a third party. In this context, dicta from the case of Vitalarie (A General Partnership) -v- Bank of Nova Scotia [2002] OJ No 4902 (SCJ) is relevant where it was stated a bank is responsible to a third party if it fails to make reasonable inquiries despite having reasonable grounds of knowing its customer's fraud. We thus find the trial court did not err in its interpretation and application of Section 82 of the Advocates Act."[emphasis added].

32. DW-1's evidence that they did not conduct a search at the company's registry shows that the Bank deviated from the norm and abrogated its duty to the members of the public. There is sufficient evidence that if the 1st respondent had carried out due diligence on the directors of the company, it could have easily found out that the individuals opening the account were not the actual directors. It could also have found out that the documents presented by the individuals were indeed fake. A background check of the 'company' at the Registrar of Companies would also have alerted the respondent of whether the 'company' that opened that opened and operated the account did exist.

33. The question is why should the bank carry out customer due diligence? Customer Due Diligence (CDD) is the act of performing background checks and other screening processes on a customer. By performing CDD checks, a bank can ensure they properly assess the level of risk a customer poses before they allow them to open an account. The 1st Respondent no doubt failed to carry out customer due diligence which is an act of negligence on their part by omission. That negligence led to the fraudsters opening and operating an account in the name of the appellant company and withdrawing all the money which they banked using cheques drawn in favour of the appellant.

34. Havelock J (as he then was, in *Kenya Grange Vehicle Industries Ltd v Southern Credit Banking Corporation Ltd* [2014] eKLR made a similar finding when he cited extensively the decision in *Marfani &Co Ltd v Midland Bank Ltd* [1968]2All ER 573:

> "...What facts ought to be known to the banker, ie what inquiries he should make, and what facts are sufficient to cause him reasonably to suspect that the customer is not the true owner, must depend on current banking practice, and change as that practice changes. Cases decided thirty years ago, when the use by the general public of banking facilities was much less widespread, may not be a reliable guide to what the duty of a careful banker, in relation to inquiries and as to facts which should give rise to suspicion, is today.
>
> The duty of care owed by the banker to the true owner of the cheque does not arise until the cheque is delivered to him by his customer. It is then, and then only, that any duty to make inquiries can arise. Any antecedent inquiries that he has made are relevant only in so far as they have already brought to his knowledge facts which a careful banker ought to ascertain about his customers before accepting for collection the cheque which is the subject-matter of the action, and so have relieved him of any need to ascertain them again when the cheque which is the subject matter of the action is delivered to him. What the court has to do is to look at all the circumstances such as would cause a reasonable banker possessed of such information about his customer as a reasonable banker would possess, to suspect that his customer was not the true owner of the cheque".

35. The learned Judge further extensively analyzed the evidence and other authorities on the subject of negligence by Banks and stated as follows, and I concur:

> "The line of authorities as cited to this Court by the Plaintiff lays testament to the position where the Defendant bank owes a duty of care to the true owner of the cheques. Charlesworth & Percy on Negligence (supra) at paragraph 9-85 details as follows:
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> "Where a bank is acting as a clearing bank, that is, as agent for collection of a cheque on behalf on another bank or financial institution, it owes a duty of care to the true owner of the cheque, but is in general entitled to consider that the duty will be performed by its own customer, who should be in a far better position to know the circumstances in which the cheque was brought for collection and the identity of the person who submitted it. But the extent to which the clearing bank can rely on its customer will vary with the circumstances."
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> Similarly, under the heading "Time for assessing the collecting bank's conduct", Brindle & Cox's excellent volume on Law of Bank Payments 2nd Edition at paragraph 7-219 details:
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> "It might be thought that as a matter of construction of section 4 of the Cheques Act 1957, the relevant time for determining whether the collecting bank had complied with its duty of care towards the true owner of the cheque is the time it receives payment. However, in Marfani & Co Ltd v Midland Bank Ltd (supra) Diplock LJ held that the relevant time was

the time when the collecting bank pays out the proceeds of the cheque to his own customer holder, so depriving the true owner of his right to follow the money into the bank's hands. Thus, facts and matters which come to the collecting bank's attention between the time it receives payment of the cheque and the time when the holder draws against the cheque, are relevant. In Marfani, this enabled the collecting bank to prove that it had acted without negligence. Equally, facts which should put the collecting bank on inquiry might be received during this time."

