



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT MALINDI

CIVIL SUIT NO. 5 OF 2014

MERRY BEACH LIMITED..... PLAINTIFF

VERSUS

BARCLAYS BANK OF KENYA LIMITED.....1ST DEFENDANT

GIANLUIGI CERNUSCHI2ND DEFENDANT

CORAM: Hon. Justice R. Nyakundi

Kinyua Muyaa for the Plaintiff

Ms. Kaguri for the 1st defendant

J U D G M E N T

Background

The plaintiff brought this suit vide an amended plaint dated 23.03.2016 seeking the following orders;

- a. A declaration that the 1st defendant owed a duty of care and had a statutory obligation to the plaintiff to effect payments out of the plaintiff's accounts held at the 1st defendant's branch at Malindi only on terms of the mandate including that crossed cheques could only be opened by the 2nd defendant jointly with Mr. Massoud Mowlazadeh and that electronic transfer could only be effected from the said accounts upon the authority in writing of both the 2nd defendant and Mr. Massoud Mowlazadeh.**
- b. A declaration that the sum of Kshs. 27,023,646 and Euros 60,000 as specified in paragraph 14 of the amended plaint were paid out of the said accounts by fraud.**
- c. A declaration that the 1st defendant failed to discharge its contractual and statutory duty to the plaintiff concerning the operations of the two accounts and that failure led into the direct loss of the plaintiff's sum in the amounts of Kshs.27,023,646 and Euros 60,000.**
- d. A declaration that the 1st defendant colluded with the 2nd defendant to defraud the plaintiff the sum of Kshs. 27,023,646 and Euros 60,000.**
- e. Judgment against the defendant in the sum of Kshs. 27,023,646 and Euros 60,000.**
- f. Interest calculated at 12% per annum from the respective dates that the said payments were effected.**
- g. Costs of the suit**

The 1st defendant filed an amended statement of defence and counter-claim on 30.10.2018. The 1st defendant in its defence states that the subject bank accounts were operated as per the terms and conditions relative to the said accounts agreed upon completing the requisite application form, the plaintiff's resolutions and as per the banking laws and regulations.

Further the defendant avers that it conducted its business and professional obligations in compliance with its duty of care to the plaintiff on payments made via cheques presented to it by the plaintiff and its signatories **Mr. Massoud Mowlazadeh** and the 2nd defendant.

The 1st defendant counter-claims against the plaintiff that the plaintiff never gave any instructions to the 1st defendant as not to honor any cheques drawn in favor of the 2nd defendant from the subject accounts and thus seeks;

a. A declaration that the plaintiff breached the terms and conditions of the accounts and the cheque book held with the 1st defendant.

b. A declaration that the 1st defendant is not entitled to compensate the plaintiff any sums paid out of the subject accounts.

c. In the alternative, the court be pleased to order the 2nd defendant to indemnify the 1st defendant as per the Notice of claim filed against the co-defendants.

d. Costs of the suit and the counter-claim.

The 2nd defendant never entered appearance and there is an interlocutory judgment against him.

Facts

The plaintiff is a limited liability company incorporated in Kenya with a share capital of Kshs. 100,000 divided into 1,000 shares of Kshs. 100 each. **Mr. Massoud Mowlazadeh** holds 998 of those shares while his son **Mahmood Mowlazadeh** has 1 share and the 2nd defendant **Gianluigi Cernuschi** holds the other one share.

The plaintiff opened a Kenya Shillings Account number 1027690 and a euro Account Number 7244054 at the 1st defendant's branch at Malindi in March 2009. The 1st defendant bank required the plaintiff to specify the manner in which it wished the accounts to be operated to ensure the security of its money and the integrity of those accounts.

The plaintiff had funds in both Kenya shillings and euros in its accounts. The plaintiff realized that funds had been withdrawn from those accounts and from the year 2012 wrote to the 1st defendant inquiring about the anomalies. The 1st defendant promised to avail copies of the paid cheques to the plaintiff.

Following an order of the court of appeal in the judgment dated 14th December 2017, the 1st defendant in January 2018 provided original and copies of some of the cheques and stated that it had destroyed some of the cheques.

Evidence of the parties.

The matter proceeded by way of hearing with the plaintiff calling one witness and the 1st defendant calling two witnesses.

