Better than damages: actions for performance against Swiss banks regarding fraudulent transfers

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I. Introduction

When fraudulent transfer instructions are given to a bank, who executes them in breach of its good faith duty of care, it is often assumed that an action for damages based on breach of the bank's contractual duty should be brought by the client against the bank.

However, a series of rulings by the Swiss Federal Court confirm that a better alternative exists, namely the action for performance.

Indeed, when a bank executes a transfer instruction, it does not actually use the cash on the client's account to do so. Cash on a client's account represents a scriptural claim of the client against the bank for the restitution of that amount. When executing a transfer, the bank uses its own assets to do so, namely it usually instructs its correspondent bank to debit its *nostro* account to execute the transfer. Once the transfer has been executed, the bank debits its client's account of the amount of the transferred amount and the fees, thus offsetting the amount of the reimbursement with its debt of restitution to the client.

In the action for performance, the client claims that, due to the breach of its duties of care, the bank wrongly set off its claim for reimbursement against the client's claim for restitution of the cash on the account, and that the bank must therefore reverse the debit that took place.

In a series of rulings, the Federal Court has systematized the conditions that must be met, and the counterclaims that the bank may bring against the client (those rulings have notably been

commented by Fabien Liégeois and Célian Hirsch, *Ordres bancaires frauduleux: discours de la méthode*, in La Semaine judiciaire 2021 II pp. 117-154):

1. Ruling 146 III 121, 4A_504/2018 of 10 December 2019 (in French).
2. Ruling 4A_337/2019 of 18 December 2019 (in French).
3. Ruling 4A_161/2020 of 6 July 2020 (in French).
4. Ruling 146 III 326, 4A_9/2020 of 9 July 2020 (in French).
5. Ruling ATF 146 III 387 4A_178/2019 / 4A_192/2019 of 6 August 2020 (in French).

II. The Federal Court's case law

When a client considers that the bank executed transactions on the basis of a fraudulent order, several options are theoretically available to him. The client can act on the grounds of:

- a claim for contractual liability; or
- a claim for performance.

In the latter case, the client does not claim for the compensation of a loss but will seek the restitution of the amount unduly debited from his account, which under Swiss law will constitute a claim to perform the contract properly.

In recent years, the Federal Court has developed a three-step method to analyse the client's claim for performance, applicable in cases of a bank executing a fraudulent order.

Step 1

The first step is to examine whether the bank executed the transaction within valid agency or without valid agency.

In this context, it should be noted that according to case law, the bank owns the money in its client's account, towards which the client only has a claim for restitution.

If the bank transfers money from an account to a third party upon the client's or one of his representatives' instruction (**within a valid agency contract**), it acquires a claim for reimbursement (Article 402 of the Swiss Code of Obligations (CO)). The bank can set off its claim for reimbursement against the client's claim for restitution. The bank's claim for reimbursement presupposes that it executed correctly the order given by the client, in particular that there was no mistake with regard to the recipient or the account number indicated by the client.

However, if the bank transfers money from the client's account to a third party without a valid order from the client or one of his representatives (**without a valid agency contract**), it does

not acquire a claim for reimbursement. As a consequence, the bank cannot set off its claim for reimbursement against the client's claim for restitution of the money deposited in his account. It must reverse the payment and Article 402 CO does not apply. In case of transfers carried out by the bank without valid agency, due to, for examples, undetected forgeries or lack of legitimacy, the client therefore has a claim for the restitution of his assets, which is a claim for the performance of the contract.

The question of whether or not a transfer instruction was given within valid agency is particularly difficult if the client is represented: in order to know whether the transfers were executed with or without valid agency from the client, one has to examine the powers of the representative and the good faith of the bank dealing with the representative.

According to Article 3 of the Swiss Civil Code (CC), good faith is presumed. However, a person cannot invoke the presumption of good faith if the diligence required by the circumstances was not exercised.

If the representative had the powers to instruct the bank, it must be considered that the order was given within the agency contract entered with the client and the analysis ends here.

On the contrary, when the representative had no powers to instruct the bank, the following situations must be distinguished:

- The representative acted on behalf of the client without having any authority to do so, i.e. where the act he performed was not covered by the power of attorney (**excess of the power of representation**).

- In the case of **abuse of the power of representation**, the legal act performed by the representative falls, at least abstractly and objectively, within the scope of the power of attorney communicated to the bank. However, the representative never actually intended to act on behalf of the client: he only used the appearance arising from the powers communicated to act exclusively in his own interest and potentially in a criminal manner.

Depending on whether the case is one of abuse or excess of power of attorney, the attention required of the bank is not the same.

Indeed, in the case of excess, only serious doubts about the real powers of the representative can lead to the denial of the good faith of the bank.