22. Indeed, the Marfani case was cited by both the Plaintiff and the Defendant in their respective submissions before this Court. Somewhat surprisingly, the Defendant did not refer the Court to the provisions of section 3 of the Cheques Act (Cap 35, Laws of Kenya). Those provisions are very much along the lines of section 4 of the English Cheques Act (1957) and reads as follows:

"3. (1) A banker who gives value for, or has a lien on, a cheque payable to order which the payee delivers to him for collection either without endorsing it or without endorsing it regularly has such rights, if any, as he would have had if upon delivery the payee had endorsed it regularly in blank.

(2) Where a banker, in good faith and without negligence and in the ordinary course of business –

a. receives payment for a customer of a prescribed instrument to which the customer has no title or has a defective title; or

a. having credited the customer's account with the amount of a prescribed instrument to which the customer has no title or a defective title, receives payment of the instrument for himself, the banker does not incur any liability to the true owner of the instrument by reason only of his having received payment of it; and a banker is not to be treated for the purposes of this subsection as having been negligent by reason only that he has failed to concern himself with the absence of, or irregularity in, endorsement of a prescribed instrument of which the customer in question appears to the payee".

23. Diplock LJ extensively commented upon the common law position vis-a-vis the statutory position under the English Act. In the Marfani case he detailed as follows:

"At common law one's duty to one's neighbour who is the owner, or entitled to possession, of any goods is to refrain from doing any voluntary act in relation to his goods which is an usurpation of his proprietary or possessory rights in them. Subject to some exceptions which are irrelevant for the purposes of the present case, it matters not that the doer of the act of usurpation did not know, and could not by the exercise of any reasonable care have known, of his neighbour's interest in the goods. This duty is absolute; he acts at his peril.

A banker's business, of its very nature, exposes him daily to this peril. His contract with his customer requires him to accept possession of cheques delivered to him by his customer, to present them for payment to the banks on which the cheques are drawn, to receive payment of them and to credit the amount thereof to his own customer's account, either on receipt of the cheques themselves from the customer, or on receipt of actual payment of the cheques from the banks on which they are drawn. If the customer is not entitled to the cheque which he delivers to his banker for collection, the banker, however, innocent and careful he might have been, would at common law be liable to the true owner of the cheque for the amount of which he receives payment, either as damages for conversion or under the cognate cause of action, based historically on assumpsit, for money had and received.

So strict a liability, so absolute a duty, on bankers would have discouraged the development of banking business. It was accordingly progressively mitigated by statute, first by s 82 of the Bills of Exchange Act, 1882, then by the Bills of Exchange (Crossed Cheques) Act, 1906, and finally by s 4 of the Cheques Act, 1957, which is the current statute with which we are concerned, and sub-s. (1) of which reads as follows:

'(1) where a banker, in good faith and without negligence – (a) receives payment for a customer of an instrument to which this section applies; or (b) having credited a customer's account with the amount of such an instrument, receives payment thereof for himself, and the customer has no title, or a defective title, to the instrument, the banker does not incur any liability to the true owner of the instrument by reason only of having received payment thereof'.

