GOWLING WLG

Gowling WLG's National Banking Litigation Group is pleased to present a summary of decisions rendered in 2020-2021 in the area of banking litigation. This report does not claim to be exhaustive but contains a summary of the decisions we thought would be of interest to you.

I. QUÉBEC CASE LAW

- ***Toronto-Dominion Bank* v. *Pourshafiey*, 2020 QCCA 1582**

Bank does not need to provide any explanation to its customers prior to closing their account, but it must provide a reasonable notice and needs to maintain its services during said notice period.

Bank may also be allowed to close the account without notice for a default stipulated in the banking agreement, but must raise the default at the time of the closing of the account and not after.

- ***Cie d'assurance générale Co-Operators* v. *Sollio Groupe Coopératif*, 2020 CSC 41 (in appeal to the decision *Compagnie d'assurances générale Co-Operators* v. *Coop fédérée*, 2019 QCCA 1678)**

A payment order for an electronic transfer of funds (wire transfer) is not a bill of exchange and is not governed by the Bills of Exchange Act but rather constitute a mandate from the account holder to its bank.

In 2020, the Supreme Court dismissed an appeal of a 2019 decision by the Québec Court of Appeal. The judgment involved a case of phishing against Coop fédérée who issued a payment order authorizing its financial institution, the National Bank of Canada, to carry out a transfer of funds in the amount of $4.9 M USD to the account of a designated beneficiary in a Hong Kong bank. When Coop fédérée realized the scam, the funds had already been depleted and thus, Coop fédérée filed a suit against its insurers. In addition to the numerous issues related to the insurance coverage, the Court of Appeal considered, among other things, whether the payment order for the wire transfer was subject to the *Bills of Exchange Act* and, more generally, the legal nature of electronic funds transfers. The Court of Appeal found that the electronic funds transfer lacked the essential characteristic of a bill of exchange namely because an electronic funds transfer does not involve a presentation for payment, confers no right of action on the named beneficiary if the bank refuses to perform the payment order, and the notion of negotiability is also foreign to an electronic funds transfer since the person for whom a transfer is intended cannot endorse the title in favour of a third party unlike a bill of exchange. Thus, the Court of Appeal came to the conclusion that the payment order for an electronic funds transfer is not a bill of exchange, but rather a mandate given by the account holder to its bank as defined in the Civil Code of Québec.

- ***Pilon* v. *Bangue Amex du Canada*, 2021 QCCA 414**

Bank's practice to charge over-the-limit fees to credit cardholders is valid.

Pilon is appealing a judgment dismissing her request for authorization to institute a class action. The respondent's banks issue credit cards with a credit limit that the cardholders are not permitted to exceed. However, occasionally, banks allow the cardholders to make one or more transactions that result in them exceeding the credit limit. Pilon argues that this practice is in breach of Section 6 of the *Credit Business Practices Regulations* and Section 128 of the Québec *Consumer Protection Act,* which prohibit lenders from increasing a credit card limit without the express consent of the consumer.

The banks argued that an important distinction must be made between surpassing a credit limit and increasing the said limit. By allowing a cardholder to surpass their credit limit, the bank does not increase the limit of the credit card. The Superior Court refused to authorize the class action. The Court of Appeal dismissed the appeal on the basis that an overrun can occur without constituting an increase of the credit limit.

In May 2021, Pilon submitted a motion for leave to appeal to the Supreme Court that is still pending.

- ***Haroch* v. *Toronto-Dominion Bank*, 2021 QCCA 1504**

Prepayment fees charged by banks in case of early reimbursement of a closed-term mortgage are valid. Moreover, a motion to amend an originating proceeding will be dismissed if it materially changes the nature of the claim at the appeal stage.