PW1 Walter Kilonzi the plaintiff's company secretary. He stated that he had been the plaintiff's company secretary from the year 2009.

He testified that in the year 2009, the plaintiff's directors were Gianluigi Cernuschi and **Mr. Massoud Mowlazadeh** before Gianluigi Cernuschi resigned in the year 2012.

He further informed the court that he had visited the defendant's branch at Malindi six times to follow up on the paid cheques after they had discovered that there were anomalies in the two accounts. He informed the court that money had been transferred from both accounts electronically and that the Plaintiff had not authorized any transfer of funds nor signed any cheques to authorize any transfer.

DW1 Peninah Mwenda the Branch manager of the 1st defendant at Malindi branch, told the court that the bank followed the instructions of the plaintiff and that once a cheque is cashed it means that the cheque is cashed by the owner of the account. She testified that from the bank statements all cheques were paid out and that the plaintiff never complained or stopped the payment of any cheque.

On the issue of the destruction of cheques, she stated that the bank had a policy of destroying cheques after 7 years and that the cheques cashed in 2009 were due for destruction in 2016 and the cheques in question had been destroyed in 2015 before the lapse of 7 years.

DW2 Tom Mwakinda the operations director of the 1st defendant stated that he had worked for the 1st defendant 27 years. He told the court that the plaintiff did not need to open the cheques because the bank has a different practice.

He testified that that all cheques were properly drawn and paid in accordance with all instructions. He however, stated that he had not seen the cheques for Euros 50,000 and Euros 10,000.

The parties agreed on a list of issues for determination and the same was filed in court on 24th march 2021 which I will frame as follows;

i. Whether the plaintiff authorized the filing and prosecution of this suit.

ii. Whether the 1st defendant breached its duty of care to the plaintiff

iii. Whether there was fraud by the 2nd defendant.

iv. Whether the 1st defendant breached its contractual and statutory obligation to the plaintiff concerning the operation of the plaintiff's accounts

v. Whether the plaintiff breached the terms and conditions upon which the two accounts were opened.

vi. Whether at the time of filing the amended defence and counter claim the 1st defendant was in possession, custody or control of all the cheques or copies of cheques in issue

vii. Whether the plaintiff has suffered loss and damages for the sum of Kshs. 27,023,646 and Euros 60,000

viii. Whether the 1st defendant acted fraudulently and/or in collusion with the 2nd defendant in payment of money from the plaintiff's accounts

ix. Whether the 1st defendant should be indemnified by the 2nd defendant as per the notice of claim filed against the co-defendant

x. Whether the defendants, jointly and severally should pay to the plaintiff the sum of Kshs. 27,023,646 and Euros 60,000 together with interest

xi. Who bears the costs of the suit and counter claim

Analysis and determination.

Whether the plaintiff authorized the filing and prosecution of this suit

The 1st defendant filed a preliminary objection dated 15th September 2015 on grounds that the suit had been instituted without a valid director's resolution and as such the suit should be struck out.

The 1st defendant submits that that by resolution filed on 28th February 2014 bears one signature of the directors yet the company had two directors and for that ground, the resolution is invalid.

The plaintiff submits that the 1st defendant is not privy to the inner workings of the Plaintiff's Board of directors. That none of the Plaintiff's directors or shareholders has challenged the Plaintiff's resolutions.

The question which arises in this case is whether the filing of the instant suit was duly authorized by the plaintiff company. In other words did the plaintiff, being a corporation, obtain the boards authorization to commence this suit?

The authorization envisaged by **Order 4 Rule 1 (4)** is written authority under seal, but courts have however held that the mere failure to file the resolution of the company together with the plaint did not invalidate the suit as such a resolution could be filed at any time before the suit is fixed for hearing. (See **Leo Investments Ltd vs Trident Insurance Company Ltd [2014] eKLR** and **Republic vs Registrar General and others (2005) eKLR**).

Paragraph 2 of the Verifying Affidavit states that annexed with the amended plaint is a resolution of the board. There is no dispute that there was a resolution by the board authorizing the filing of this suit. What is contested is the competence of the resolution.

Whether the 1st defendant breached its duty of care to the plaintiff

A duty of care is a legal obligation which is imposed on an individual, requiring adherence to a standard of reasonable care while performing any acts that could foreseeably harm others. It is the first element that must be established to proceed with an action in negligence. The claimant must be able to show a duty of care imposed by law which the defendant has breached. In turn, breaching a duty may subject an individual to liability.