"The only respect in which this substituted statutory duty differs from a common law cause of action in negligence is that, since it takes the form of a qualified immunity from a strict liability at common law, the onus of showing that he did take such reasonable care lies on the defendant banker. Granted good faith in the banker (the other condition of the immunity) the usual matter with respect to which the banker must take reasonable care is to satisfy himself that his own customer's title to the cheque delivered to him for collection is not defective, i.e. that no other person is the true owner of it. Where the customer is in possession of the cheque at the time of delivery for collection, and appears on the face of it to be the "holder", i.e. the payee or indorsee or the bearer, the banker is, in my view, entitled to assume that the customer is the owner of the cheque unless there are facts which are known, or ought to be known, to the banker which would cause a reasonable banker to suspect that the customer is not the true owner.

What facts ought to be known to the banker, i.e. what inquiries he should make, and what facts are sufficient to cause him reasonably to suspect that the customer is not the true owner, must depend on current banking practice, and change as that practice changes. Cases decided thirty years ago, when the use by the general public of banking facilities was much less widespread, may not be a reliable guide to what the duty of a careful banker, in relation to inquiries and as to facts which should give rise to suspicion, is today.

The duty of care owed by the banker to the true owner of the cheque does not arise until the cheque is delivered to him by his customer. It is then, and then only, that any duty to make inquiries can arise. Any antecedent inquiries that he has made are relevant only in so far as they have already brought to his knowledge facts which a careful banker ought to ascertain about his customers before accepting for collection the cheque which is the subject-matter of the action, and so have relieved him of any need to ascertain them again when the cheque which is the subject matter of the action is delivered to him. What the court has to do is to look at all the circumstances such as would cause a reasonable banker possessed of such information about his customer as a reasonable banker would possess, to suspect that his customer was not the true owner of the cheque".

24. The Marfani case was extensively referred to in the Court of Appeal matter of the Standard Chartered Bank Kenya Ltd v Intercom Services Ltd & 4 Ors [2004] eKLR principally by Onyango Otieno AgJA (as he then was) when after quoting the second of the above passages, he went on to say:

"The learned judge was fully alive to the above requirements and he reproduced part of the above decision I have reproduced hereinabove. The extent to which the inquiry should go, according to the above case, depends on the circumstances of each case. As a first appellate court, I am also enjoined to peruse and analyze the same circumstances that existed in this case subject to limitations I have stated above, to be able to come to my own conclusion as to whether or not the appellant went too far in its enquiry."

In the same case Githinji JA went a step further in his adoption of the Judgement of Diplock JA with reference to the case of Thackwell v Barclays Bank Plc [1986] 1 All ER 676 at page 687 wherein then the learned Judge stated:

"That test was applied with approval... in relation to the defence afforded to a collecting banker under Section 4 of the Cheques Act 1957 (English). That passage was again cited with approval by Parker, LJ in the Court of Appeal in Lipkin Garman vs Karpnale Ltd [1992] 4 All ER 409 at page 439 paragraphs g-j, who, in addition, observes that cases dealing with the question of breach of duty of care by a paying bank to its customer when carrying out customers' mandate must be approached with caution as they are no more decisions of fact i.e. of the application of the law to an endless variety of circumstances. His lordship sounded a further warning in approaching those cases at page 440 paragraph b thus: 'In addition, cases relating to a collecting banker being sued in conversion and those relating to a paying bank sued for breach of contract raise different considerations. In the former class of case it is for the banker to establish that he collected without negligence, in the latter the burden is on the customer to prove negligence. The statutory protection is also different in the two types of cases...'. In the present case, both counsel relied on the numerous English and Commonwealth decisions in support of their respective case. The decisions referred to fall into two classes. The first class relates to the case where the customer had sued his banker as the paying bank under the bank/customer contract or under the doctrine of constructive trustee to recover money paid

out to third parties from the account in breach of contract or constructive trust. That class of authorities is not relevant to the present case.

In the second class of cases, the true owner of the cheque had sued a bank in tort – (conversion) to recover money paid out by the bank to its customer. The cases of Marfani & Co Ltd v Midland Bank Ltd. (Supra) and Thackwell v Barclays Bank Plc (supra) [1896], 1 All ER 676 are good examples of the second class of the authorities."