The Québec Court of Appeal dismissed an appeal of a Superior Court judgment dismissing an application for certification of a class action where the appellants were contesting the validity of the prepayment fees charged by banks when a borrower reimburses his/her mortgage loan before term in case of closed term mortgage. The Superior Court had refused to authorize the class action on the ground that the prepayment charges were perfectly valid under the Québec Civil Code, the *Bank Act* and the *Bank Regulations*. In appeal, the appellants had changed their ground of contestation by admitting the validity of the prepayment charge except for the discount component taken into consideration by the banks in calculating the interest rate differential to determine the amount of the prepayment fees. The discount is the rebate that the banks give to a borrower on the posted interest rate at the time of signature of the loan.

The Court of Appeal ruled that the appellants could not amend their arguments in appeal because they were raising a new cause of action that was not initially alleged in their application for certification in Superior Court. In addition it was unfair for the respondents (the banks) to have to defend in appeal against such new allegations even though the appellants had made some oral submissions in Superior Court on their new argument and some banks had objected to it and raised that it was illegally argued.

- ***Association pour la protection automobile (APA) v. Banque de Montréal*, 2021 QCCA 676**

A class action is authorized against certain financial institutions in relation to administration fees charged by them to their customers in relation to the registration of sale contracts in the public registry (RDPRM).

On an application for authorization to institute a class action, the judge cannot take into account the evidence filed by the respondent that is subject to contestation by the applicant (i.e., that is not clear, certain and determinant).

The Automobile Protection Association (APA) and Ms. Meilleur are appealing a Superior Court judgment authorizing in part a class action against the Bank of Nova Scotia (BNS) and the Bank of Montreal (BMO) in connection with administration fees charged by the banks in case of instalment sale contracts of a movable property. However, the Superior Court's decision refused to authorize the class action against Fédération des Caisses Desjardins du Québec (Desjardins). BNS and BMO cross-appealed the said judgment in order to have the motion for authorization of the class action dismissed.

The Court of Appeal granted the appeal in part. Neither BNS nor BMO presented complete evidence of their costs related to the administration fees charged. However, the Court came to the conclusion that similar contracts of other financial institutions did demonstrate the abusive nature of the administration fees charged to consumers by BNS and BMO. In the Court's opinion, there is no reason to intervene in the trial judge's decision to allow the class action against BNS and BMO. Regarding the refusal to authorize the class action against Desjardins, the latter did submit evidence of its costs in connection with the disputed administration fees. However, since this evidence was subject to contestation, and was not clear, certain and determinant, the trial judge should not have used it to dismiss the application for authorization of the class action against Desjardins. Therefore, the Court of Appeal granted the appeal and authorized the class action against Desjardins as well.

II. ONTARIO CASE LAW

- ***McDonald and Dickson v. TD Bank*, 2021 ONSC 3872**

Bank does not owe a general duty of care to customers to prevent fraud by an insider of the client.

This case sets out the scope of a bank's obligations to a client who has been defrauded by an insider of the client. Banks do not owe a general duty of care to customers to prevent insider abuse. Even if a duty of care existed in this case, TD Bank did not fall below the standard of care of a reasonable banker. This case also serves as a reminder that the court should consider facts as they were known at the relevant time. Hindsight should not be used to impose liability on financial institutions based on years of after-the-fact forensic examination and tracing of funds by a third party.

The Ontario Superior Court of Justice dismissed a $4.5 billion negligence claim against TD Bank ("TD") related to a USD $8 billion fraud Ponzi scheme that spanned over 18 years, the second largest Ponzi scheme in history. In this case, Stanford International Bank Limited ("SIB") was an offshore bank operating in Antigua and was solely owned by Allen Stanford ("Stanford"). For 18 years, TD was the primary domestic correspondent bank for SIB offering on-shore US dollar banking services. Stanford operated a Ponzi scheme through SIB using its TD account. In 2008, the Ponzi scheme collapsed and SIB was found liable for billions of dollars in damages to Stanford's Ponzi victims. SIB's court-appointed liquidators (the "Plaintiff") commenced a claim against TD alleging knowing assistance in breach of its fiduciary duty and for negligence. The causes of action claimed that TD should have been on guard to protect the Plaintiff from "insider abuse" by the sole owner and controlling mind of SIB.