In the case of abuse, doubts of relatively low intensity are already sufficient. If the representative acts unlawfully to the detriment of the client and thus abuses his powers,

Article 3 para. 2 CC must be applied without restriction. This increases the requirements as to the attention required of the third party. Even slight negligence may already give rise to bad faith, in particular if the bank executes the transactions without paying attention to objective indications of abuse which suggest that the representative is acting against the interests of the client.

In summary, if the transfer order does not come from the client or an authorised representative (and the bank cannot rely on its good faith vis-à-vis the representative), the order is considered to have been given without valid agency and the judge will examine the next step.

Step 2

The second step requires an examination of which rules apply to the consequences of an unauthorised transfer.

The financial risk arising from unauthorised payments made by the bank is a risk of the bank, not of the client. However, this legal allocation of the risk can be contractually modified, by adopting a **risk transfer clause**.

General terms and conditions of banks often include such a risk transfer clause, which generally provides that the damage resulting from undetected lack of legitimacy or forgeries is to be borne by the client, except in the case of gross negligence on the part of the bank. The effect of this clause is that the risk normally borne by the bank is transferred to the client.

The client must thus be able to prove that the bank has committed a gross negligence. According to case law, this is the case when the bank violates elementary rules of prudence which any reasonable person in the same circumstances would have followed. Conversely, a person commits slight negligence if he fails to exercise all the care that could have been expected, although his fault - which cannot be excused - cannot be considered a breach of the most elementary rules of prudence. When the bank commits a gross negligence, the risk transfer clause is void and the legal system applies.

According to certain rulings of the Federal Court, the **complaints clause** should also be considered in this second step. Indeed, general conditions of banks often provide that any complaint relating to a transaction must be made by the client within a certain period of time from receipt of the transaction notice or the account statement. In the absence of any complaint, the client is deemed to have ratified the transaction (tacit ratification).

The reasoning of the Federal Court in some decisions is that if the bank committed gross negligence and is thus precluded to invoke the risk transfer clause, the judge will still take into account the client's own negligence in relation to his obligation to react in due time. If the judge

considers that the client's negligence (absence of reaction) overshadows the bank's negligence, tacit ratification can be opposed to the client. The client's claim will therefore be rejected.

In some cases, the Federal Court has also used the concept of abuse of rights (Article 2 para. 2 CC) in relation to the complaints clause. It stated that – when the banking communications are retained by the bank (hold mail) and the client does not react in time to contest the transactions – the application of the complaints clause can lead to shocking consequences. The judge can exclude this clause (meaning the bank will not be able to invoke it) based on the rules of abuse of right. For instance, there is an abuse of rights if the bank takes advantage of a hold mail agreement to act knowingly to the detriment of the client or if, after having managed an account for several years in accordance with the client's oral instructions, it intentionally deviates from these instructions even though this was not foreseen (e.g. in the case of an asset management contract), or if it is aware that the client does not approve the acts communicated by the bank. The Federal Court has specified that case law on abuse of rights is only applicable to the situation of a hold mail agreement and is not applicable when the banking communications (e.g. transaction notice) have been actually received by the client, respectively his representative. In our opinion, however, in particular cases where the bank has committed a very serious fault, the defence based on abuse of rights should still apply even if there was no hold mail but communication by post.

Step 3

In the last step of the reasoning, the judge will examine whether the bank has a claim for damages against the client for having wrongfully contributed to causing or aggravating the damage by violating his own obligations. This is a **liability claim** by the bank against its client, based mainly on Article 97 para. 1 CO, which the bank will try to set off against the client's claim for the restitution of the account balance.

The client would be in a breach of his contractual obligations if he contributed in any way to causing the damage by inducing the bank to make the undue transfer or by contributing to the aggravation of the damage.

According to some rulings of the Federal Court, it is in this third step of the reasoning that the **complaints clause** should be examined as a breach of contract on the part of the client. In this scenario, the bank will not have been able to invoke the risk transfer clause (second step) because of its gross negligence and, in order to defeat the client's claim for restitution, it will blame the client for having breached the contract because of his failure to challenge the bank's litigious operations in due time.

In examining the bank's claim for damages, the judge will assess the seriousness of the bank's contributory fault in relation to the client's fault for not having reacted in time. He may consider that the bank's negligence breaches the causal link with the bank’s loss and deprives the bank of its counterclaim, or reduces it.

III. Conclusion

The action for performance represents a very valid alternative to an action for contractual liability for damages.

In order to establish the lack of good faith of the bank, it will often be preferable to bring regulatory or criminal proceedings against the bank, as the powers of investigation of the Financial Markets Supervision Authority FINMA or public prosecutors far exceed those of civil courts. An alternative is, when the client has become insolvent, to use the coercive powers of the Bankruptcy Office, whether the bankruptcy is a Swiss one or a foreign one recognized in Switzerland.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.