Emergence of the Mareva by Letter: Banks' Liability to Non-Customer Victims of Fraud

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Recent Canadian judicial decisions have established that a bank owes a duty of care to non-customers once it has actual knowledge of, or is wilfully blind to, the use of its services for fraudulent purposes. Depending on the circumstances, the possibility is still open that a bank may owe such a duty even where it does not have actual knowledge (or wilful blindness or recklessness) of the fraud. A similar recognition of a duty financial institutions have to third party victims when they are put on notice of fraud can be seen in decisions emanating from American, English and Swiss courts. The emergence of this duty increases the viability of the extrajudicial mechanism commonly referred to as a Mareva by Letter. By placing a bank on notice that its institution is being used to further fraudulent activities,

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and therefore opening the bank up to various public and private law duties to prevent any further misappropriation of funds, the Mareva by Letter can serve as an effective asset-preservation tool for victims of fraud. Even lacking the force of law inherent in a judicial order, the knowledge of its customer's fraud provided by a comprehensive private party letter is likely to create what amounts to a Mareva injunction – effectively compelling the financial institution to investigate and freeze the customer's account(s). As a result of its practicality, victims of fraud would be wise to add such a letter to the arsenal of weapons available to combat the potentially devastating effects of fraud. As well, banks should be aware of their potential liability and be prepared to respond to such letters appropriately.

Emergence of a duty of care owed by banks to non-customers under Canadian law

With the growth of fraudulent activity occurring through bank services, it is becoming increasingly incumbent on financial institutions to pursue with reasonable diligence not only their own clients' protection against fraud, but potential non-customer victims as well. On balance, a bank with actual knowledge of such activity is often best suited to intervene to prevent further fraudulent transactions and the dissipation of the misappropriated funds so as to reduce the ultimate harm caused to the victim. In recognition of this reality, the law has begun shifting some of the risk of fraud onto banks. The once-prominent concept that a bank owes a duty of care only to its customers has been significantly eroded within various Canadian jurisdictions in recent years. In its 2001 decision in *Semac Industries Ltd v 1131426 Ontario Ltd*, the Ontario Supreme Court determined that a bank that knows of a customer's fraud in the use of its facilities, or has reasonable grounds for believing or is put on its inquiry and fails to make reasonable inquiries, will be liable to those suffering a loss from the fraud.[1] Numerous subsequent cases have developed this principle, and it is now well established that in certain situations, a bank will owe a duty of care to a third party who is defrauded by the bank's customer.[2] Such a duty is discharged by reporting the issue to the appropriate authorities and, in many cases, freezing the customer's account.[3] The nascent principle was recently restated in *Dynasty Furniture*, a

1 2001 CanLII 28375 (ON SC) ('*Semac Industries*'), para 68.

2 See for example *A & A Jewellers Ltd v Royal Bank of Canada*, 2001 CanLII 24012 (ON CA), *Dupont Heating & Air Conditioning Ltd v Bank of Montreal*, 2009 CanLII 2906 (ON SC), *Stone v Royal Bank of Canada*, 2009 BCPC 256, *Ramias v Johnson*, 2009 ABQB 386, *Mirage Consulting Ltd v Astra Credit Union Ltd* [2008] MJ No 314 (CA).

3 *Dynasty Furniture v Manufacturing Ltd v Toronto Dominion Bank*, 2010 ONSC 436 ('*Dynasty Furniture*'), at para 14.

case that arose in an effort to compensate victims of the Allen Stanford Ponzi scheme. In its decision, the Ontario Superior Court of Justice held that if a bank has actual knowledge of a customer's fraudulent activities, or is wilfully blind to or recklessly disregarded the existence of such activities, the third party victim would have a reasonable cause of action against the bank.[4] In this case, the court declined to permit the claim in negligence to proceed based on constructive knowledge. However, in affirming this decision, the Ontario Court of Appeal left open the possibility that a bank may be found to have a duty to a non-customer in circumstances where it does not have actual knowledge (wilful blindness or recklessness) of the fraudulent activities being conducted through an account of its customer.[5] The basis for finding liability in such a situation would be that the bank had constructive knowledge of the fraud, or ought to have known of its occurrence, and failed to take measures to prevent it.

The law in other common and civil law jurisdictions appears to be following the trend of placing a share of the risk of fraud onto the bank's shoulders. Though US and English courts have been more reluctant to find the existence of a duty of care owed by banks to third party fraud victims than courts in Canada, and as demonstrated below, Switzerland as well, there are nonetheless an increasing number of English and American decisions that indicate a willingness to find bank liability to non-customers where a fraud is evident, known and preventable.

English judicial developments

Recent English decisions have determined that there is no general duty of care owed by banks to non-customers, thus preventing successful third party actions against banks for negligence.[6] However, the law does recognise liability on the basis of constructive trust theories. The classic statement setting out the liability of a third party as constructive trustee can be found in the oft-cited case of *Barnes v Addy*,[7] where Lord Selborne said:

> '[S]trangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions… unless those agents received and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees.'