The court dismissed the Plaintiff's claim for knowing assistance. It was found that TD did not have actual knowledge of Stanford's breach of his fiduciary duty to SIB, nor was TD reckless or willfully blind as there was no evidence on record that TD had reason to believe that Stanford might breach his fiduciary duty to SIB. The court found that Stanford's fraudulent scheme was elaborate and highly concealed given that SIB had around 100 employees who were unaware of the fraud and thought they were working at a legitimate financial institution. Further, SIB had strong Anti-Money Laundering ("AML") policies to help avoid outside scrutiny that would have exposed the Ponzi scheme. The only reason to believe that Stanford was operating a Ponzi scheme was through the benefit of hindsight.

The court also dismissed the Plaintiff's claim for negligence. The duty of care that banks owe towards their customers is to execute particular transactions pursuant to a client's instructions during the ongoing operation of the account. The court held that the claim failed at the duty of care stage since the required proximity was not established. Although TD undertook to comply with the banking procedures that applied to the operation of SIB's account, TD did not need to extend its monitoring to the internal operations of SIB. This extension would only apply when there is clear evidence that a financial institution had notice that a bank account was being used for nefarious purposes or that there was fraudulent conduct.

- ***Scotia Capital Inc.* v. *Aphria Inc.*, 2021 ONSC 1469**

Bank is successful in claiming 1.5 M$ fee to defend client against hostile takeover bid.

This case serves as a reminder that the burden to establish acceptance of a repudiated contract is on the party asserting acceptance, and such acceptance must be clearly and unequivocally communicated to the repudiating party within a reasonable time.

In this case, Scotia Capital Inc. ("Scotia"), a subsidiary of The Bank of Nova Scotia, and Aphria Inc. ("Aphria") entered into an engagement letter (the "Contract") for Scotia to defend Aphria against a hostile takeover bid. The attempted takeover eventually failed, and Aphria Inc. remained independent. At issue was whether the interpretation of the Contract required Aphria to pay a $2.5M Independence Fee (the "Fee"). A portion of the Fee was for a $1M Opinion Fee which Aphria paid, but Aphria refused to pay the remaining $1.5M. Aphria alleged that Scotia's services did not lead to Aphria remaining independent. Ultimately, the court found in favour of Scotia, ruling that "Aphria's defence to the claim fails because it got exactly what it bargained for: a successful defence of the hostile takeover bid and its independence going forward." Based on the evidence provided by Scotia there was no repudiation as Scotia continued to provide services to Aphria even after the takeover bid was rejected. Scotia had not received any indication that Aphria was dissatisfied nor of its intention to take any steps that could be considered as a repudiation of the Contract. The court ordered Aphria to pay Scotia the $1.5M plus expenses of $50,000.

- ***Carroll* v. *Toronto-Dominion Bank*, 2021 ONCA 38**

Applicant must have direct interest in a trust in order to have standing to ask the court to exercise its inherent jurisdiction to supervise it despite allegations of regulatory non compliance.

- ***MacDonald et al* v. *BMO Trust Company et al.*, 2020 ONSC 93**

Bank owes a fiduciary duty with respect to funds being held in trust or in investment accounts, but also in relation to the disbursement of said funds.

This case was certified as a class action eight years ago but was before the court for a hearing on its merits in 2020. This case serves as a reminder that banks owe a fiduciary duty under general trust law, trust agreements and agency agreements in relation to any funds being held in investment accounts or funds held in trust. There is a fiduciary duty in relation to any disbursement of those funds to ensure that clients know exactly what is being charged before any fees are deducted.

- ***Foodinvest Limited* v. *Royal Bank of Canada*, 2020 ONCA 665**

Bank does not owe a duty of care to customers who use its self-service transfer system to conduct their own transactions unless it is an agreed upon service in the banking agreement or unless the bank's personnel do intervene in the transactions.