25. The case before court obviously falls under the second class of the authorities above referred to. Indeed it is the Plaintiff's case, by its Amended Plaint dated 20th September 2007, that the Defendant was firstly, negligent for failing in its duty to observe the basic banking procedures and safeguards as to the opening of the said account number 81100032 and secondly, breached its fiduciary duty towards the Plaintiff as the true owner of the cheques drawn in its name. However, it was only in the Plaintiff's submissions that the word "conversion" was first used. The Court presumes that by the time the Plaintiff got round to writing its submissions, it had reviewed MS Parthasarathy's volume on Cheques in Law and Practice, Fifth Edition in which the learned author had defined "conversion" as:

"An act of or complex series of acts, of willful interference, without lawful justification with any chattel in a manner inconsistent with the right of another, whereby the other is deprived of the use and possession of it."

The learned author had gone on to say in simplification of the term as regards banking:

"Occasionally, a bank may collect a cheque (or bank draft) for a customer who has no title or only a defective title to it. The bank would then have committed an act of conversion and, if the general principles of law applied, would be liable to the true owner to pay damages arising from the conversion to refund the 'money had and received'".

In my view, the submissions of the Plaintiff did not go far enough in reinforcing its view that what the actions of the Defendant bank amounted to was, in fact, an act of conversion. To this end, M S Parthasarathy in his said volume goes on to state further under the heading "Conversion" as follows:

"A person is guilty of conversion, in the modern sense of the term, if he wrongly takes, detains, or disposes of, another's property. Conversion is defined as 'an act, or complex series of acts, of willful interference, without lawful justification, with any chattel in a manner inconsistent with the right of another, whereby that other is deprived of the use and possession of it'. Intention, implied in willful interference, refers only to the intentional commission of the act. Where the act done is necessarily a denial of the other's right or an assertion of a right inconsistent with it, the tort may have been committed, though the doer may not know of, or intend to challenge, the property or possession of the other.

A cheque represents a claim to money of the drawer in the hands of the drawee bank. Once a bank collects the money and credits it to the account of the customer for whom it has collected the cheque, the bank becomes a debtor of

the customer to the extent (unless the credit goes to reduce an overdraft on the account). It may not, therefore, be easy to see how the bank can be held to have converted the moneys represented by the cheque. As explained by Scrutton LJ in Lloyds Bank Ltd v Chartered Bank of India, Australia and China, courts have overcome the difficulty 'by treating the conversion as of the chattel, the piece of paper, the cheque under which the money was collected, and the value of the chattel converted as the money had and received under it'.

In Midland Bank Ltd v Reckitt, Atkin LJ recalled his own remarks in A L Underwood Ltd v Bank of Liverpool and Martins Ltd:

'The bank so disposed of the chattels, the cheques, as to deprive both themselves and the true owners of the dominion over them, and in exchange for the pieces of paper constituted themselves the debtors of the customer. I cannot imagine a plainer case of conversion. It is quite irrelevant to the issue of conversion that after payment the pieces of paper came into possession of the paying bank to be held as vouchers on account of the true owner'.

Denning J explained the legal principles in Nelson v Narholt as under:

'A man's money is property which is protected by law. It may exist in various forms, such as coins, treasury notes, cash at bank, or cheques, or bills of exchange of which he is 'the holder', but, whatever its form, it is protected according to one uniform principle. If it is taken from the rightful owner, or, indeed, from the beneficial owner, without his authority, he can recover the amount from any person into whose hands it can be traced, unless and until it reaches one who receives it in good faith and for value and without notice of the want of authority. Even if the one who received it acted in good faith, nevertheless if he had notice that is, if he knew of the want of authority or is to be taken to have known of it – he must repay. All the cases that occur in the books of trustees or agents who draw cheques on the trust account or the principal's account for their own private purposes, or of directors who apply their company's cheque for their own account, fall within this one principle. The rightful owner can recover the amount from anyone who takes the money with notice, subject, of course, to the limitation that he cannot recover twice over. This principle has been evolved by the courts of law and equity side by side. In equity it took the form of an action to follow moneys impressed with an express trust, or with a constructive trust owing to a fiduciary relationship . In law, it took the form of an action for money had and received or damages for conversion of a cheque. It is no longer appropriate, however, to draw a distinction between law and equity. Principles have now to be stated in the light of their combined effect. .... Remedies now depend on the substance of the right, not on whether they can be fitted into a particular frame work. The right here is not peculiar to equity or contract or tort, but falls naturally within the important category of a case where the court orders restitution, if the justice of the case so requires'."