4 *Dynasty Furniture*, at para 84.

5 *Dynasty Furniture Manufacturing Ltd v Toronto Dominion Bank*, 2010 ONCA 514 (CanLII), at para 9.

6 *Customs and Excise Commissioners v Barclays Bank* [2004] 2 All ER 789.

7 (1874) 9 Ch App 244 at 251.

In this seminal case Lord Selborne laid down two branches of liability as a constructive trustee:

1. 'Knowing assistance' (though it is now more often referred to as 'dishonest assistance' in view of the Privy Council decision in *Royal Brunei Airlines v Tan*);[8] and
2. 'Knowing receipt' of trust property.

Dishonest assistance

The general principle underlying this form of liability is that a stranger to a constructive trust will also be liable to account as a constructive trustee if he knowingly assists in the furtherance of a fraudulent and dishonest breach of trust. It is not necessary that the party sought to be made liable as a constructive trustee should have received any part of the trust property, but the breach of trust must have been fraudulent. The basis of the stranger's liability is not receipt of trust property but participation in a fraud.[9]

Where there has been a breach of fiduciary duty the key target of subsequent litigation will often not be the fiduciary, but third parties who have received assets or their proceeds from the fiduciary (knowing receipt) or who can be said to have knowingly assisted in the breach (dishonest assistance). To establish liability under the knowing or 'dishonest' assistance theory, a claimant must show that:

1. There has been a breach of trust or fiduciary duty;
2. Assistance was provided by the defendant in respect of that breach; and
3. The defendant knew of the breach. In the banking context, this category of liability can encompass a situation where, for example, a bank somehow facilitates transactions involving a breach of trust or fiduciary duty.

The issue of what constitutes 'knowledge' in the context of dishonest assistance was authoritatively settled in *Royal Brunei Airlines Sdn Bhd v Tan*.[10] The House of Lords held that dishonesty was a necessary ingredient of such liability. Lord Nicholls stated that 'in the context of the accessory liability principle acting dishonestly… means simply not acting as an honest person in the circumstances… . Carelessness is not dishonesty. Thus for the most part dishonesty is to be equated with conscious impropriety'.[11] The *Royal Brunei* approach was approved of in the Privy Council decision in *Barlow Clowes International Ltd & Anor v Eurotrust*

8 [1995] 2 AC 178.

9 *Barnes v Addy* (1874) 9 Ch App 244.

10 [1995] 2 AC 378 ('*Royal Brunei*').

11 *Ibid* 389.

International Ltd & Ors (Isle of Man).[12] The decision in *Barlow Clowes* clears up some of the ambiguity that resulted in the law in this area following *Twinsectra Ltd v Yardley*.[13] Thus in order to establish liability under this head there must be knowledge or suspicion accompanied by a conscious decision not to make enquiries and a defendant cannot escape liability simply by asserting that he did not know that the money was held in trust or did not know what a trust meant. The brief summary of the facts of that case are as follows.

Barlow Clowes was operating a fraudulent offshore investment scheme, which offered purported investments in UK gilt-edged securities. The bulk of an approximate £140 million of investments was misappropriated by Mr Clowes and his associates. By the time of Clowes' imprisonment following the collapse of the scheme, approximately £8.6 million of investors' funds had been funnelled through bank accounts maintained by companies administered from the Isle of Man by a company then known as ITC, which provided offshore financial services. Barlow Clowes (in liquidation) commenced proceedings in the High Court of the Isle of Man against ITC and two of its directors. All three defendants were found to have dishonestly assisted Mr Clowes and one of his associates ('Mr Cramer') to misappropriate funds. One of the defendants, Henwood, successfully appealed against the finding of the lower court that he had been a dishonest assistant on the basis that this conclusion was not supported by the evidence. Barlow Clowes appealed that decision to the Privy Council.

On appeal by Barlow Clowes, it was argued on behalf of Henwood that it was necessary to establish that he had to have been aware that his state of mind would, by ordinary standards, be regarded as dishonest. It was only if that was established that he could be said to be consciously dishonest and liable for dishonest assistance. In support of the argument, Henwood's counsel relied on the following statement by Lord Hutton in the Court of Appeal judgment of *Twinsectra Ltd vYardley*:

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12 [2005] UKPC 37 (10 October 2005) ('*Barlow Clowes*').

13 [2002] 2 AC 164 ('*Twinsectra*'). The House of Lords' decision in *Twinsectra* led to considerable uncertainty regarding the test for determining whether a third party should be accountable to a victim in equity for dishonest assistance. Although the Privy Council sought to clarify the law in *Barlow Clowes*, the Court of Appeal's decision in *Abou-Rahmah v Abacha* (www.lawreports.co.uk/HouseofLords/decisionresults07.htm (20 February 2007)) demonstrates that until the House of Lords has to decide on this issue again, the uncertainty is bound to prevail. The majority opinion in *Abou-Rahmah* is that untargeted, speculative or general suspicions that are not sufficiently connected with the specific circumstances of the breach of trust or fiduciary duty will not suffice to establish dishonesty, either on the basis of actual knowledge of sufficient facts to render one's participation dishonest or on the basis of wilful blindness (sometimes called 'blind-eye knowledge').

