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CLASS ACTIONS and FINANCIAL INSTITUTIONS IN CANADA

Prepared for:

COMBAR
North American Committee Meeting
New York, U.S.A.

May 31-June 2, 2017

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CLASS ACTIONS AGAINST BANKS IN CANADA

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Canada's financial institutions are natural targets of class proceedings – they are well-resourced, have a wide customer base, provide commoditized products and often use standardized forms. A recent ruling of the Supreme Court of Canada has expanded the potential for bank liability in holding that Canada's federally regulated banks are subject to provincial consumer protection legislation regarding which banks have historically enjoyed immunity. This significant development has further broadened the exposure of financial institutions to liability through class proceedings.

A. Banks Are Natural Targets of Class Actions

Banks are natural targets of class actions. Two categories of cases aptly illustrate this point.

(i) Banking Liability Based on Fraud Perpetrated by Third Parties

When a fraudulent scheme leaves a trail of victims behind who do not have an effective remedy against a perpetrator who has either absconded from the jurisdiction, or is incarcerated or otherwise impecunious, the victims will often seek redress from the financial institution that was allegedly a knowing conduit or vehicle for the fraud.

For instance, in a recent class proceeding, the Bank of Montreal ("BMO") was implicated in a fraud, in which several thousand investors were defrauded by an unscrupulous promoter. In an effort to recover their investment, the investors turned to the secondary players, including BMO. Two class actions were certified against BMO for alleged knowing receipt, knowing assistance and negligence.[2] Royal Bank of Canada ("RBC") and the Toronto-Dominion Bank ("TD") as well as other financial institutions were targeted for alleged knowing assistance in *Jer v. Royal Bank of Canada*[3]*,* another class proceeding resulting from a Ponzi scheme.

Recently, the Ontario Court of Appeal further enlarged the potential liability of financial institutions arising from another's fraud by recognizing that a bank can "passively" provide knowing

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[2] *Kherani v. Bank Of Montreal*, 2012 ONSC 2230 and 2012 ONSC 4679; see also *Pardhan v. Bank of Montreal*, 2013 ONSC 2229 and 2012 ONSC 4681, leave to appeal motions dismissed 2013 ONSC 355 (Div.Ct.).

[3] 2014 BCCA 116.

assistance.[4] The *Carriere* decision represents an expansive interpretation of the "assistance" requirement in "knowing assistance" cases, indicating that Canadian courts will subject financial institutions to heightened scrutiny in these circumstances. Banks can therefore anticipate that they will continue to be named as defendants in class proceedings implicating them in the fraud of third parties.

(ii) Securities Class Actions

Historically, investors who allegedly suffered loss as a result of misleading disclosure in the secondary market had to prove individual reliance, a constituent element of the common law tort of negligent misrepresentation. This rendered remedies for such investors largely hypothetical. To address this obstacle, many Canadian legislatures have enacted statutory causes of action which dispense with the need to prove reliance. This has enabled securities class actions which had historically faltered under the old reliance requirement. However, in order to avoid "strike suits", Canadian legislatures have simultaneously enacted a requirement to obtain judicial leave before such claims can proceed. This leave requirement serves an important gatekeeping function and helps to ensure that by jettisoning the reliance requirement, the statutory cause of action for misrepresentation does not lead to frivolous claims.

The Supreme Court of Canada (the "SCC") defined the standard to apply to the leave test in the *Theratechnologies*[5] case. The SCC held that a court must undertake a reasoned consideration of the evidence to ensure that the case has merit, although the court is not supposed to conduct a "mini-trial" or a full analysis of the evidence. Rather, it must be shown that there is a reasonable or realistic chance that the action will succeed. There must be a plausible analysis of the applicable legislative provisions, and some credible evidence in support of the claim. The SCC thereby injected robustness into the leave test in order to vet unmeritorious claims.

Shortly after *Theratechnologies,* the SCC revisited the leave test in a class proceeding against CIBC, a leading Canadian bank.[6]. The *CIBC* case involved a securities claim against the bank for allegedly failing to record and disclose the extent of its exposure to and position in the U.S. residential mortgage market as the subprime mortgage crisis unfolded. The plaintiff asserted, *inter alia*, a statutory misrepresentation claim under Ontario's *Securities Act* in respect of shares trading in the secondary market. The SCC confirmed the *Theratechnologies* standard for obtaining leave – i.e., there must be a reasonable or realistic chance the action will succeed. Leave was granted in the *CIBC* case and the proceeding was ultimately certified.

