KEY POINTS

- The Court of Appeal's decision in *First City Monument Bank Plc v Zumax Nigeria Ltd* firmly rejects the imposition of an express or "Quistclose" trust in the context of routine international funds transfers via correspondent banks.
- The decision is an orthodox analysis of well-established trust principles to the international banking context, and a welcome return to the status quo.
- Moving forward, the imposition of a trust in the context of international bank transfers would require something out of the norm.
- The latest advances in cross-border and cross-currency funds settlement systems only serve to diminish the likelihood for claims against participating banks to be founded on trust rather than conventional contractual principles.

Feature

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Court of Appeal rejects imposition of trust in international funds transfer context

The Court of Appeal's decision in *First City Monument Bank Plc v Zumax Nigeria Ltd* [2019] EWCA Civ 294 provides welcome clarity to those engaged in international banking and the financing of international trade.

The case involved a number of international bank transfers executed via correspondent accounts. Transfer instructions were provided in manuscript to the payer's bank, identifying the ultimate intended recipient, the substance of which was largely passed on to the correspondent bank and in turn the payee's bank. The Court of Appeal unanimously overturned a finding that these arrangements gave rise to a trust relationship of any sort.

THE FACTS AND FIRST INSTANCE DECISION

The transfers in question represented payment for engineering and other services provided by a Nigerian company (Zumax) to oil companies and other international clients invoiced in dollars. Zumax held accounts in Nigeria, denominated in Nigerian Naira, with its Nigerian bankers (IMB), but did not hold bank accounts denominated in US Dollars.

For US Dollars, Zumax instead used a nominee company incorporated in the Isle of Man (Redsear) to receive the dollar payments into an account denominated in dollars with its London bankers (Chase). When funds were to be transferred from the Redsear Account back to Nigeria, the mechanism used was that Redsear would instruct Chase to transfer the relevant amount to one of three accounts held by IMB with correspondent bankers in London (Commerzbank), for IMB to then account to Zumax in respect thereof in Nigeria.

In each case, Redsear gave manuscript transfer instructions to its bank, Chase, to effect the relevant transfer from the Redsear Account into the relevant IMB Commerzbank Account. The wording of the manuscript instructions varied but usually included words identifying the IMB account and the intended eventual recipient such as "for further credit to Zumax". Whilst there was no evidence of what passed between Chase and Commerzbank, it was common ground that the manuscript transfer instructions were acted upon by Chase, and the relevant amounts were remitted into the IMB Commerzbank Accounts as instructed. The Commerzbank account statements which were what would have been seen by IMB contained entries which in most (but not all) cases reflected the substance of the manuscript instructions which initiated the transactions.

These facts are unlikely to strike the reader as particularly remarkable. The use of correspondent banks to provide services for other financial institutions is an everyday feature of international commercial life. Such arrangements are particularly common in the servicing of transactions originating in a foreign country in which the payee's bank has no physical presence. The manuscript transfer instructions used wording similar to those found on SWIFT payment messages or similar, which are again a routine feature of international commercial financing- serving the important function of identifying the ultimate intended recipient of the funds, to whom the final party in the banking chain should give credit.

However, the surprising feature of this case was that the first instance judge (Barling J) had concluded that such arrangements gave rise to either an express trust in favour of Zumax; or else a *Quistclose* trust (ie a trust of the sort found in *Barclays Bank v Quistclose* [1970] AC 567), whereby IMB held the funds on trust for Redsear with a power to apply them for the stated purpose of crediting Zumax, failing which they would be returnable to Redsear.

This "trust" analysis had been advanced for two main reasons:

- First, the claim was brought against FCMB (the Bank), a successor entity to IMB's historic business activities, many years after the transfers in question – which dated back to 2000-2002. A "trust" analysis was put forward by Zumax to circumvent the Bank's inevitable limitation defence under s 21 of the Limitation Act 1980: pursuant to which no period of limitation prescribed by the Act applies to claims to recover trust property. An ordinary contractual or debt claim against the Bank would not benefit from this exclusion.
- Second, based on a claim in trust Zumax claimed an account of profits which it pleaded at some US$211m as at January 2017 (on a principal claim of around US$3.5m) – a figure which dwarfed the amounts usually claimable as simple interest on an ordinary contractual or debt claim.

THE COURT OF APPEAL'S DECISION

The Court of Appeal's decision comprehensively rejected and overturned Barling J's "trust" analysis, providing a welcome return to the status quo in international banking and trade finance disputes.

Feature

As the judgment of Lord Justice Newey explained at [47]:

> "… having accepted the various transfers that had been made for the credit of one of its customers (viz. Zumax), IMB was obligated to credit Zumax with them, either through Zumax's Naira account in Lagos or … potentially in some other way … I do not, however, consider that IMB became a trustee. Its obligations were personal."