> '... It would be less than just for the law to permit a finding that a defendant had been "dishonest" in assisting in a breach of trust where he knew of the facts which created the trust and its breach but had not been aware that what he was doing would be regarded by honest men as being dishonest... although he should not escape a finding of dishonesty because he sets his own standards of honesty and does not regard as dishonest what he knows would offend the normally accepted standards of honest conduct.'[14]

The Privy Council accepted that the above-quoted passage from *Twinsectra* was ambiguous. It had given rise to academic debate over whether the effect of *Twinsectra* was to result in a departure from the law on dishonest assistance as previously understood and whether there was now a need to enquire into the defendant's views about generally acceptable standards of honesty.

The Privy Council held that in fact the law did not require the defendant to have knowledge of a transaction so as to make his involvement contrary to normally acceptable standards of honest conduct. Moreover, the law did not require the defendant to have considered what those normally acceptable standards were.

Further, the Privy Council agreed that there was evidence that Henwood had been informed that Clowes and Cramer were misappropriating clients' money. There was no evidence that Henwood had made enquiries into those allegations. The first-instance judge was fully justified in concluding that Henwood's failure to raise questions at that time was the result of a deliberate and dishonest decision. It was not necessary to know the 'precise involvement' of Cramer in the company's affairs in order to suspect that neither he nor anyone else had the right to use Barlow Clowes money for speculative investments of their own. Nor was it necessary for Henwood to have concluded that the disposals were of moneys held in trust – it was sufficient that he suspected as much. The money in *Barlow Clowes* either belonged to the company and as such was subject to fiduciary duties imposed on the company's directors or was held on trust for the investors. In either case, Clowes and Cramer were not entitled to use the funds as they wished. The Privy Council held that an individual can know, and certainly suspect, that he is assisting in a misappropriation of funds without knowing that the funds are held in trust or what a trust means.

While this decision is a welcome clarification, it is nonetheless a Privy Council decision and not of the same persuasive authority as a House of Lords (now known as the Supreme Court of the UK) decision in England and Wales.[15] Thus, only actual knowledge, recklessness or wilful blindness will

14 [2002] 2 AC 164 at 174.

15 Equally, *Barlow Clowes* is a binding decision in those Commonwealth jurisdictions that still allow final appeals to lie to the Privy Council.

render a bank liable for participating in a breach of trust. Mere constructive knowledge cannot render a bank liable under the 'knowing assistance' category of constructive trusteeship.

Receipt-based liability

In order to ground a claim in knowing receipt, a claimant must be able to satisfy the following criteria:

1. Disposal of assets in breach of fiduciary duty;
2. The beneficial receipt by the defendant of assets that are traceable as representing the assets of the plaintiff; and
3. Knowledge on the part of the defendant that the assets he or she received are traceable to a breach of fiduciary duty.

These criteria were set out in the Hong Kong case of *Billion Silver Development Ltd v All Wide Investments Ltd*.[16] Cheung J, followed the approach in *El Ajou v Dollars Land Holdings plc*.[17]

As P J Millett explained:

> 'the essential characteristic of a recipient… is that he should have received the property for his own use and benefit. That is why neither the paying nor the collecting bank can normally be made liable as recipient. In paying or collecting money for a customer the bank acts only as his agent. It sets up no title of its own. It is otherwise, however, if the collecting bank uses the money to reduce or discharge the customer's overdraft. In doing so it receives the money for its own benefit.… [Footnotes omitted.][18]

In order to satisfy the beneficial receipt criteria a claimant must show that the bank received trust property for its own use and benefit. In contrast to accessory liability under the 'dishonest assistance' theory, knowing receipt is a 'receipt-based' liability. Thus where a bank receives money in an account as an agent for its customers and not for its own benefit, such receipt is insufficient to establish liability on the basis of knowing receipt. In *Agip (Africa) Ltd v Jackson*, Millett J explained this requirement in the following terms:

> '[T]he recipient must have received the property for his own use and benefit. This is why neither the paying nor collecting bank can normally be brought within it. In paying or collecting money for a customer the bank acts only as his agent. It is otherwise, however, if the collecting bank uses the money to reduce or discharge the customer's overdraft. In doing so, it receives the money for its own benefit.'[19]

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16 HCA 5046/1999, 7 May 1999, unreported.

17 [1994] 2 All ER 685.

18 P J Millett, 'Tracing the Proceeds of Fraud' (1991) 107 LQR 71 at 82–83.

19 [1991] Ch 547, [1992] 4 All ER 451 at 404 ('*Agip*').