In **Karak Brothers Company Ltd v Burden [1972] All ER 1210**, the Court observed as follows:

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 within its contract with its customer. The standard of that reasonable care and skill is an objective standard applicable to bankers. Whether or not it has been attained in any particular case has to be decided in the light of all the relevant facts, which can vary almost infinitely.

The bank's duty of care to its customers may also arise concurrently in tort. Thus in **Selangor United Rubber Estates Ltd v Cradock (No. 3) [1968] 1 WLR 1555, Ungood-Thomas J.**, stated as follows, as regarding a bank's duty of care:

To my mind... 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 within its contract with its customer. The standard of that reasonable care and skill is an objective standard applicable to bankers. Whether or not it has been attained in any particular case has to be decided in the light of all relevant facts which can vary almost infinitely.

The question I am called to address first is whether the 1st defendant owed the Plaintiff a duty of care and if so, whether that duty was breached.

From the evidence on record, it is clear that there was a scope of mandate setting out the signatories to the accounts and that the same mandate would remain in force unless varied by the mandated signatories. There has been no proof that the said mandate at any point was varied. As such, the bank was under the obligation to perform its duties as per the plaintiff's authority, in paying out the cheques and the electronic transfer of funds without having the consent of both signatories. The purpose of the duty of care vested with the defendant bank was to protect the plaintiff against just the sort of misappropriation of its funds as it happened here. To attribute the fraud of that magnitude to the plaintiff would be to denude the duty of any value in cases where it is most needed. That is why I am unable to accept the defendant bank arguments in this whole saga of the 'payment system' adopted to perpetuate a fraud.

The law on negotiable instruments is crystal clear, that crossing of a cheque is an instruction given to the paying banker to pay the amount of the cheque through a banker only and not directly to the person presenting it at the counter. The crossing on a cheque is intended to ensure that its payment is made to the right payee.

It is however essential that the maker or drawer of a cheque has lawful possession over it to enable him endorse or negotiate it. The plaintiff has questioned the authentication of the endorser subject maker of the disputed cheques. There is no rebuttal evidence from the defendant bank of its statutory obligations. I find that the defendant bank acted negligently and breached its duty of care to the plaintiff.

Whether there was fraud by the 2nd defendant.

Black's Law Dictionary defines fraud as; *A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment.*

In *Katende vs. Haridas and Company Limited* [2008] 2 EA 173, it was held that:

“Fraud can be participatory which means the party participates in fraudulent dealings. However, fraud can be imputed on a person that is when he or she was aware of the fraud and condoned it, or benefited from it or used it to deprive another person of his rights. In short all those who actually participate in the fraudulent transaction and who had knowledge of it are privy and have notice of fraud.”

In *Silayo vs. CRDB (1966) Ltd* [2002] 1 EA 288, it was held that:

“In civil action where fraud or other matter is or may be a crime is alleged against a party or against persons to the action, the standard to be applied is that applicable in civil actions generally, namely, proof on the balance of probability, and not the higher proof of beyond all reasonable doubt required in criminal matters...The elements of gravity of an issue are part of the range of circumstances which have to be weighed when deciding as to the balance of probabilities.”

In *R.G Patel v. Lalji Makani*, [1957] E.A it was held that:

“All allegations of fraud must be strictly proved, although the standard of proof may not be so heavy as to require proof beyond reasonable doubt, something more than a mere balance of probabilities is required.”

An issuing bank is only obliged to honor cheques drawn by a customer when they are accompanied by documents which appear on their face to be regular and in accordance with the terms and conditions of account operating standards. A bank is obliged not to pay any cheque where prima facie evidence exist of a fraud.

In the instant case, the fraud was demonstrated by the presentation made by **Gianluigi** to honor a cheque of the plaintiff in absence of the benefit of a corresponding endorsement instrument to attest to the signatory. In the underlying transaction of such a character the bank had the power and discretion to withhold payment, of cash to **Mr. Gianluigi**. This was not a mere discrepancy, clearly controverted as alleged by the defendant, for on the face of it the cheques tendered sufficiently established to the knowledge of all defendant bank a high probability of a fraud being committed by one of the directors of the plaintiff company. The defendant bank had ample opportunity to inform the plaintiff of the alleged irregularities with respect of the questionable instruments. The rule of 'account' operations held with the defendant bank required strict documentary compliance not only that the tendered cheques appear on their face, upon reasonably careful examination to conform to terms and conditions of the 'account' but they also appear to be consistent with one another, in particular in the sense that they refer to the transactions authorized by the plaintiff. The rule of strict documentary cheque compliance does extend to minor variations or discrepancies that are sufficiently material to justify a refusal of payment.