This case established that the bank does not owe a duty of care to customers who are using their self-service transfer facility to do their own transactions without the involvement of bank personnel if the governing contract does not include that service within the agreed upon scope of services. The appellant, Foodinvest Limited, contracted with the respondent, Royal Bank of Canada (RBC) for use of a self-service transfer facility provided by RBC, RBC Express. RBC Express allowed the customer to personally transfer and receive funds from other financial institutions. Foodinvest Limited sued RBC stating that the bank had a duty of care to pass on information that it had been provided by the Polish bank about suspected fraud in relation to two transactions where Foodinvest Limited had used RBC Express to transfer funds.

The motion judge granted summary judgment in favour of RBC and dismissed the claim. The motion judge found that the customer had failed to show that the bank owed them a duty of care that extends to an obligation to pass on the information provided by the Polish bank. Even if the duty of care existed, the Court found that there was no evidence that the standard of care, which the bank owed, had fallen below the applicable standard of care. At appeal, the claim was dismissed. In the agreement between the customer and the bank, it set out the scope of the bank's liability with respect to services offered to customers. The bank's duty of care related specifically to the execution of transfers made using the service it provided. This duty of care extended to taking reasonable steps to ensure transfers were properly authorized and carried out according to the customer's instructions. However, nowhere in the agreement did it require the bank to concern itself with the specifics of underlying transactions. As such, transfers were authorized by the customer and were carried out according to their intentions and instructions. If the customer was cheated, his/her loss flowed from the entities he/she did business with, not from any failure of services provided by the bank.

- ***Aeon Sodding Corp. v. The Royal Bank of Canada*, 2020 ONSC 4520**

Verification clause in banking agreement should be construed in regard of those who are in the best position to detect fraud.

In banking agreements, verification clauses should be construed in favour of those who are in the best position to detect fraud. *Aeon Sodding Corp.* v*. The Royal Bank of Canada* provides an example of how clients of financial institutions are generally in the best position to detect financial fraud. Banks owe a duty of care to both their clients and other financial institutions. In this case, it was VISA.

Aeon Sodding Corp., a residential landscaping company, hired a legal professional to collect unpaid accounts through court proceedings ("M"). Aeon Sodding Corp. paid these amounts to M by using a VISA credit card issued by Royal Bank of Canada (RBC). Later, Aeon Sodding Corp. discovered that M had misrepresented himself and was not a legal representative. Aeon Sodding Corp. had paid over $432,814.16 to M by VISA. Aeon Sodding Corp. requested that RBC provide a refund due to this misrepresentation, but after investigation, RBC refused as the time for disputing the charges had expired. Aeon Sodding Corp. brought an action against RBC for breach of contract.

The Court considered the terms of the VISA agreement and whether RBC had acted reasonably when Aeon Sodding Corp. requested a refund. RBC had obtained the required information from Aeon Sodding Corp. to properly investigate the matter and make a decision. The Court also found that RBC held a duty of care to VISA and that RBC needed to follow VISA's permitted limitation periods. The court dismissed Aeon Sodding Corp.'s claim for breach of contract. Further, the court held that to shift the risk of loss from the Aeon Sodding Corp. to RBC under the verification clause in the VISA agreement was not appropriate as Aeon Sodding Corp. was in best position to discover the fraudulent activity of M.

III. ALBERTA CASE LAW

- ***Canadian Western Bank v. 1364994 Alberta Ltd.*, 2021 ABQB 868**

Mortgage amending agreement will rank in priority to subsequent encumbrancers provided the funds were advanced before subsequent registrations.

A question of priorities arose between two subsequent encumbrancers following a payment into court of excess sale proceeds in a foreclosure action between Canadian Western Bank ("CWB") and the defendant 1364994 Alberta Ltd. ("136").

CWB held a first mortgage granted against two pieces of property. After the lands were sold as part of the foreclosure proceedings, sale proceeds of $676,000 remained for the subsequent encumbrancers. The subsequent encumbrancers included a private lender, Dang Kam Mui ("Mui"), who had a second mortgage and caveat securing an agreement charging land, and Scheffer Andrew Ltd. ("Scheffer"), who had a builders' lien registered on title to the lands. Mui's mortgage and caveat were registered prior to the builders' lien. Subsequent to registration of Scheffer's builders' lien, Mui registered a mortgage amending agreement against title to the lands. The issue was whether the mortgage amending agreement took priority over the builders' lien, such that Mui would be entitled to all of the excess sales proceeds.