While receipt of trust property as an agent is insufficient to affix a bank with liability, where banks receive loan repayments, or take security over property as loan collateral, for example, beneficial receipt in the context of knowing receipt can be established. In the case of *Maronis Holdings Ltd v Nippon Credit Australia Ltd*,[20] the defendant bank took a mortgage over land from the claimant as security for a loan. The claimant claimed that the mortgage was advanced by its directors in breach of their fiduciary duties and instituted proceedings against the defendant bank on the basis of knowing receipt. The judge accepted that the taking of the mortgage would constitute beneficial receipt for the purpose of recipient liability. However, on the facts of the case, the defendant bank was found not to have the requisite knowledge of the breach of fiduciary duty.

The question of what constitutes knowledge of breach of fiduciary duty in the context of a knowing receipt claim is perhaps best answered by reference to the test laid down by Peter Gibson J in *Baden v Société Generale pour Favoriser le Developpment du Commerce et de L'Industrie en Franc SA*, where he said:

> 'It is clear that a stranger to a trust may make himself accountable to the beneficiaries under the trust in certain circumstances. The two main categories of circumstances have been given the convenient labels in *Snell's Principles of Equity* (28th edn) pp 194, 195, "knowing receipt or dealing" and "knowing assistance". The first category of "knowing receipt or dealing" is described in *Snell*, op cit at p 194 as follows:
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> > "A person receiving property which is subject to a trust ... becomes a constructive trustee if he falls within either of two heads, namely: (i) that he received trust property with actual or constructive notice that it was trust property and that the transfer to him was a breach of trust; or (ii) that although he received it without notice of the trust, he was not a bona fide purchaser for value without notice of the trust, and yet, after he had subsequently acquired notice of the trust, he dealt with the property in a manner inconsistent with the trust."
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> I admit to doubt as to whether the bounds of this category might not be drawn too narrowly in *Snell*. For example, why should a person who, having received trust property knowing it to be such but without notice of a breach of trust because there was none, subsequently deals with the property in a manner inconsistent with the trust not be a constructive trustee within the "knowing receipt or dealing" category?'[21]

While constructive knowledge will not suffice to affix liability under the dishonest assistance head, it is sufficient to find a stranger to the trust liable

20 [2001] NSWSC 448.
21 [1992] 4 All ER 161 at 235.

on the basis of 'knowing receipt'. A leading English authority, in terms of formulating the test for constructive knowledge in breach of trust cases, is *Selangor*. There, a company director carried out a fraudulent takeover bid by using the company's funds to purchase its own shares. Two banks were involved in the takeover. One bank acted on behalf of the director by paying, for a fee, those shareholders who had agreed to sell. The bank's fee was paid for by way of an advance from a second bank, where the company's account had been transferred. The second bank was repaid with trust funds drawn from the company's account. In addressing the banks' liability, Ungoed-Thomas J did not distinguish between receipt and assistance cases. He presumed, at p 1095, that there was only one category of liability for strangers to the trust who, unlike trustees *de son tort*, 'act in their own right and not for beneficiaries'. Relying on this single category of liability, Ungoed-Thomas J found both banks liable as constructive trustees, holding: 'The knowledge required to hold a stranger liable as constructive trustee in a dishonest and fraudulent design, is knowledge of circumstances which would indicate to an honest, reasonable man that such a design was being committed or would put him on enquiry, which the stranger failed to make, whether it was being committed.'[22]

In *El Ajou v Dollar Land Holdings plc*, Millett J was prepared to assume that constructive knowledge was a sufficient basis for liability:

> 'In the absence of full argument I am content to assume, without deciding, that dishonesty or want of probity involving actual knowledge (whether proved or inferred) is not a precondition of liability; but that a recipient is not expected to be unduly suspicious and is not to be held liable unless he went ahead without further inquiry in circumstances in which an honest and reasonable man would have realised that the money was probably trust money and was being misapplied.'[23]

While receipt based liability does not require the same level of knowledge as under the assistance-based liability, it does require that the bank beneficially receive the funds in question. It is probably safe to assume that in the majority of cases involving the transfer of illegally obtained funds the bank will simply be operating as a transit vehicle. Thus, in most cases proof of actual knowledge (or recklessness or wilful blindness) on the part of the bank will be required in order to affix a bank with liability to third parties for dealing with tainted funds.

Given the technicalities involved in successfully asserting a claim in assistance or receipt, this article posits the view that liability for receipt of

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22 *Selangor United Rubber Estates Ltd v Bradock (No 3)* [1968] 1 WLR 1555 at 1590.
23 [1994] 2 All ER 685 at 739.

tainted funds is better achieved by simply putting the bank on notice by means of an unambiguously phrased letter referring to the underlying and necessary facts of an apparent fraud, and covering a bundle of supporting evidence. Accordingly, the bank then must reconsider its position after acquiring actual knowledge of the scheme.