26. This theme has been extensively explored in Clerk & Lindsell on Torts, 20th Edition where after the learned authors had defined the modes of conversion in paragraph 17-08 looked at the tort in direct relationship to negotiable instruments and securities. At paragraph 17-37 the authors had this to say:

> "Cheques, negotiable instruments and other securities, such as guarantees, insurance policies and bonds, considered as corporeal property, are simply pieces of paper. Their sole value is as choses in action, which cannot as such be converted. If, however, such physical documents are unlawfully dealt with, as where a cheque is stolen and paid into a bank account controlled by the thief, the person entitled to them may recover full damages based on their value as chooses in action. This principle extends to any document which is specially prepared in the ordinary course of business as evidence of a debt or obligation, and thus including (for example) share certificates and trading stamps. Nevertheless, it applies only in so far as the document is, in fact, a valid security. Thus no substantial recovery is available in respect of a cheque which, when converted, had been avoided as a result of an unauthorised alteration. The measure of damages is prima facie the value of the debt or obligation of which the document is evidence." (Underlining mine).

36. The learned Judge concluded that:

> " Under the banker/customer relationship as between the Defendant and the said holders, I find that the Defendant was under a legal obligation to pay the credit proceeds of the said account number 81100032 to them. Such is in relation to Issue No 7. As regards to whether the loss of the Plaintiff was due to the negligence of the Defendant bank, I so find in favour of the Plaintiff. As above, I find the Defendant guilty of negligence in the opening of the said account as aforesaid. I also find that the Defendant failed to take proper precautions so as to ensure that the holders (signatories) to the said account were legally who they said they were. The ostensible company as per the forged Certificate of Incorporation was formed on the December 24, 2003. Its so-called directors and shareholders were seeking the opening of an account for the so-called company 11 months later yet the Defendant failed to even check whether the same was in operation, where was its premises and other obvious questions that should have been asked by DW 1."

37. A similar situation obtains in this case. As was held by the Court of Appeal in the *Equity Bank* case(*supra*), Central to the issue of liability of the 1st Respondent Bank is the role and place of CBK Prudential Guidelines. The Prudential Guidelines place a duty on all licensed banks to make enquiries regarding the legitimacy of funds and transactions. The Guidelines require that a bank should make enquiries on a case by case basis for large, frequent or unusual transfers in relation to the parties and the nature of the transaction.

The CBK Guidelines are issued under Section 33(4) of the *Banking Act*, which empowers the Central Bank to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system. Section 33 (4) of the *Banking Act* provides:

> " 4) The Central Bank may issue directions to institutions 20 generally for the better carrying out of its functions under this Act and in particular, with respect to-
>
> (a) the standards to be adhered to by an institution in the conduct of its business in Kenya or in any country where a branch or subsidiary of the institution is located; and

(b) guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

(5) A person who fails to comply with any direction under this section commits an offence and shall, in addition to the penalty prescribed under section 49, be liable to such additional penalty as may be prescribed, for each day or part thereof during which the offence continues."

