When does a bank owe a duty to protect third party victims from frauds?

Can a victim of fraud successfully sue the bank where the fraudster maintained his accounts and deposited stolen funds? Victims of fraudulent schemes often have little opportunity to recover their losses from the fraudsters, but banks have deep pockets. It is not uncommon to see these victims sue the fraudsters' banks. In such cases, plaintiffs will argue that the bank ought to have known what was going on in the fraudster's account and ought to have taken steps to protect third parties who were, or might have been at risk. I have seen these types of claims repeatedly.

It is very difficult for a plaintiff to succeed in an action against a third party bank with which the plaintiff has no prior relationship. Such a claim would normally be based either in negligence or in breach of trust. A party can be found liable in negligence only if the court finds that the defendant owed a common law duty of care to the plaintiff, that it breached this duty of care, and that this breach caused a loss to the plaintiff. If a defendant owed no duty of care to the plaintiff, there can be no liability, regardless of whether the particular defendant's conduct was careless in the circumstances. So when will a bank owe a duty of care to a non-customer?

The traditional rule has been that a bank would ordinarily owe no duty of care to a non-customer and in any event, would have no obligation to monitor the transactions in its customers' accounts. Thus, a bank would not ordinarily be aware of the existence or the identities of non-customers whose cheques were deposited to a (fraudulent) customer's account. Nor would the bank be aware of the fraudulent activities going on in the account. To put a bank to the trouble of monitoring its customer's accounts would create a vast indeterminate class of persons to whom the bank could owe a duty, and this would be onerous on the bank and harmful to the wheels of commerce.

Traditionally, there were some possible exceptions to this rule; first, in the case where there were "suspicious circumstances" such that a duty to inquire on the part of the bank might arise. "Suspicious circumstances" are subject to an objective test; namely, where the so-called "reasonable banker" formed a view that something was odd and warranted further inquiry. The other way that a duty of care to a non-customer could arise was in the case where the bank had actual knowledge of a particular non-customer and had actual participation in some conduct so that the duty of care to the non-customer would arise out of the common law rules pertaining to the existence of duty of care; i.e., where there was sufficient proximity (of relationship) and foreseeability (of harm).

In 2010, the case of ***Dynasty Furniture v. TD Bank***[1] seem to solidify the law in favour of banks. The motion court judge Justice Wilton-Siegel reviewed the jurisprudence in great detail, and found that "absent *actual* knowledge of fraud upon the part of a bank" [my italics], a bank could *never* owe a duty of care to a non-customer. Justice Wilton-Siegel either distinguished or expressly declined to follow those cases that had found otherwise. The Court of Appeal upheld this decision although that court took one small step backwards from the categorical nature of the motion judge's decision and stated that it did not "find it necessary to decide whether a bank may ever be found to have a duty to a non-customer in circumstances where it does not have actual knowledge (willful blindness or recklessness) of the fraudulent activities being conducted through the account of its customer."

Subsequently, in the decision of ***Pardhan v. Bank of Montreal,***[2] this issue was reviewed again. This was a motion by BMO to dismiss the claim and the underlying issue was whether the matter

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1 2010 ONSC 436, Affd. 2010 ONCA 514

2 2012 OSCC 2229

could be dealt with at a summary level or whether it should go to trial so that the ultimate decision on liability could be made with a full evidentiary record. In that case, the corporate security department of BMO had had some information about possible fraudulent dealings of the fraudster. Clearly, the motion judge was troubled by this and, accordingly, found that, in the circumstances, a trial was required before any decision on the bank's duty of care could be made.

Now we have the recent decision of ***1169822 Ontario Limited v. TD Bank***[3]. This case involved a Ponzi scheme that was operated by Seaquest Corporation. Seaquest had accounts at TD Bank. When the scheme fell apart, some of the victims sued TD Bank, alleging that the Bank either "knowingly assisted in a breach of trust" or, alternatively, owed a duty of care to the victims of the Ponzi scheme, breached the duty and was liable in negligence.

The tort of knowing assistance of breach of trust can be established only if the defendant had actual knowledge of the breach of trust. [The tort of "knowing receipt" of trust has a lesser knowledge requirement for the defendant; that of *constructive*, that than *actual*, knowledge of the breach.] Obviously, if the court had found that TD had actual knowledge of the breach of trust (and of the fraud), this would have been an easy win for the plaintiffs. In this case, the judge held that TD had no actual knowledge, so the issue, as in the earlier cases, was whether the bank's apparent constructive knowledge of wrongdoing was enough to create a duty of care to a non-customer.

In ***Seaquest***, Justice Dumphy noted that the courts in Ontario have long insisted that only proof of actual knowledge of the fraud (or willful blindness of recklessness) will suffice to require a bank to take steps to protect third parties from a fraud being perpetrated by its customer using accounts at the bank. In this case, the plaintiffs argued that there were various "red flags" such that TD really ought to have had some idea that the fraud was going on and ought to have made further inquiries which then would have prevented, or at least reduced, the fraud. The plaintiffs argued that the recent decision of the Supreme Court of Canada in ***Deloitte & Touche v. Livent***[4] provided that a duty of care could and should be inferred in such circumstances of constructive knowledge.

Justice Dumphy considered the jurisprudence and went through the facts very carefully. He concluded that the common law has "not yet embraced" the idea of imposing upon a bank a duty of care to prevent harm to a stranger caused by a dishonest customer of the bank, where the bank has no more than constructive knowledge of the fraud in question.

In ***Seaquest***, there was evidence of "red flags" that TD might have considered. This gave the plaintiffs room to argue that on these facts, the court should expand the circumstances where a duty of care could exist to a non-customer. This would not have been a good case for summary judgment simply because in cases where liability depends upon the nuances of the defendant's knowledge of relevant events, judges like to have a "full factual matrix" before making a decision. In lots of other cases, the plaintiffs sue banks where there is little or no evidence of red flags; where there is just wishful thinking on the part of the plaintiffs. Where the plaintiff's evidence is thin, a motion for judgment might be the way to go.

R. Lester, August 1, 2018

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[3] 2018 ONSC 1631

[4] 2017 SCC 63