US judicial developments on bank liability

In American jurisprudence on bank liability in cases of fraud, knowledge on the part of the bank can be the crux of a bank's potential liability to non-customers. With fraud on the rise and courts increasingly willing to impose liability on banks, a Mareva by Letter can become not only a useful tool for plaintiffs, but perhaps the key piece of evidence used to hold American banks liable for investors' losses in a fraudulent scheme. As stated in *Fine v Sovereign Bank*, 'there is a continuum into which that knowledge may fall'.[24]
'Knowledge' can be:
1. Actual knowledge;
2. Constructive knowledge following 'red flag' warnings; or
3. Deliberate ignorance.

On one end of the continuum is actual knowledge that a debtor is breaching its fiduciary duties and is engaged in a fraud. At the other end of the spectrum is behaviour akin to burying one's head in the sand. In the middle is constructive notice that, if the bank had investigated, it would have discovered the fraud. The contents of a Mareva by Letter advising a bank of fraud or suspicious activity is the basis on which to establish that a bank had actual knowledge of a breach of fiduciary duty or the underlying fraud itself or, alternatively, could be deemed a 'red flag' sufficient to place the bank on constructive notice of a problem. If a bank chooses to ignore such a letter, it runs the risk that liability will be imposed for all activity taking place after that point in time.

While most legal theories used by non-customers against financial institutions implicate some form of knowledge on the part of the bank, the degree and extent of that knowledge may vary depending on the elements of a given claim for relief. The three primary areas under which bank liability may be found are breach of fiduciary duty owed to non-customers, negligence and aiding and abetting fraud or breach of fiduciary duty. These are discussed in turn.

Under American law, banks may be liable to non-customers under a breach of fiduciary duty theory depending on whether it can be established

24 634 F Supp 2d 126, 137 (D Mass 2008).

that a fiduciary duty is owed to the non-customers. Historically, courts have followed the general principle that banks do not owe a duty of care to non-customers with whom the bank has no relationship.[25] However, with the mounting number of elaborate fraudulent schemes, courts have been extending a bank's duties to non-customers under certain circumstances. For example, courts in New York have increasingly recognised that 'a bank may be held liable for its customer's misappropriation where (1) there is a fiduciary relationship between the customer and the non-customer, (2) the bank knows or ought to know of the fiduciary relationship, and (3) the bank has "actual knowledge or notice that a diversion is to occur or is ongoing"'.[26]

Accordingly, exceptional circumstances giving rise to bank liability to non-customers clearly involves knowledge on the part of the bank. Both actual knowledge and constructive knowledge have been found sufficient to impose liability on a bank for breach of fiduciary duty to non-customers.[27] Further, 'Red flags', which suggest money laundering or fraudulent activity, may give rise to a duty to investigate account activity, which would put a bank on notice of a fiduciary relationship.[28] 'Deliberate ignorance' may also be sufficient to establish knowledge on the part of the bank for purposes of a breach of fiduciary duty claim brought by non-customers. As held in *Chaney v Dreyfus*, '[R]equisite knowledge can be established through the doctrine of deliberate ignorance. Deliberate ignorance exists where there is "a conscious effort to avoid positive knowledge of a fact which is an element of an offense charged... so [the defendant] can plead lack of positive knowledge in the event he should be caught"'.[29] In other words, even where a bank does not have a direct relationship with the non-customer plaintiff, the bank may be found liable if in possession of knowledge sufficient to meet the standard in a given jurisdiction. A well-timed and properly worded Mareva by Letter could

25 See, eg, *Lerner v Fleet Bank*, NA, 459 F 3d 273, 286 (2d Cir 2006) ('As a general matter, "[b]anks do not owe non-customers a duty to protect them from the intentional torts of their customers".') and *Eisenberg v Wachovia*, NA, 301 F 3d 220 (4th Cir 2002) (stating that to extend a bank's duties of care to non-customers would 'expose banks to unlimited liability for unforeseeable frauds').

26 *Chaney v Dreyfus Service Corp*, 595 F 3d 219, 232 (5th Cir 2010); see also *Fine v Sovereign Bank*, 634 F Supp 2d 126, 137 (D Mass 2008) (liability may arise to non-customers 'in extraordinary circumstances', where the bank knew that the debtor's agent was a fiduciary and that the debtor's actions in embezzling constituted a breach of his duties).

27 *Chaney v Dreyfus Service Corp*, 595 F 3d 219, 233 (5th Cir 2010).

28 *Lerner v Fleet Bank*, NA, 459 F 3d 273, 287–886 (2d Cir 2006), which held that any duty to investigate account activity can arise only if the institution knows or ought to know of the fiduciary nature of the funds of which it is in possession and there is a pattern of suspicious activity in the account.

29 *Chaney v Dreyfus* at 241.

provide such knowledge and, therefore, cause banks seriously to consider freezing the account at issue so as to avoid any ongoing liability.

