Reid Lester
Laishley Reed LLP
Email: rlester@laishleyreed.com
Toronto Tel: 416.981.9415
Vancouver Tel: 604.684.3112

Account Take-Overs: Lessons in the Law of Restitution, Trusts and Tracing

I have recently been involved in a number of files relating to (bank) account take-overs. These matters have given rise to interesting issues relating to the law of restitution, trusts and tracing. Moreover, there have been a few recent decisions that have considered these same issues. I discuss all this (briefly!) below.

The background is this: China has currency controls which limit to $50,000 the allowable annual transfers out of the country. One method that has been used to evade these controls is for a Chinese national who is living in Canada (Person A) who has money in China and wants to get it out of China and into Canada, to be "paired up" (generally, by a currency exchange "broker") to a Chinese national (Person B) who has money in Canada which he is willing to pay out in Canada in exchange for a payment to him of the equivalent sums of money in China. The idea is that Person A agrees to transfer from her account in China the sum, in Chinese yuan, of, let's say, the equivalent of $200K CDN (the amounts involved are generally in the hundreds of thousands of dollars). In exchange, Person B, who has (ostensibly) has money in Canada, agrees to transfer $200K from a bank account in Canada to Person A's account in Canada. In my experience, Persons A and B, if they meet at all, do so for the first time immediately prior to the transaction. You might think that these transactions were inherently risky and that they give rise to obvious concerns about money laundering!

Not surprisingly, my files have involved scams: unknown fraudsters obtain control over the account of a bank client (generally through the use of stolen ID or a forged power of attorney). The fraudsters, acting as Person B, then arrange to transfer CDN dollars to Person A in Canada, while Person A arranges for family members in China to transfer the same amount in yuan to a Chinese bank account. Usually, Person A in Canada is not apparently involved in the initial fraud. Once the fraud is discovered, the bank repays its client for the loss, and steps into the client's shoes to attempt recovery. We have often been able to trace some portion of the stolen funds to these recipient accounts (maintained by Persons A), only to have these account holders assert that the funds should belong to *them* on the basis that they had no knowledge or involvement in the theft of the funds from the client account, and that they received the transferred funds in exchange for *their* transfer, in China, of the equivalent amount of money to a third party account in China. We are also normally confronted with the argument (citing the 1982 decision of the SCC in ***Marvco Colour v. Harris***) that, as between two innocent victims of a fraud, the bank had a better opportunity to prevent the initial theft, so that the recipient should be entitled to keep the funds. This argument has also been used to justify the demand by Person A's lawyer that the Bank provide the results of any investigation it may have carried out (a demand we have always refused as being irrelevant).

The issue then arises as to who bears the loss here; or taken another way, who should be entitled to retain the traced funds? In my view, the answer will always come down to whether the recipient of the funds in Canada can establish that she took receipt of the funds as a *bona fide* purchaser for value without notice (of any fraud); i.e. a "BFPV". I explain below.

This type of loss is a "tracing of stolen property" claim; it is not a claim about the victim's (the bank's) conduct. To the extent that the defrauded bank can trace the stolen funds to Person A's account, the bank has a property interest in these funds. In any tracing claim, the stolen funds (including the proceeds of a draft) remain the property of the victim of the theft, and any holder of the stolen funds, or holder of any asset (including a bank account) into which the funds can be traced, holds the funds or the asset in trust for the true owner. This continues until the money reaches someone who takes possession of the funds, or the asset, as a BFPV. The conduct of the victim of the theft (i.e., the bank) is irrelevant to that party's ownership of the stolen funds.

The case law establishes that in order to be *bona fide*, a person must behave reasonably in the circumstances, and in the case of a fund transfer, she must carry out whatever due diligence is reasonable in the circumstances; she cannot close her eyes to the possibility that there might be something untoward with the transaction. Each case is different and must be considered on its own merits. The onus is on the recipient of the funds to establish her *bona fides*, failing which the true owner's property interest is not extinguished.

Unfortunately, I have seen several instances where opposing parties (representing the recipients of the stolen funds) have cited the ***Marvco Colour*** decision in support of the proposition that in any case where there are two apparently "innocent" victims of a fraud, the loss should be borne by the bank, since the bank failed to prevent the theft at first instance. Thus, ***Marvco*** is cited in support of the proposition that a bank's failure to stop a fraud should strip the bank of its interest in the stolen property, or alternatively, strip the bank of its ability to recoup the funds on the basis that the monies were paid out under a mistake of fact. I think this is just wrong, and in fact, I think this is a misreading of the ***Marvco*** decision which, after all, considered the issue of whether the person who had not bothered to read a security document before signing, should be able to shift the loss over to the lender who relied upon that security document in good faith. In that narrow instance, the court found that *non est factum* was not available as a defence in the foreclosure proceeding. That case did not involve the tracing of stolen funds or a claim made in respect of a mistake of fact.

