

The duty of care of directors in a cyberfraud

June 12, 2020

In the recent case, *Emirate Distributors Ltd v. AALL & Zyleman Co Ltd*¹, the High Court considered the standard of the duty of care owed to the two plaintiff companies in a cyberfraud by the defendant management and secretarial service company (the Management Company) and its three employees, who were also nominee directors of the plaintiffs (the Directors).

The Management Company had been responsible for incorporating the Plaintiffs and subsequently was specifically engaged to handle remittances from the Plaintiffs' accounts (the Accounts). Pursuant to fraudulent instructions sent by imposters, the Management Company effected remittances in a total sum of US\$1,898,000.

In this case, the Management Company admitted that it owed a duty of care in tort to the Plaintiffs to exercise reasonable care, skill and diligence in carrying out the payment instructions from the Plaintiffs. It was the standard of that duty of care that was disputed.

As the second and third Defendants were each an authorised signatory of the Accounts, and the Management Company was in possession of the security device for bank purposes, the employees of the Management Company were the only ones that handled and had the power to make remittances. As such, the court ruled that the standard of care was a high one.

The court held that, in order for the Management Company to discharge its duty of care, it was responsible for putting in place proper and adequate procedures for carrying out the Plaintiffs' instructions for remittances. In this case, the court found that the payment procedures put in place by the Management Company were neither proper nor adequate. The handler of the remittances and her supervisor (the third Defendant) were also found to have failed to exercise reasonable care, skill and diligence, which caused the Plaintiffs' loss.

As for the Directors, the court was of the view that there is no differentiation in directors' duties between a nominee director and any other director. However, in this case, the Plaintiffs had not discharged their burden of proving that a duty of care was owed by the Directors and there was no evidence that the Plaintiffs had ever expected them to exercise a continuing duty to acquire and maintain a sufficient knowledge and understanding of the Plaintiffs' business to enable them properly to discharge their duties as directors. As such, it was found that the Directors had a more qualified role in respect of the Plaintiffs, which was limited to signing the documents in the capacity of a director on behalf of the Plaintiffs as instructed and, therefore, they did not personally owe a duty of care to the Plaintiffs in tort to take reasonable and/or adequate steps to ensure that proper payment procedures were in place.

Ultimately, damages to be paid by the Management Company were reduced by 50% in light of the Plaintiffs' contributory negligence. In particular, the representative of the Plaintiffs whose email had been hacked by the fraudsters was a practising attorney and yet his emails were not encrypted. The court also took the view that the ultimate beneficial owners, who were able to access and view online balances of the Accounts, should have taken a more active role in supervising their own money.

Points to note

Although the Directors were not found to have owed a duty of care to the Plaintiffs in this particular case, nominee directors or, indeed, any other directors should be mindful of their duties as director of a company, particularly when dealing with monetary matters. Directors have a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them to properly discharge their duties as directors. Where any functions are delegated, there remains a continuous duty to supervise them.

This reminder applies not only to nominee directors but, as evident from this case, to all parties involved. As a result of the Plaintiffs' contributory negligence, their damages were reduced by a 50% discount.

In order to avoid or minimise the risks of cyberfraud, systematic and standardised payment and confirmation procedures should be adopted so that any irregularities can be detected at an earlier stage. Directors can delegate particular functions to those below them in the management chain and to trust their competence and integrity to a reasonable extent but, if the systems of delegation are inadequate, then the person with overall responsibility (i.e. the directors) must take some blame.

1. [2020] HKCFI 851↔

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