The victims of a fraudulent scheme may also seek to pursue a claim of negligence against the bank into which the perpetrator deposited the investor funds. The elements of such a claim are:

1. A legal duty to use due care;
2. A breach of such legal duty; and
3. The breach as the proximate or legal cause of the resulting injury.[30]

Similar to a breach of fiduciary duty claim, the general rule is that a bank owes no duty to non-customers, thereby making proof of a negligence claim against a bank problematic.[31] Nevertheless, 'a bank may be liable for participating in [such a] diversion, either by itself acquiring a benefit, or by notice or knowledge that a diversion is intended or being executed'.[32] For example, in *Lerner*, the court let stand a claim of negligence against a bank brought by a non-customer of the bank where the customer had deposited its funds in the debtor's bank accounts with an assurance that the debtor was an attorney and where it was alleged that the bank knew the accounts were to be maintained as trust accounts for client funds.[33] For the most part, courts do not appear eager to extend liability to non-customers under a negligence theory but will do so under certain circumstances.

The third mechanism with which fraud victims may attempt to pursue banks for compensation is through a claim of aiding and abetting fraud or breach of fiduciary duty. Knowledge is a key element for aiding and abetting theories of liability, claims for which may also be brought against a bank by a non-customer. These theories provide exposure for banks even if the bank did not financially gain from the tort, or owe the corporate debtor an independent duty.[34]

To prove aiding and abetting fraud, the plaintiff must establish the following three elements:

1. The existence of a fraud;
2. The defendant's knowledge of the fraud; and
3. That the defendant provided substantial assistance to advance the fraud's commission.[35]

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30 *Lerner v Fleet Bank*, NA, 459 F 3d 273, 286 (2d Cir 2006); see also *Chaney v Dreyfus Service Corp*, 595 F 3d 219 (5th Cir 2010).

31 See, eg, *Conder v Union Planters Bank*, NA, 384 F 3d 397, 399 (7th Cir 2004), in which it was held that under Indiana law, a bank owes no duty to prevent Ponzi schemers from committing fraud.

32 *Lerner v Fleet Bank*, 459 F 3d 273, 287 (2d Cir 2006).

33 459 F 3d 273, 281 (2d Cir 2006).

34 *Neilson v Union Bank*, at 1128.

35 *Wight v Bankamerica Corp*, 219 F 3d 79, 91 (2d Cir 2000).

In *Fine v Sovereign Bank*, the Court further established that, 'proving knowledge of a fiduciary breach requires the plaintiffs to prove both knowledge of fiduciary status and knowledge that the action was a breach'.[36] Actual knowledge of these elements is critical, given that courts have specifically determined that constructive knowledge is insufficient.[37] Nonetheless, while more than recklessness is required to satisfy the knowledge element of aiding and abetting, conscious avoidance may be sufficient. For example, in *Lautenberg Foundation v Madoff*, the Court held that 'conscious avoidance involves a culpable state of mind, rather than mere negligence on the part of the defendant in failing to investigate and discover the primary violation', as 'it can almost be said that the defendant actually knew because he or she suspected a fact and realized its probability, but refrained from confirming it in order later to be able to deny knowledge'.[38]

Swiss legal developments

Under Swiss law, as is the case in most civil law jurisdictions, non-contractual liability exists in the presence of an illicit act, which, through the fault of the perpetrator, caused damage to a third party.[39] The issue of bank liability, and consequently the effects thereon of a Mareva by Letter, must therefore be examined in light of the Swiss law provisions on money laundering. In 1990, a money laundering offence, namely 'an act of a nature to prevent the identification of the origin, the discovery or confiscation of assets which he knew or should have presumed that were the product of a felony',[40] was introduced into the Swiss Penal Code (SPC). Money laundering by negligence is not punishable. In 1994, a lack of due diligence offence was introduced as well, punishing, even in the case of negligence, 'whoever professionally accepts, keeps safe, or assists in investing or transferring assets belonging to a third person without checking with due diligence the identity of their beneficial owner'.[41] The Federal Law on the Prevention of Money Laundering in the Financial Sector (SLML), introduced in 1998, imposes on financial intermediaries, such as banks, duties to verify party identities, clarify

36 634 F Supp 2d 126, 137 (D Mass 2008); see also *Casey v US Bank National Association*, 127 Cal App 4th 1138 (4th Dist 2005).

37 *Neilson v Union Bank of California*, NA, 290 F Supp 2dd 1101, 1119–22; see also *Mazzaro de Abreu v Bank of America Corp*, 525 F Supp 2d 381, 388–89 (SDNY 2007) (bank's 'alleged profit motive does not provide a strong inference of fraudulent intent, and thus does not imply actual knowledge of the underlying fraud').

38 2009 WL 2928913, at *16 (DNJ 2009).

