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• SUPREME COURT OF CANADA SIDES WITH SECURED CREDITOR IN FRAUD CASE •

Ben Leith, Osler, Hoskin & Harcourt LLP

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In a contest between two creditors over the proceeds of shares credited to an investment account which were traceable to fraudulently obtained funds, the Supreme Court of Canada held in favour of Bank of Montreal ("BMO"), a secured creditor. While the secured creditor came out ahead in this case, the timing of how the case unfolded was a significant contributing factor to that success and lenders must remain on guard for fraudsters.

In *i Trade Finance Inc. v. Bank of Montreal*,[1] the Court had to determine whether shares purchased through a pool of funds advanced under a fraudulent representation could be claimed by i Trade Finance Inc. ("i Trade"), which had lent money to the defrauding party (the "Fraudster") or to BMO, who accepted a pledge of the shares from the Fraudster as security for an advance under a MasterCard account. The Court characterized i Trade's interest as an equitable interest in the shares which was defeated by the *Personal Property Security Act* (Ontario) [the *PPSA*] R.S.O. 1990, c. P.10, security interest held by BMO. The decision hinges on the timing of

In seeking to recover the funds, the drawee bank relied, among other things, on the doctrine of mistake of fact. It was on this ground that the Court granted the bank judgment for the spent funds. Where a paying party makes a payment under a mistake of fact (the cheque was real) which causes that party to make a payment (the drawee bank credits the depositing customer's account), then the paying party (the drawee bank) is entitled to recover the money paid unless:

a) the payer intended the payee to have the money at all events, whether the fact be true or false (whether the cheque was counterfeit or not), or is deemed in law to do so;

b) the payment is made for good consideration, such as where the money is paid to discharge and does discharge a debt owed to the payee by the payer or by a third party by who he is authorized to discharge the debt; or

c) the payee has changed his position in good faith, or is deemed in law to have done so.

The Court found that the pre-existing debts that had been paid with the counterfeit cheque funds existed independent of the receipt of those funds. The debts were not incurred in reliance on the receipt of those funds. As a result, they had to be paid back. In what might be taken as a skeptical view of the good faith of Messrs. Hashka and Backman, the Court went on to find that in any event they had spent these funds in circumstances where they could not have had a "legitimate expectation" of entitlement to the subject funds. In short, their explanation of the underlying facts was not sufficiently credible.

So, if your account balance rockets skyward because of a "bank error", think twice before you go ahead and spend any of that money. If you do, you will likely be liable to pay it back when the error is discovered.

[*Editor's note*: Peter Roberts is a litigator based in Vancouver, British Columbia. His 20-year experience includes practising criminal law, civil and commercial litigation, including claims involving allegations of fraud, as well as real property litigation, products liability, professional negligence claims, insurance defense and coverage, defamation, commercial disputes, contracts, class actions, copyright and trademark matters, company law and banking and insolvency litigation. He also has experience with various types of injunctions, including Mareva and Anton Pillar injunctions.]

• WHOSE BANK ACCOUNT IS IT ANYWAY? A BANK'S RIGHT TO CLOSE AN ACCOUNT AGAINST THE CUSTOMER'S WILL •

Hilary Clarke, Lisa Brost and Richard McCluskey, McMillan LLP

It is not good business for a bank to tell a customer to move its accounts elsewhere, but banks will occasionally do so. Typically, this happens where there has been a breakdown of trust in the banking relationship, for example where the bank suspects fraudulent activity, such as money laundering or cheque kiting, or ties to terrorism. In fact, banks are not only wise to terminate the relationship in these circumstances, but are often required to do so pursuant to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*.[1]

However, the grounds upon which a bank may wish to end a relationship are occasionally less clear and clients, not always thrilled to learn that their bank accounts have been terminated, will often take issue with the right of the bank to do so. The question becomes, is a bank entitled to close a client account and terminate a banking relationship at its discretion? Courts have said that the answer is yes.

Banks Assert Right to Close Accounts

Financial institutions are consistently threatened with litigation for terminating banking relationships and closing down client accounts. Plaintiffs will often find creative ways to argue that a bank is obliged to continue to operate accounts for the former client. Any number of claims have been asserted, including: (a) breach of the express terms of the account agreement; (b) breach of an implied term in the account agreement not to terminate; (c) breach of a duty of good faith; (d) breach of a fiduciary duty; and (e) unlawful interference with economic interests. Plaintiffs have also alleged that any clause permitting the bank to terminate the account without notice is unconscionable and should have been brought to the client's attention.