Sadly, there have been recent decisions where judges have - mistakenly in my view - cited ***Marvco*** approvingly in support of the arguments referenced above. Mesbur J. did so in ***Rogers v. Priyance*** (a 2016 case I was involved in) and then Nishikawa J., in ***BMO v. Asia Pacific Int'l***[1], followed suit. What is particularly frustrating is that in neither of these cases did the judge consider the logical results of their arguments; namely, that such a finding suggests the property right of a victim of theft could or should be extinguished by virtue of that party's failure to prevent the fraud. In my view, this is backwards: it is the *recipient's* conduct that the court must scrutinize in order to determine if the recipient is a BFPV. As it turned out, in spite of these judicial mishaps, the courts in those cases ultimately found that the funds recipients had discharged their onus and established that they were BFPV, which, in my view, is always the determinative issue in a tracing (and mistake of fact) claim.

CIBC v. Bloomforex,[2] a case from 2020, pushes back in the proper direction. The facts in this case were as follows. Certain fraudsters, impersonating legitimate customers of CIBC and BMO, opened foreign exchange accounts with Bloomforex for the stated purpose of depositing Chinese yuan to an account in China belonging to one Ms. Du. The fraudsters caused CIBC and BMO to wire money from these Bank customers' accounts to an RBC account maintained by Bloomforex. Bloomforex

---

1 2018 ONSC 4215

2 2020 Carswell Ont. 245

accepted these Canadian deposits and, on the strength of these deposits, and acting on instructions from the fraudsters, it arranged for third parties in China to deposit an equivalent amount in Chinese yuan into Ms. Du's account in China. The fraud was subsequently discovered and CIBC and BMO made their own clients whole. The funds at RBC were frozen.

The banks claimed an interest in these funds and asserted their claim based on the cause of action of "money paid under a mistake of fact". Under that cause of action, a person who pays money under a mistake of fact is, at first instance, entitled to recover the funds unless the recipient was, among other things, a BFPV, or unless it had changed position in good faith upon reliance of the receipt of the funds. Bloomforex asserted that it satisfied both conditions. Bloomforex also argued that the so-called "two innocent parties to a fraud" test (discussed above) should apply, and that if the banks and Bloomforex were both innocent victims to the fraud, the banks were in a better position to have prevented the fraud so that they should bear the loss. In support of this position, Bloomforex cited the ***Priyance Hospitality*** and ***Asia Pacific*** cases, referenced above.

Bloomforex moved for summary judgment and the banks resisted on the basis that a trial was required. In his deliberations, Justice Penny considered whether Bloomforex had acted in good faith and/or changed positon in good faith. Because Bloomforex is a money exchange company, Penny J. explored very closely whether or not Bloomforex had complied fully with all of the various anti-money laundering regulations that have been established in Canada. In Justice Penny's view, if it were the case that Bloomforex had not complied with its statutory AML obligations, this might be grounds for a finding that it had not fully acted in good faith in its receipt of the funds (from the banks). Both sides produced expert evidence in this regard. Ultimately, Penny J. found that whether Bloomforex had changed its position, and/or whether it did so innocently and in good faith, required a trial. This was a helpful finding since it suggests that the mere fact of the payment by Bloomforex of funds in China was not by itself sufficient to establish its *bona fides*.

On the second issue - the "two innocent parties to a fraud" – Bloomforex cited Justice Mesbur's comments in the ***Priyance Hospitality*** case where she opined, among other things, that a person who paid out money under a mistake of fact should not be entitled to reply upon that doctrine to recover the funds if that payor had been negligent in paying the money out. The banks argued that Justice Mesbur's conclusion in this regard was incorrect and that under a "two innocent parties to a fraud" test, the fault of the payor was surely irrelevant since, in *every* case of money paid under a mistake of fact, there was by definition "a mistake" by the payor, so that if Mesbur J.'s *dicta* prevailed, then no one could *ever* prevail in a mistake of fact case. I agree fully with this comment. I also note that other than Mesbur J.'s own comments on this issue (and other than the decision in ***Asia Pacific***, which cites Mesbur J), I am not aware of any support for this positon in the jurisprudence. In his reasons, Justice Penny had sympathy for the banks' point of view on this point, though ultimately, he decided that this too required a trial.

R. Lester April 27, 2020