Mui argued that the mortgage amending agreement amended the original mortgage to include funds already advanced and secured by the agreement charging land, with the result that he would have priority.

The Court accepted Mui's argument. The Court reviewed the provisions of the *Land Titles Act* (Alberta) and the *Builders' Lien Act* (Alberta), noting s. 11(4) of the *Builders' Lien Act*, provides that a registered mortgage has priority over a lien where it is secured or where money is advanced by the lender prior to the registration of the lien. As the original mortgage was registered against the lands prior to the Builders' lien, and the additional funds the subject of the mortgage amending agreement were advanced prior to registration of the lien, the Court considered it to be the same mortgage secured by the agreement charging land registered prior to the lien. Consequently, the entire debt had priority over the lien.

- ***Crossroads-DMD Mortgage Investment Corporation* v. *MNP Ltd.*, 2021 ABCA 417**

When first mortgages merge into fees simple, there remains no secured charges and the second mortgages stand in first priority.

MNP Ltd. ("MNP") in its capacity as trustee in bankruptcy to Sun Country Mortgage Investment Corporation ("Sun Country"), and receiver and manager of DMD II Mortgage Investment Corporation sold three properties as part of insolvency proceedings. Crossroads-DMD Mortgage Investment Corporation ("Crossroads") appealed the decision of the Court of Queen's Bench wherein Crossroads's application to be paid in priority from the net sales proceeds was dismissed. The appeal involved a number of mortgages against three properties owned by a group of affiliated corporations who were in the business of mortgage investing.

Two properties were owned by Crossroads and another related company. The first mortgages were fully paid out. However, instead of being discharged, the mortgages were transferred into the names of Crossroads and the related companies as mortgagees. Later a second mortgage was granted against the property to Crossroads resulting in two mortgages registered on title to the properties.

Another property was owned by DMD II. A third party had first ranking mortgage on title to the lands. DMD II also granted a second mortgage to Crossroads. Later, the mortgage to the third party was paid out and the mortgage was transferred to DMD II alone.

MNP accepted the validity of the second mortgages but took the position that the first mortgages were also valid, with the result that Crossroads, Sun Country and DMD II would have priority to the net proceeds as first mortgagees.

The Court rejected MNP's argument, finding that when the owners of the properties paid out the first mortgages for which they were liable, the first mortgages merged into the ownership interests. Consequently, the first mortgages could not be used to defeat or prejudice subsequent charges on title.

In reaching its conclusion, the Court relied on the doctrine of merger. At common law, if the mortgagor and the owner of the land became the same person, the mortgage merged with the ownership and was extinguished, as a person cannot be their own debtor. However, the common law doctrine of merger has been delimited by s. 62 of the *Law of Property Act* (Alberta), which permits the continued applicability of the equitable doctrine of merger. In equity, the presumption of merger can be rebutted if the owner intended the mortgage to remain separate from ownership. The onus of proving such an intention is on the party who opposes merger. However, the intention-based exception will not be applied when the debt underlying the mortgage is paid by the person who is liable to pay it. In such circumstances, a charge cannot be maintained against other charges for which that person is liable, and merger will apply regardless of the owner's intentions.

In this case, the presumption of merger was not rebutted, as there was no evidence the owner intended the mortgage interests to remain distinct. As a result, the first mortgages were no longer enforceable causing the second mortgages to rank in priority.

- ***Business Development Bank* v. *1956689 Alberta Ltd.*, 2021 ABQB 141**

A Guarantees Acknowledgment Act Certificate executed by a lawyer can be used by a bank as conclusive proof that the Act was complied with.