39 Article 41 of the Swiss Code of Obligation – SCO.

40 Article 305bis SPC.

41 Article 305ter SPC.

the economic background of transactions, document and keep records of all such steps for ten years so as to be available to regulatory organisations and for audits.[42] The law further requires financial intermediaries to immediately file a report with the Money Laundering Reporting Office Switzerland (MROS) of suspicious activity.[43] On reporting such a suspicion, the financial intermediary must immediately freeze the assets that are connected with the report, until it receives a freezing order from the competent prosecution authority, but at the most for five working days from the time at which the report has been filed, and may not inform the person affected or third parties until such delay has elapsed.

Victims of predicate offences to money laundering have increasingly attempted to sue banks for damages in connection with their breach of the above provisions. Based on recent decisions of the Federal Court – Switzerland's supreme court – a breach of the criminal money laundering provision entails the liability for damages under article 41 SCO towards the victim of the predicate offence if the money laundering activity prevented the criminal forfeiture of the assets (which is essentially deemed to favour the interests of the victim, who, under Swiss law is entitled to be allocated the forfeited proceeds[44]). Such liability only exists if the money laundering acts were committed intentionally within the meaning of the Swiss Penal Code, and not by negligence.[45] The Federal Court has further deemed that breaches of due diligence rules or of rules aimed at preventing money laundering do not per se entail civil liability,[46] but may amount to external proof of money laundering by recklessness (*dolus eventualis*).[47] In addition, the Federal Court recently deemed that the existence of such duties entails that allowing money laundering through one's abstention is also punishable.[48]

As a result, similar to the requirements of a Mareva by Letter within Canada and other countries, a letter of notice sent to a Swiss bank suspected of harbouring the proceeds of crime should not only contain statements but also evidence of the crimes and their connection with the assets held by the bank, so as to cause the bank to have 'founded suspicions' that would require it to issue a money laundering report to the MROS and cause a temporary freeze under articles 9 and 10 SLML. A breach of this obligation following the receipt of the letter could be evidence of money laundering by recklessness and/or abstention, which would give rise to liability. And similar

42 Articles 3–8 SLML.
43 Article 9 SLML.
44 ATF 129 IV 322 of 8 September 2003.
45 ATF 133 III 323 of 18 April 2007.
46 ATF 134 III 529 of 13 June 2008.
47 ATF 6B_900/2009 of 21 October 2010.
48 6B_908/2009 and 6B_919/2009 of 3 November 2010.

to other jurisdictions, a letter of notice should immediately be followed by a criminal complaint to the competent Swiss prosecuting authorities, so as to ensure action on their part and curtail the release of the funds after the five-day freeze period provided by article 10 SLML.

Benefits and requirements of the Mareva by Letter

Accordingly, while the test for liability adopted by British and American courts is arguably more stringent than in Canada and Switzerland, actual knowledge of a fraud will necessitate a bank in any of these jurisdictions to take certain positive actions, and an intentional disregard of these responsibilities is likely to give rise to a cause of action by a third party victim. The existence of these obligations therefore provides increasing legitimacy and potency to letters that put a bank on notice of its customer's potential or actual fraud. The duty of care owed by a bank to a non-customer would arise after and as a result of the third party's presentation to the bank of evidence of fraudulent activity. Once the fraud becomes known to a bank, beyond having its statutory obligations to report suspicious behaviour, a civil action against the bank may arise if it wilfully or negligently fails to preserve the assets held by the fraudster pending further information or direction.[49] A bank in receipt of a private letter is therefore prone to investigate further and freeze its customer's assets if sufficient information is provided that would give rise to actual knowledge of the fraud. Of course, a private letter is not the only way through which a bank may acquire the requisite knowledge of fraud to become liable, but it is a highly effective and quick mechanism. It further provides any number of victims of the fraud the ability to rely on a letter sent by another victim, which put the bank on notice, in arguing for bank liability – effectively 'piggybacking' on the bank's acquired notice from the other party's letter.

The Mareva by Letter is a comparatively new development in complex international fraud litigation. Its relative novelty is likely to be short-lived given the recent developments in the common law world regarding bank liability to third party victims of fraud. By establishing a written communication and direct relationship between the bank and third party victim, through a letter that provides evidence of a fraud, there is a strong basis in a range of jurisdictions for establishing that the bank ought reasonably to have had the victim in contemplation in the conduct of its banking relationship with the fraudster, and failing to prevent further harm to the victim by temporarily freezing the assets in question should warrant bank liability.[50]

49 *Semac Industries*, at paras 67, 68; *Dynasty Furniture*, at paras 14, 61.

50 *Dynasty Furniture*, at para 70.

In most situations involving commercial fraud, swift action is essential to obtaining the desired relief; and alongside the expanding obligations placed on banks once it has knowledge of fraud, the legal and practical appeal of the Mareva by Letter intensifies.

A sophisticated fraudster is likely to be efficient in continuously transferring and concealing assets, and so the time taken by victims to prepare, file and argue an *ex parte* Mareva injunction application, in potentially numerous jurisdictions, may make the endeavour entirely futile. There is a strong possibility that by the time a freezing order is issued, the assets are no longer at the bank previously identified. The speed with which funds are transferred and the prospect of the fraudster becoming aware of situation can be countered, however, by a Mareva by Letter; it offers a preliminary means to asset recovery that does not require the time-consuming and complicated process of a court order.