This analysis was approved and buttressed in a further supporting judgment of Lord Justice Lewison. Lord Justice Males agreed with both leading judgments.

The analysis *en route* to this conclusion was in truth no more than an orthodox application of well-established principles of trust law to the relevant commercial context. The threshold tests which apply are as follows:

- For a finding of an *express* trust, there would have needed to be evidence establishing each of the so-called "three certainties": certainty of objects, subject matter and crucially certainty of words/intention to create a trust.
- For a "*Quistclose*" trust on terms described above, the evidence would have needed to establish that it was objectively intended by both the paying party (Redsear) and the recipient (IMB) that the money passing between them was *not* to be at IMB's "free disposal" upon receipt into the correspondent bank accounts (which, in the usual way, were accounts into which the funds were mingled with various other transfers and other monies destined for other customers). This test had to be applied bearing in mind the structure of the arrangements and the contractual mechanisms involved.

The various factors cited demanding the conclusion that these thresholds were *not* met included, in particular, the following:

- The fact that a particular bank transfer might have been made for a particular purpose or to credit a particular ultimate recipient does not of itself mean that it was intended to be the subject of a trust (Newey LJ at [33]);
- The Redsear instructions and the entries in the Commerzbank statements (only the latter reached IMB) did not manifest the necessary intention that the funds should not be at IMB's free disposal. The instructions were needed in order to identify the entity for whose benefit the transfers were made and to facilitate the transfers. As Newey LJ explained: "Payers must routinely seek to identify to whom a payment is to be credited without any trust being intended" (Newey LJ at [34]).
- Contrary to the findings at first instance, in fact the funds could not be said to have been "segregated" in any meaningful way. On arrival into the IMB Commerzbank accounts the transfers were mingled with other money transferred from numerous sources for the ultimate credit of a range of recipients, and with funds that on any view were IMB's alone: Newey LJ at [35]; Lewison LJ at [81]. Per Lewison LJ the recording of the credit in the correspondent account was "no more than bookkeeping" [82];
- It was necessary to consider "the structure of the arrangements and the contractual mechanisms involved" [36] (citing Patten LJ *in Bieber v Teathers Ltd* [2012] EWCA 1466). The commercial arrangements in this case were commonplace in international banking and essential for international funds transfers where the payee's bank has no presence in the originating country. Zumax's Counsel had been unable to explain how a recipient bank in an international funds transfer case could go about *avoiding* the onerous obligations of a trustee – short of simply returning the funds to sender. As Lewison LJ noted [81], this would almost certainly be a breach of contract between the payee's bank (IMB) and its customer (Zumax) and extremely damaging to the banker/customer relationship.
- Both judgments further emphasised the fundamental principle that money placed in the custody of a banker is, to all intents and purposes, that of the bank to do as it pleases (per long-established caselaw such as *Foley v Hill* (1848) 2 HLC 28; *Joachimson v Swiss Bank Corporation* [1921] 3 KB 110. As Lewison LJ pointed out at [76]: "In point of law, the payment instruction is an instruction to the bank to debit the customer's account in the amount of the payment; and to credit (or procure the credit) of the payee's account with a credit in the equivalent amount". It is not an instruction to hold a segregated fund on trust.
- Their lordships also emphasised the well-rehearsed warnings in the leading cases against "the wholesale importation into commercial law of equitable principles inconsistent with the certainty and speed which are essential requirements for the orderly conduct of business affairs" (per Lord Browne-Wilkinson in *Westdeutsche Landesbank v Islington LBC* [1996] AC 669).
- Other factors relied upon by the judge in support of his conclusion, such as documents referring to account balances "belonging to" Zumax or similar, amounted to the sort of loose parlance which is commonly adopted (eg "your bank account contains £xx") but which is not intended to describe the legal arrangements involved in any meaningful way.

Quite apart from all of this, the Court of Appeal recognised that for Zumax to bring a claim under a *Quistclose* trust, Barling J would have also needed to be satisfied that Zumax had acquired the rights to enforce that trust instead of Redsear (the settlor and beneficiary if the *Quistclose* analysis were to work). The point ultimately did not arise, but Newey LJ expressly did not wish to be taken as approving the judge's analysis that Zumax had exceptionally established some exception to the usual position on title to enforce the trust: Newey LJ at [50].

RAMIFICATIONS FOR THE FUTURE

The Court of Appeal's analysis provides welcome certainty and a return to the status quo for those engaged in international bank transfers via correspondent banks. A similar result had already been reached at first instance in the first instance decision of *Abou-Rahmah v Abacha* [2006] 1 Lloyd's Rep 484: a case involving funds transfer via a correspondent bank coupled with a Swift Transfer instruction identifying the ultimate intended recipient. The Barling J decision in *Zumax* had created conflicting first instance decisions in factually analogous circumstances, which the Court of Appeal's judgment has now firmly resolved.