The corporate borrowers entered into loan agreements with Business Development Bank ("BDB") and the guarantors signed personal guarantees that guaranteed the obligations of the borrowers to BDB. The guarantees were executed before a lawyer and attached a Certificate pursuant to the *Guarantees Acknowledgment Act* (Alberta) (the "Act"). The lawyer certified that the personal guarantors appeared before her in person and acknowledged they signed the guarantees. The lawyer also certified that she assured herself that the personal guarantors were aware of the contents of the guarantees and understood the terms.

The loans went into default and BDB commenced an action against the borrowers and the personal guarantors. The Master granted summary judgment in favour of BDB against all of the defendants. The personal guarantors appealed the Master's decision.

The two personal guarantors pleaded the doctrine of *non est factum*, arguing they were never told they were guaranteeing any loans and a representative of BDB assured them that the "loan was unsecured" and there was "nothing to worry about".

The Court dismissed the appeal, first finding that the *Guarantees Acknowledgement Act* was complied with. The Court held that a lawyer's Certificate provided in accordance with the Act is conclusive proof of compliance with the Act and the person to whom the guarantee is given need not look behind the Certificate to determine compliance. The Court also rejected the argument that BDB was not acting in good faith when its representative assured the personal guarantors there was "nothing to worry about". The Court held that the words "good faith" in s. 5(c) relate to whether the requirements of the Act have been complied with, with the result that a creditor could not rely on the Certificate if it did not have a good faith belief there had been compliance with the Act.

The Court also found that the plea of *non est factum* did not raise a genuine issue for trial. For a plea of *non est factum* to succeed, it must be shown a document was executed as a result of a misrepresentation as to the nature and character of the document and not merely its contents. The Court held there was no evidence that the personal guarantors were signing something other than guarantees, and they were, at a minimum, careless when they signed the guarantees.

IV. BRITISH COLUMBIA CASE LAW

- ***Jastram Properties Ltd.* v. *HSBC Bank Canada*, 2021 BCSC 2204**

Certification granted in class action alleging the Bank had actual knowledge of fraud committed by client and owed third parties a duty to take reasonable steps to stop the fraud which might include an obligation to warn other financial institutions of the fraud.

- ***Zheng* v. *Bank of China (Canada) Vancouver Richmond Branch*, 2021 BCSC 2357**

Exclusion of Liability Clause in favour of the Bank enforced

The Plaintiff, Li Zheng ("Zheng"), sought to hold the Defendant Bank responsible for carrying out Zheng's request to transfer $69,000 to a fraudster in Hong Kong.

In requesting the transfer of funds, Zheng completed and signed an Application for Remittance form, which included a set of "Conditions of Transfer" and an exclusion of liability clause in favour of the Bank. The Bank brought an application to strike Zheng's claim, which application was granted by a Master and upheld on appeal in this decision.

Zheng pleaded the Bank had a duty to warn she might be the victim of fraud, and the Bank breached the duty of care owing to her, as the Bank had a duty to make inquiries in the face of potential fraud. The Court found it was not plain and obvious Zheng's claim would fail.

However, the Court went on to find the exclusion of liability clause in the Conditions of Transfer bars any claim against the Bank. The exclusion of liability clause provided that the Bank was not liable to Zheng for any improper payment to a recipient, unless "caused solely by the negligence or willful misconduct of the Bank." As the Court was satisfied, there was no reasonable prospect Zheng could establish her loss was solely caused by the Bank's negligence or willful misconduct, Zheng's claim was dismissed in its entirety.

Thank you to all members of our group who contributed to preparing this report namely Jean-François Hamel, Emma Dalziel, Jennifer Seidel, Stephen Kroeger, Vincent Lamarre-Deraps, Alison Gray and Jeffrey Kukla.

Please do not hesitate to contact us should you have any question.

Ronald Audette
Partner, National Lead – Banking Litigation Group
T +1 514 392-9559
ronald.audette@gowlingwlg.com
Ronald Audette Gowling WLG Profile

GOWLING WLG

Gowling WLG (Canada) LLP
Suite 3700, 1 Place Ville Marie
Montréal QC H3B 3P4
Canada