In the case at bar, the plaintiff was indeed prejudiced by those acts of negligence in the sense of the loss incurred attributable to fraudulent cheques being honored. I am according to the view that there is prima facie evidence to support that the alleged fraud in respect of the questionable cheques was within the knowledge of the defendant bank. It is obvious and clear that one director of the plaintiff without a resolution usurped, the powers of the entire company to exercise autonomy in transacting huge amounts of money without corresponding leave from the other directors. I guess, the fundamental rule in a bank/client relationship involving account held of a company like the plaintiff, the cheques or documents presented for payment must appear on their face, upon reasonable examination, to be in accordance with

the terms and conditions of 'account operating standards'. There is no room for discretion. In bank payment system it matters not whether the discrepancy is significant or minute. Where in this case, the defendant bank debited the plaintiff account persuasive to an improper drawn cheque, an action for recovery of the amount, of the debit sometimes referred to as the damage must lie.

Any reasonable banker would have realized that there were many obvious, even glaring, signs that the questionable cheques presented for payments were for perpetrating a fraud for the purpose of benefiting one of the directors and not the plaintiff. He was clearly withdrawing the money for his own use and not for the purpose of benefiting the plaintiff. In view of the various transactions, for cash payments on the drawn cheques, there was plenty of evidence to put the defendant bank on notice that there was something seriously wrong with the way **Mr. Gianluigi** was operating the plaintiff's account. It is clear from the evidence that there was a striking contrast between the way in which some payment requests were processed, without the second signatory of the eligible director, being counter verified and how the disputed payments were handled by the defendant bank.

In short, every rule was broken on the plaintiff's account and there was no evidence that the defendant bank within the rubric of fiduciary relationship, in fact, monitored or exercised care or caution on the chain of transactions conducted by **Gianluigi**. Therefore, the 2nd defendant accepted the transfer of funds with full knowledge that the same was fraudulent.

Whether the 1st defendant breached its contractual and statutory obligation to the plaintiff concerning the operation of the plaintiff's accounts

The essentials of an action for breach of statutory duty are also stated in **Clerk & Lindsell on Torts, Eighteenth Edition** at paragraph 11-04 page 600 as follows:

"1. The claimant must show that the damage he suffered falls within the ambit of the statute, namely that it was of the type that the legislation was intended to prevent and that the claimant belonged to the category of persons that the statute was intended to protect. It is not sufficiently simply that the loss would not have occurred if the defendant had complied with terms of the statute. This rule performs a function similar to that of remoteness of damage.

2. It must be proved that the statutory duty was breached. The standard of liability varies considerably with the wording of the statute, ranging from liability in negligence to strict liability.

3. As with other torts, the claimant must prove that the breach of statutory duty caused his loss, which he will fail to do if the damage caused his loss, which he will fail to do if the damage would have occurred in any event.

4. Finally, there is the question whether there are any defences available to the action."

Having discussed extensively herein the duty of care and its consequent breach, it also follows that the 1st defendant breached its contractual and statutory obligation to the plaintiff. That said, I do not see how the plaintiff breached the terms and conditions upon which the two accounts were opened. The significance of the foregoing statement in the present context is clear on the fiduciary relationship between a bank and its customers. A crucial case reference on this legal proposition in the instant matter is **Karak Brokers Co. Ltd v Burden {1972} 1WLR 602 {1972} ALL ER {1210} Brightman J** put the issue succinctly thus:

" 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 within its contract with its customer. The standard of that reasonable care and skill is an objective standard applicable to bankers. Whether or not it has been attained in any particular case has to be decided in the light of all the relevant facts, which can vary almost infinitely."