A Mareva by Letter involves placing a third party holder of assets, namely a bank, on notice that those assets are imposed with a constructive trust in favour of someone other than the party who the holder was previously led to believe is the true owner or the accounts at issue are being used to further a fraudulent scheme.[51] The purpose of the letter would generally be to request that the bank prevent the transfer of assets from any suspected accounts pending court orders or further clarification of the facts surrounding the potentially fraudulent activity. There is, of course, always the possibility that a bank after considering the letter is not satisfied that there is sufficient evidence for it to take the requested steps and, further to its duty to its customer, informs the customer of the letter. This would be likely to result in the customer's removal of the assets. In this scenario, if it was determined that the customer was holding fraudulently obtained funds, the third party victim would have a stronger chance of recourse against the bank in reliance on the letter as an evidentiary foundation for the bank's actual knowledge.

Given its recent development, there is limited jurisprudence that delineates the required elements of an effectual Mareva by Letter. Letters that have been effective in the past, however, generally inform the financial institution of the true origin or beneficial ownership of the assets, and advise the bank of its potential accessory liability in the event of any transfer or disposal of the assets in question. The letter should disclose the basis for the belief that certain accounts maintained by the bank contain the proceeds of fraud and the foundation for the claim that the bank is a constructive trustee of the funds in the account. It is further advisable that the letter to

51 Martin Kenney, *Mareva by Letter – Preserving Assets Extra-Judicially* (Martindale-Hubbell), para 1.2.

a Canadian bank, in order to follow the requirements outlined in the Bank Act for the implementation of a court-ordered asset freeze, be served on the branch that has possession of the property in issue or that is the branch of account in respect of the deposit account.[52] Service in this manner is advisable in separate jurisdictions as well, whether required by legislation or not, as beyond any legal obligation, it also has practical benefits in terms of bank administrative efficiency.

Legal professionals with experience in this area have opined that to have the desired effect, a letter to the bank should provide sufficient detail to demonstrate a prima facie case of fraud. At the very least, sufficient evidence should be presented to the bank to provide comfort that the conclusion being urged on it regarding the provenance of the assets is in fact a reasonable one to be drawn in the circumstances. This way the bank will feel justified in temporarily refusing to relinquish control over the customer's assets.[53]

Letters of this nature, even those evidencing all possible indicators of fraud, used to be disregarded by banks. Financial institutions generally saw their duty to their customers as paramount. More often than not, this approach could have been taken with the bank suffering little to no adverse effects. The recent trend in the case law indicating the bank's dual obligations in circumstances where it has actual knowledge of fraud should therefore be raised in the letter. A bank will have to weigh the risks of ignoring a letter that outlines a case for fraud as well as the potential liability of the bank if nothing is done to mitigate the fraud's effects. Accordingly, to be as persuasive and effective as possible, potential claims based on negligence or knowing assistance in breach of trust should be included in the content of the letter. An aptly worded notice will ensure the letter is given its due consideration.

Conclusion

The possible liability of banks to third party fraud victims should entice potential plaintiffs to put a bank on notice of a fraud through the issue of a letter. In preparing a Mareva by Letter, victims and their representatives should be mindful of the bank's dual obligations on receipt of the letter. There are, of course, risks associated with a bank's effective compliance with an asset preservation appeal. A bank that complies with a freezing request without a court injunction risks being held liable to its customer in the event that any attempted transactions are blocked and it is later revealed that the

52 Bank Act, SC 1991, c 4, s 462(1).

53 Martin Kenney, 'The Mareva by Letter: Destroying a Banker's Defence of Good Faith', *International Law Office Newsletter*, 15 August 2005.

basis for the blockage was faulty or non-existent. Accordingly, it must be recognised that compliance with the letter is probable only if it leads the bank to conclude, after balancing its risk, that the likelihood of liability is greater if it fails to heed the letter's demands.

As a result, a letter that provides sufficient particulars and evidence of fraud, and that outlines the bank's legal obligations in the circumstances, would afford a bank the comfort that any actions it takes to enforce the Mareva by Letter were made reasonably and in good faith. This would protect the bank from liability on both fronts and ensure greater bank acquiescence with non-customer requests. Banks should consider a proactive strategy in order to be prepared to respond to such letters, which would include an ability to assess the merits of the letter as an evidentiary foundation of fraud and weigh the risks of compliance and non-compliance with the request to freeze the accounts.

The apparent benefits to fraud victims in utilising a Mareva by Letter as the first step in recovering their assets must not be overlooked. The viability of the Mareva by Letter as an effective asset preservation tool marks a significant advancement in the remedial framework against losses occasioned by fraud, and should be utilised by victims of fraud in all circumstances that warrant it.