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As the ramifications in this case show, the obligations of a trustee are something which those handling the transfer instructions neither want or expect or need. Moreover, subject to limitation, recipients are perfectly adequately protected by personal remedies in contract/debt, without the "super-added" cause of action in trust. Yet if the "trust" analysis had been upheld in the present case, then it is difficult to see why a *Quistclose* trust would not have been imposed in almost every other international funds transfer case involving correspondent banks, or indeed every bank transfer involving a bank-to-bank stage coupled with some sort of transfer instruction identifying the ultimate recipient. This would be a most unsatisfactory conclusion which would effectively paralyse international transfers.

Moving forward, it seems unlikely that such a radical "trust" analysis would be upheld again in a routine international funds transfer case. The imposition of a *Quistclose* trust over funds in transit remains possible but very much the exception rather than the norm. Special factors will be needed in order to show that the objective intention in the relevant contractual context was that the funds should not be at the free disposal of the recipient bank upon receipt (subject to the usual promissory obligation to credit an equivalent amount to the ultimate payee).

Exceptional fact scenarios

Of prime importance in every case will be the evidence of the objective intention of the settlor. As cases such as *Zumax* show, routine transfer instructions which merely identify to the payee's bank which of its customers the transfer is for, will almost certainly be insufficient to manifest an intention to create a trust or that the monies should not be at the Bank's free disposal. Something out of the routine will be required.

An example of such an exceptional situation might be the first instance Isle of Man decision of *Magenta Finance and Trading Company v Savings and Investment Bank Ltd* [1984-86] MLR 116. In that case, the plaintiff had arranged to buy a painting from a gallery and borrowed money for that purpose, to be remitted by the lender into a specific correspondent account held by the plaintiff's bank SIB at Barclays. The court found as a fact that SIB was given specific instructions from its customer that upon receipt of the funds from a third party they were to be remitted to the gallery. This was sufficient for an exceptional finding that the funds were objectively intended to be held on trust.

It remains to be seen whether the English courts would be prepared to reach the same conclusion on similar facts in the light of *Zumax* and *Abou-Rahmah*, but clearly Magenta involved special and unusual facts well outside the context of ordinary international commercial funds transfers. Notably the subsequent Manx appellate decision of *du Preez v Kaupthing Singer & Friedlander* (2010) 12 ITELR 943 (cited by Lewison LJ at [81]) disavowed any trust in the absence of objective evidence establishing a common understanding, communicated by the payer to the recipient at the time of the transfer, and accepted by the recipient, that the monies were to be used for a specific purpose, and not to form part of the general funds of the recipient (albeit hypothesising that on different facts and with an express instruction from a customer to its own bank as to a forthwith payment from a specific fund, a trust could be found). On any view the opportunities for such circumstances to arise in the context of routine international funds transfers will be limited.

Contexts for future arguments

A further question is what factors might drive claimants to attempt this unorthodox analysis again in an international funds transfer context. Besides cases involving historic transfers where limitation defences are available to contractual claims, or cases involving very large account of profits claims (as in *Zumax* itself), the most likely candidate would be an insolvency context.

However, there is every reason to expect precisely the same restrictive analysis in that context too. In particular, it would be impossible to justify affording "super claimant" priority status to transferees whose funds were still in the banking system at the time of an insolvency, as opposed to the simple debtor/creditor relationship applicable to those whose transfers had been completed (eg once the funds show as a balance in the transferee's account)- absent some compelling circumstances which showed that this was objectively intended.

Advances in cross-currency clearing systems

Finally, mention should also be made of the most recent advances in cross-border automated clearing and settlement systems. Providers such as Earthport and Ripple (recently acquired by Visa) offer real-time cross-border bank payments, with instant settlement of monies across borders such that the funds are credited to the destination account instantly alongside the messaging notification. Participants no longer have to rely on third party correspondents for transactions involving multiple currencies (nor bear the charges associated therewith), and no longer have to wait days before the funds show in their accounts.

It is too early to say whether these instant settlement systems will in due course challenge or even replace the existing hegemony of the traditional correspondent banking approach to cross-currency payments (recognised at eg Newey LJ [26]: "An international funds transfer will require the services of at least one correspondent bank unless the payer's bank and the payee's bank are themselves correspondents (i.e., hold accounts with each other)").

However, what seems clear is that even the removal of the correspondent bank from the equation altogether would be most unlikely to yield a fresh wave of successful actions founded on trust. Indeed, direct transfer to the destination account should if anything support and buttress the conclusion that the default position is a cause of action against the payee's bank in contract/debt – with the imposition of a trust being neither necessary nor objectively intended by the participants in such transfer systems. ■

Further Reading:

- All I wanna do is take your money: segregated accounts and equitable charges (2015) 4 JIBFL 203.
- Case Analysis (2015) 4 JIBFL 237.
- LexisPSL: Banking & Finance Practice Note: Purpose clauses in facility agreements and Quistclose trusts.