38. The Court of Appeal further stated as follows, which I find to be in *pari materia* with this case:

" In this matter, the appellant urged that the trial court erred in relying on the CBK Guidelines which are neither a subsidiary legislation nor a statute. The Statutory Instruments Act No 23 of 2013 defines a "statutory instrument" to mean any rule, order, regulation, direction, form, tariff of costs or fees, letters patent, commission, warrant, proclamation, by-law, resolution, guideline or other statutory instrument issued, made or established in the execution of a power conferred by or under an Act of Parliament under which that statutory instrument or subsidiary legislation is expressly authorized to be issued. Going by the definition of statutory instrument, we find that the CBK Guidelines having been issued pursuant to Section 33 (4) of the Banking Act is a statutory instrument with legal force.

44. In the instant appeal, it was conceded that even if the appellant were in breach of Clause 4.3. of the Prudential Guidelines, the breach did not cause loss or damage to the 1st respondent. This leads us to the issue of liability of the appellant to the 1st respondent and the question of causation, foreseeability and remoteness of the loss suffered by the 1st respondent.

45. On the issue of liability and duty of care owed by the appellant Bank to the 1st respondent, the trial court was guided by comparative jurisprudence. Being so guided, the court arrived at the conclusion that the appellant owed a duty of care to the 1st respondent. The appellant faults the trial court for arriving at this conclusion. Citing the case of Caparo Industries Plc -v- Dickman [1990] UKHL it was submitted that it was not proved that the appellant Bank could reasonably foresee that its actions were likely to harm the 1st respondent who was not a customer of the bank; that there existed no relationship of proximity between the appellant and the 1st respondent. Relying on dicta from Pardhan -v- Bank of Montreal 2012 ONSC 2229 (CANLII) it was submitted that there was no proximate relationship between the appellant Bank and the 1st respondent who was a third party to the Bank. Several other judicial decisions were cited in support of its submissions that no duty of care was owed by the appellant to the 1st respondent.

46. Given the undisputed facts of this case, did the appellant Bank owe a duty of care to the 1st respondent who was not its customer?

47. In Tricon International Limited v Giro Commercial Bank Limited [2012] eKLR it was recognized that there is an obligation on banks to make enquiries as mandated by the Prudential Guidelines. In this regard, the quote from Diplock, LJ in the case of Marfani & Co Ltd v Midland Bank Ltd [1968] 2 ALL ER 573 and particularly at page 579 commends itself to us:

"What facts ought to be known to the Banker, i.e what inquiries he should make, and what facts are sufficient to cause him reasonably to suspect that the customer is not the true owner, must depend on current banking practice and change as practice changes. Cases decided thirty years ago, when the use by the general public of banking facilities was much less widespread, may not be a reasonable guide to what the duty of a careful banker, in relation to inquiries as to facts which should give rise to suspicion, is today.

The duty of care owed by the Banker to the true owner of the cheque does not arise until the cheque is delivered to him by his customer. It is then, and then only, that any duty to make inquiries can arise. Any antecedent inquiries that he has made are relevant only in so far as they have already brought to his knowledge facts which a careful banker ought to ascertain about his customers before accepting for collection the cheque which is the subject matter of the action, and so have relieved him of any need to ascertain them again when the cheque which is the subject matter of the action is delivered to him. What the Court has to do is to look at all the circumstances at the time of the acts complained of, and ask itself were those circumstances such as would cause a reasonable banker possessed of such information, about his customer as a reasonable banker would possess, to suspect that his customer was not the true owner of the cheque."

39. The Court further stated as follows:

> " 50. We are further persuaded by the comparative decision of the Supreme Court of the Netherlands where it was held that banks have a special duty of care not only to their clients but also to third parties; that the duty owed to a third party depends on the circumstances of each case; that under certain circumstances banks will be acting unlawfully if they fail to investigate whether the client is acting in accordance with regulatory legislation. (See Supreme Court of the Netherlands, 9 January 1998, ECLI:NL:HR:1998: ZC2536, NJ 1999/285 (MeesPierson/Ten Bos), legal finding 3.6.2.). It was further held that if a bank's investigation shows that the client has acted in violation of regulatory legislation it will, in principle, need to take steps to protect the interests of third parties; that the measures which are appropriate in any specific case will depend on the circumstances of that case."

