

## financial services litigation bulletin

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### taking a run at the constitutional division of powers?

#### *Quebec Court applies provincial consumer protection laws to award huge damages in class actions against Canadian financial institutions*

The Quebec Superior Court recently ordered ten Canadian financial institutions who issued credit cards to pay over \$200 million in general and punitive damages to Quebec card holders who used their cards to pay for goods or services in a foreign currency<sup>1</sup>. The court's determinations in the three related class actions were premised on its finding that the card issuers had charged a fee or commission that was separate from amounts applied to card balances in respect of conversion rates.

The court held that in failing to expressly disclose such a commission in their agreements with card holders, the federally chartered banks and credit union had breached certain provisions of Quebec's consumer protection laws. The financial institutions were ordered to pay the amounts collected in respect of such commissions as well as punitive damages. The decision is particularly notable both in terms of the court's application of provincial legislation to federally chartered banks and its characterization of conversion charges. The decision is currently under appeal.

#### background

Three related class actions were brought against all major banks and credit card issuers operating in Quebec. The plaintiff classes were composed of card holders who used a credit card to enter into foreign currency transactions during a specific time period.

When a card holder makes a purchase in foreign currency, it appears on his or her monthly statement in the form of a global amount represented in Canadian dollars. The amount is calculated by multiplying the transaction amount by the exchange rate. The exchange rate encompasses two components:

- the daily conversion rate for the currency in question; and
- conversion fees that vary depending on the financial institution or the type of credit card.

<sup>1</sup> *Marcotte v. Bank of Montreal et al.*, [2009] J.Q. No. 5771 (S.C.); *Adams v. AMEX Bank of Canada*, [2009] J.Q. No. 5769 (S.C.); and *Marcotte v. Federation Des Caisses Desjardins Du Quebec*, [2009] J.Q. No. 5770 (S.C.).

The conversion rate is established by Visa, MasterCard or American Express based on an interbank market rate. The conversion fees are then added to the daily conversion rate. The conversion from the foreign merchant's currency to Canadian dollars is completed at the Visa, MasterCard or American Express network level rather than by the card issuing financial institution. The conversion fees, however, are applied by the financial institution. It is these conversion fees that were the subject of these class actions.

The plaintiff classes contended that the conversion fees billed by the banks were credit charges. If these fees constituted credit charges, Quebec's *Consumer Protection Act* (the "CPA") would require that they be calculated and disclosed to the card holder in the form of an annual percentage. As certain of the defendant banks were alleged to have failed to expressly disclose the existence of conversion fees to their clients for a certain period of time, they may have been in contravention of the CPA, if it were to apply.

The CPA also requires that any "credit charges" be indicated in terms of dollars and cents on the card holder's statement and that the statement indicate that such charges relate to the period for which the card holder is being billed.

Further, if the conversion fees constituted credit charges within the meaning of the CPA, the defendant banks would not be in compliance with the provincial law given that conversion fees were imposed before a statement was sent to a card holder, without granting the 21-day grace period required by the CPA.

The defendant financial institutions contended that the conversion fees were not credit charges within the meaning of the CPA, but were rather "net capital". Under the CPA, credit charges cannot include net capital, or the amount of credit which is actually extended to the debtor. The financial institutions argued that that the conversion fees were a component of the exchange rate that they billed when a transaction was completed in foreign funds. Further, according to the financial institutions, the conversion constituted a distinct service unrelated to the credit contract and was therefore not subject to CPA provisions that apply to credit charges.

Furthermore, the banks that did not expressly disclose the existence of conversion fees to their clients contended that the card holders were in fact aware of such conversion fees because such fees were simply part of the exchange rate and the card holder was only interested in knowing the global amount of the amount charged in respect of conversion and the global amount of the transaction.

The financial institutions also argued that the CPA, a provincial statute, is not applicable given that under Canada's *Constitution Act, 1867*, banking falls within the exclusive jurisdiction of Parliament rather than provincial legislatures. The financial institutions contended that the application of the CPA to their operations would impair credit card services and foreign exchange conversion services, vital and integral components of their banking activities. Accordingly, the doctrine of inter-jurisdictional immunity applied such that the provisions of the CPA relied upon by the plaintiff classes were inoperative or inapplicable.

The financial institutions also relied on the doctrine of federal paramountcy in this regard, which provides that when the operational effects of provincial legislation are incompatible with federal legislation, the federal legislation must prevail. The financial institutions contended that they relied upon provisions of the CPA conflict in operation with, and frustrate Parliament's purpose in, the federal *Bank Act*, the *Financial Consumer Agency of Canada Act* and the *Cost of Borrowing (Banks) Regulations*.

## the court's decision

The court concluded that the conversion fees are in fact "credit fees" within the meaning of the CPA. This determination was driven in part by the fact that the currency conversion is completed at the Visa, MasterCard or American Express network level, while the conversion fees are imposed by the card issuers. This led the court to determine that the conversion fees were imposed by the card issuers in relation to an agreement to provide credit and not in relation to a currency conversion service that they are providing. The court also noted that as conversion fees are considered fees under the *Bank Act*, it is difficult to conceive that they would be anything else under CPA. The court concluded that the financial institutions were charging card holders for currency conversion, a service that they were not providing. Notably, in reaching this determination, the court found that credit cards do not extend credit in that most consumers pay their credit card balances in full and thus do not pay interest.

The court also held that even if the fees in question were not credit fees, the CPA provides that no costs may be claimed from a consumer unless the amount is indicated in the relevant contract. The court noted that the purpose of this requirement is to ensure that consumers are well-informed of the conditions of their contract. The court also noted that the financial institutions were subject to a similar disclosure obligations under the *Bank Act*. The court thus concluded that unless a card issuer clearly discloses the exact amount charged for currency conversion services, the card issuer cannot claim such fees.

With regard to the card issuers' Constitutional arguments, the court held that neither foreign currency exchange nor the extension of credit through credit cards are part of core banking activities and were thus not included in the activities over which Parliament is given exclusive jurisdiction under the *Constitution Act, 1867*. The court thus concluded that banks are obligated to comply with any and all applicable provincial legislation in providing such services. The court further held that there was no operational conflict between the CPA and the federal *Bank Act* or other applicable federal legislation, such that the doctrine of federal paramountcy did not apply and Parliament's efforts to regulate these areas were not frustrated by the application of the CPA.

The court held that the class members were entitled to reimbursement of conversion fees paid and punitive damages totalling approximately \$200 million.

## implications

The decision is notable in terms of the court's characterization of conversion fees charged in relation to foreign currency transactions. The court specifically rejected the card issuers' contention that the conversion fees are a component of the foreign exchange rate as they are part of the cost of converting foreign currency into Canadian currency. Instead, the court limited the meaning of "exchange rate" to the difference in the value at which the relevant currencies are trading, rather than the rate at which the currencies are exchanged are converted by the credit card issuers.

Perhaps of more particular importance to financial institutions, however, was the Quebec Court's determination that provincial consumer protection legislation applied to and governed the operations of the federally regulated banks, at least within the realm of credit card operations and currency conversion. The decision suggests that financial institution credit card issuers, which generally operate on a national level, must comply not only with federal legislation and authorities that regulate banks in Canada, but also with any provincial statutes, such as consumer protection legislation, that touch upon their banking or credit operations. It suggests that credit card statements must be delivered in a form that addresses both federally and provincially mandated disclosure requirements.

The defendant financial institutions have appealed the decisions. Given the ambit and significance of the court's decisions, the Quebec Court of Appeal's review of the decisions will be eagerly anticipated by the banking and credit card industry.

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### a cautionary note

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted. © McMillan LLP 2009.