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[4] *Carriere Industrial Supply Limited v. Toronto-Dominion Bank*, 2015 ONCA 852 [*Carriere*]: The constituent elements of a claim for knowing assistance of a breach of trust are (i) a breach of trust by a trustee; and (ii) knowing participation in the breach of trust by a third party. The knowledge requirement for this type of liability is actual knowledge. Recklessness or willful blindness will also suffice.

[5] *Theratechnologies Inc. v. 121851 Canada Inc.*, [2015] 2 S.C.R. 106.

[6] *Green v. CIBC*, 2015 SCC 60 [*CIBC*]

B. Large Customer Base and Commoditized Products

Credit cards[7], insurance[8] and pre-paid cards[9], among other commoditized products provided by financial institutions, are used by millions of customers. This large customer base has provided fertile soil for class actions against banks.

In *Sekhon* for instance, the plaintiff sought certification of a class proceeding against the five major banks in Canada, i.e. BMO, CIBC, RBC, Bank of Nova Scotia and TD. The plaintiff claimed that the banks enrolled customers in credit card balance protection insurance without their consent or on the basis of false misrepresentations. The plaintiffs' motion for certification was defeated mainly on the basis that the claims involve questions of fact that must be assessed individually. Although certification in *Sekhon* was unsuccessful, the case reflects that there has been heightened scrutiny by banking regulators regarding the practices of Canadian banks in aggressively selling products to its customers, which has triggered the initiation of class proceedings.

In *Jiang*, a financial institution was sued under British Columbia's *Business Practices and Consumer Protection Act*[10]for their issuance of general use prepaid cards. The chambers judge at first instance dismissed the certification application. The Court of Appeal held the chambers judge erred in principle in concluding that the plaintiff had failed to define the class with sufficient objective criteria and remitted the application back to the chambers judge for reconsideration.

In *Watson* (and several parallel actions), class proceedings have been commenced by merchants who accept Visa and MasterCard credit cards, naming as defendants most major financial institutions in Canada along with the leading credit card companies. The central allegation is that of a civil conspiracy and breach of the federal *Competition Act* in the setting of fees paid by merchants to accept credit cards as payment. The action thus challenges the long-standing architecture of the Visa and MasterCard credit card networks and the role of Canada's banks therein, and seeks billions of dollars in damages.

C. Use of Standardized Forms

Banks use standardized forms routinely. This can create similar legal relationships on a large scale, thus making banks susceptible to class actions.

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[7] *Watson v. Bank of America Corporation*, 2015 BCCA 362, reversing in part 2014 BCSC 532 [*Watson*], McCarthy Tétrault acts for the Toronto-Dominion Bank.
[8] *Sekhon v. Royal Bank of Canada*, 2017 BCSC 497 [*Sekhon*], McCarthy Tétrault acted for the Toronto-Dominion Bank.
[9] *Jiang v. Peoples Trust Company et al*, 2016 BCSC 368, rev'd in part 2017 BCCA 119 [*Jiang*].
[10] S.B.C 2004, c. 2.

A series of class actions, for instance, were brought against financial institutions arising from the proper interpretation of prepayment rights under standard mortgage agreements.[11]

D. Extensive Regulatory Oversight and Consumer Protection Legislation

Starting relatively recently, banks in Canada have been facing burgeoning liability under consumer protection legislation. Consumer protection litigation against banks can be expected to continue in light of the recent *Marcotte* Trilogy[12]. This triad of cases involved allegations that certain financial institutions breached disclosure obligations contained in provincial (not federal) statutes regarding charges imposed on credit card transactions made in a foreign currency. The *Marcotte* Trilogy confirmed that as a matter of Canadian constitutional law, provincial consumer protection legislation could apply to financial institutions, even though they are federally regulated. The SCC reasoned that the power to regulate disclosure of conversion charges does not lie at the core of federal jurisdiction over banking and that the pertinent provincial consumer protection provisions, although related to bank lending, do not impinge on the activities that are vital or essential to banking, and are therefore constitutionally sound.

As provincial consumer protection statutes exist across Canada and such statutes impose liability that is broader than a bank's liability at common law, the effect of the *Marcotte* Trilogy is that Canadian banks can continue to expect a steady stream of class proceedings based on alleged violations of consumer protection regimes.[13]

11 Arabi v. Toronto Dominion Bank, 2007 CarswellOnt 8294 (Div. Ct.) [*Arabi*], McCarthy Tétrault acted for the Toronto-Dominion Bank.

[12] *Bank of Montreal v. Marcotte*, 2014 SCC 55; *Amex Bank of Canada v. Adams*, 2014 SCC 56 and *Marcotte v. Federation des Caisses Desjardins du Quebec*, 2014 SCC 57 [the "*Marcotte*Trilogy"].

[13] For a recent example of such a case, please see *Jiang*, *supra*.

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