40. Banking industry in Kenya is governed by the *Companies Act*, the *Banking Act*, the *Central Bank of Kenya Act* and the prudential guidelines issued by the Central Bank of Kenya (CBK) from time to time. The 1st respondent having admitted that it failed to adhere to the prudential guidelines, cannot escape liability for the loss of money. Again, I am fortified by the Court of Appeal decision in the *Equity Bank* case(*supra*) where the superior Court had this to say and which is in pari materia to this case:

> " In the instant appeal, the 1st respondent alleged that the appellant bank failed in its duty to ensure that the 2nd respondent did not operate his account in a suspicious manner. That the large cash withdrawals were sufficient signs that something was not normal.
>
> 52. The CBK Prudential Guidelines provides that for large, frequent or unusual cash deposits or withdrawals - written statement from the customer is required confirming the nature of his/her business activities. In the instant matter,

it is not disputed that the 2nd respondent withdrew large sums of cash over the counter eg Ksh 5,800,000/= on July 26, 2008; Ksh 3,100,000/= and 11,647,000/= both on October 9, 2008 and Ksh 4,600,000/= on December 5, 2008.

53. Despite the express requirement under the CBK Prudential Guidelines, the appellant bank never inquired into the nature of the transaction that the 2nd respondent was engaged in that led to withdrawal of large amounts of cash over the counter. That is not to say that a banker's attitude in carrying out this exercise is to "see no evil and hear no evil". Of relevance is the banker's duty in processing payments for customers and others that was extensively discussed by this Court Standard Chartered Bank Kenya Ltd v Intercom Services Ltd and 4 others. [2004] eKLR.

54. In this matter, taking into account that the proceeds of cheques drawn in favour of a different entity was being withdrawn in cash in large sums over a short period, we find that there was a sufficient basis for the appellant Bank to be suspicious of the manner in which the 2nd respondent was operating and withdrawing cash from the account. We thus find that the appellant Bank was negligent and violated the CBK Prudential Guidelines and failed to obtain a written statement from the 2nd respondent who was its customer to explain the large sums of cash being withdrawn over the counter. We thus find the trial court did not err in arriving at the conclusion the appellant Bank was negligent and it violated the CBK Prudential Guidelines. In this context, we are comforted by the persuasive dicta in Shalimar Flowers Self Help Group v Kenya Commercial Bank [2016] eKLR where it was stated:

> 60. "All the red flags were waving in this case in my view but the Defendant by not exercising reasonable care and skill, missed or ignored them, thereby allowing the withdrawal, in quick succession, of large sums of money donated to flower workers as commissions. I find on a balance of probability that the Defendant bank was negligent in the manner in which it handled and approved the nine payments and is 100% liable."

41. Based on the evidence adduced in the lower court and on the authorities cited herein in extenso, I am satisfied that the appellant proved on a balance of probabilities that that the respondent was negligent in the manner that it handled the entire transaction with the persons who turned out to be fraudsters, leading to the appellant losing substantial sums of money where its cheques were deposited and withdrawn from an account opened and operated by the fraudsters.

42. To that extent, I find this appeal merited. the appeal is allowed in terms that the judgment of the lower court dismissing the appellant's suit with costs is hereby set aside and substituted with judgment being entered in favour of the appellant against the 1st Respondent in the sum of Kshs 1,225,398.00 with interest at court rates from the date of filing suit in the lower court until payment in full. The appellant is also awarded costs of the appeal and in the subordinate court and interest on costs at court rates from date of assessment until payment in full.

43. I so order.

DATED, SIGNED AND DELIVERED AT KISUMU THIS 28TH DAY OF DECEMBER, 2022

R.E. ABURILI

JUDGE