Courts Uphold Bank's Right to Close Accounts

A review of recent Canadian case law reveals no reported instances where such claims have succeeded. The reported decisions all support a bank's unfettered right to close client accounts and judges have refused to grant mandatory injunctions requiring the banks to continue to operate accounts against their will.[2] Banks have also had success in having these claims dismissed entirely on motions for summary judgment.[3] In some cases, the allegations levied against the banks have been ultimately characterized as frivolous or vexatious.[4]

The Terms of Account Agreement Will Govern

Courts have held that the account agreement between a bank and its client constitutes a contract like any other and the general rules of contractual interpretation will apply. As such, the terms of the account agreement will govern the relationship between the parties.

Courts have upheld a bank's right to terminate a client account, without notice, when the account agreement expressly allows it to do so. Clauses of this nature are not unusual, onerous or unconscionable and don't need to be specifically drawn to the attention of the client — especially when the client is a sophisticated commercial entity. However, if the account agreement does not permit a bank to terminate the relationship immediately, courts may read in a requirement that the bank provide reasonable notice.[5]

Further, as per general rules of contract law, there can be no implied terms read into an account agreement that contradict the explicit terms on the page. Courts will not read in an obligation that the bank continue to operate the accounts indefinitely and financial institutions are not required to continue to contract with clients they no longer wish to do business with. In short, banks do not require a "commercially reasonable justification" for terminating an account.[6]

Courts have also routinely rejected the argument that a fiduciary duty exists between a bank and its clients or that the bank owes a duty of good faith not to close the account. It has also been decided that the closure of a company's bank account does not constitute unlawful interfer-

ence with their economic interests, even if business disruption occurs.

An Individual's Right to a Personal Deposit Account

The erroneous belief that banks are not entitled to terminate client accounts likely stems from s. 4(1) of the *Access to Basic Banking Services Regulations*, which states that subject to a few exceptions, a bank shall open a personal deposit account with a deposit of less than $150,000 for an individual who can present valid identification.[7] However, there are two catches:

- Firstly, these Regulations only deal with accounts opened by natural persons for non-business purposes. They do not apply more generally to corporate bank accounts.
- Secondly, these Regulations don't explicitly deal with the termination of bank accounts. As stated by one judge: "I accept the defendant's submissions that this section and the Regulations pertain to the opening of bank accounts not to the closing of bank accounts which, therefore, remains subject to the terms of the agreement between the bank and customer."[8] Therefore, while a bank may be obligated to open a personal deposit account for an individual, they are not obliged to continue that banking relationship indefinitely.

Implications

The case law makes it clear that businesses do not have an inalienable right to a bank account and financial institutions can insist that clients — both individuals and companies — take their business elsewhere. The explicit terms of the account agreement will determine each party's rights upon termination and both banks and clients would be best served to review the terms of their agreements carefully.

[*Editor's note*: Hilary Clarke is a litigation partner at McMillan LLP. Her practice focuses on complex commercial litigation, with an emphasis on cross-border disputes.

Lisa Brost is a partner in the Litigation and Dispute Resolution Group at McMillan LLP. Her expertise is in the areas of financial services litigation, creditor/debtor disputes and restructuring and insolvency litigation.

Richard McCluskey is an associate in the Litigation and Dispute Resolution Group at McMillan LLP. He maintains a broad civil and commercial litigation practice.

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1 S.C. 2000, c. 17.
2 *RCG Forex Service Corp v. HSBC Bank Canada*, [2011] B.C.J. No. 436 [*RCG Forex*]; *B-Filer Inc. v. Bank of Nova Scotia*, [2005] A.J. No. 1240; *B-Filer Inc. v. TD Canada Trust*, [2008] A.J. No. 1397.
3 *Lovric v. Toronto Dominion Bank*, [2008] B.C.J. No. 682 [*Lovric*]; *Mechar v. Bank of Nova Scotia*, [2011] B.C.J. No. 723.
4 *RCG Forex* at para. 46; *Lovric* at para. 28.
5 *RCG Forex* at para. 32. See also *Skovsgaard v. Toronto Dominion Bank*, [1994] O.J. No. 2327 at para. 20, aff'd at [1995] O.J. No. 3090 (O.C.A.), and *Semac Industries Ltd. v. 1131426 Ontario Ltd.*, [2001] O.J. No. 3443 at para. 61.
6 *RCG Forex* at para. 33.
7 SOR/2003-184 [the *Regulations*], made pursuant to the *Bank Act,* S.C. 1991, c. 46.
8 *Lovric* at para. 14.