The Court in **Mccarthy Ltd v Absa Bank Ltd {2010} 2 SA 321** had occasion to consider the legal standing of that duty of care as follows:

"The fact alone that McCarthy had a cheque account justifies the inference that an express agreement (not necessarily reduced to writing) was concluded between McCarthy and Absa (or their predecessors) at some time in the past that such an account should be operated (it is difficult to see how a bank account might otherwise come into existence). Where such an agreement exists, as pointed out by the authors of Malan on Bills of Exchange etc. 'It is the duty of the bank to pay cheques drawn by the customer that are in all respects genuine and complete, on demand, provided sufficient funds or credit for their payment are available in the customer's account In paying cheques, the bank must adhere strictly to the customer's instructions, and must perform its duties with the required degree of care, generally, in good faith and without negligence.'

It follows that where a bank - customer relation exist it properly falls within the bank's mandate first to act only on valid instructions of the respondent and not on fraudulent instructions and second, to monthly provide the respondent with bank statements and "in contact" notifications by short message service (sms). In a case such the instant one, in which it was alleged that the defendant bank which breached that duty of care, on that prima facie basis a call for an answer was expected to negative or contrast those allegations. The defendant bank, in relation to this claim in my view failed to serve the plaintiff in accordance with the values and principles set out in the Banking Act and other collateral statutes imposing a duty of care to the bank.

By virtue of this litigation, it appears to the Court that the defendant bank duty to inform the plaintiff, the effect on the transfer of funds from its bank account by way of withdrawal cheques by one **Gianluigi** may have prevented further financial ruin as pleaded in the plaint. The test for negligence attributable to the defendant bank, is as formulated in the **South African case of Kruger v Coetzee {1966} (2) SA 428 (A) at 430 E – F**, where **Holmes JA** stated that:

“For the purposes of liability culpa arises if-

(a). a diligens paterfamilias in the position of the defendant –

(i). Would foresee the reasonable possibility of his conduct injuring another person or property and causing him patrimonial loss; and

(ii). Would take reasonable steps to guard against such occurrence; and

(b). the defendant failed to take such steps.”

It was incumbent in my view upon the defendant bank to prove that the payments in the referenced cheques were made with authority and for the benefit of the plaintiff creditors or its own benefit. The defendant bank should have summoned evidence to show that the questionable payments/withdrawals were for the benefit of the plaintiff accounts or to discharge its liabilities and not **Mr. Gianluigi**.

Whether the plaintiff has suffered loss and damages for the sum of Kshs.27,023,646 and Euros 60,000

It is not in dispute that the said amounts of money were paid from the referenced accounts. What is however, in dispute is whether the same had been authorized for payment. The 1st defendant did not provide proof of authority on how the said payments were authorized. Also suspicious is the reluctance by the 1st defendant to avail the cheques that had been cashed.

The bank statements do indeed show that monies in the said amounts were paid out. For reason that the said amounts had not been authorized by the plaintiff, then it only follows reasonably that the plaintiff did indeed suffer the loss in the stated amounts.

Whether at the time of filing the amended defence and counter claim the 1st defendant was in possession, custody or control of all the cheques or copies of cheques in issue

The counter claim was filed in 2018 and the cheques in question were allegedly destroyed by the 1st defendant in 2015.

(DW2) conceded that the cheques had been destroyed before the lapse of 7 years as per the bank’s policy on destruction of cheques.

I find it surprising that the 1st defendant bank could only produce some of the cheques after an order by the court of appeal and when its defence and counter-claim stood the risk of being struck out. This impasse on production of the cheques would have been dealt with from the very onset of this suit.

In considering the quantum of damages, I bear in mind the evidence and corresponding documentary evidence concerning the plaintiff’s accounts which was domiciled and in custody of the defendant bank. It is only the defendant which was privy to those transactions subject matter of this claim. In my view, the defendant bank bore the responsibility on the withdrawals made on those accounts without the plaintiff’s authority. It is not time to run away from such an onerous task owed to the plaintiff in conformity with the statute.

In the circumstances, I am satisfied that the plaintiff has satisfied the threshold on the burden and standard of proof on a balance of probabilities against the defendant bank. The plaintiff should therefore be allowed with costs to the plaintiff. On the other hand, the counterclaim fell short of the test of a prima facie case even to call for a rebuttal case from the plaintiff. It is only good for dismissal with costs to the plaintiff.

Orders accordingly.

DATED, SIGNED AND DISPATCHED via email AT MALINDI THIS 23RD DAY OF DECEMBER, 2021

.....

R. NYAKUNDI

JUDGE