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Service Mold v. Khalaf and TD Bank **2017 ONSC 6197, 2018 ONSC 5345 and 2019 ONCA 369**

A recent decision from the ONCA provides a helpful discussion, about how to apply the "objective" test for discovery of a loss under the terms of the *Limitations Act, 2002* (i.e., when a person "with the abilities and in the circumstances of the claimant first ought to have known" of the claim). This CA decision sets aside earlier decisions granting partial summary judgment to plaintiff so these earlier decisions no longer stand. However, *those* decisions contain helpful discussions about account agreement, and limitations defences that may be available to a bank which is sued in a cheque forgery loss. That seems like a fair amount: I'll try to be concise!

Plaintiffs designed and manufactured injection molds. They banked with TD. In 2015, plaintiffs discovered that their former bookkeeper, Khalaf (who had resigned 3 years before), had stolen large sums from plaintiffs' bank accounts through a forged cheque scheme and a phoney payroll scheme. In the first scheme, she forged cheques (ostensibly drawn by plaintiffs) made payable to herself. She was an authorized signor but all cheques required two signatures and in each case, she had forged the second signature. Rogue was in control of the cheque-printing procedure, and of posting entries to the plaintiffs' records. Thus, she was able to cover up her thefts by fabricating and destroying records. Plaintiffs sued TD on various grounds including that TD had no authority to debit the accounts in respect of forged cheques. Normally, banks can rely on the notification provisions in account agreements (which override the common law) which generally provide that client must review its account statements each month. and within 30 days, notify bank of any errors failing which bank is released from all claims. In this case, TD could not find two of the relevant account agreements representing a significant amount of the claim! On this basis, plaintiffs moved for partial summary judgment on the cheque forgery claim only (plaintiffs did NOT move for judgment re the payroll scheme and this is important later).

TD had two main defences. First, even though it could not find the account agreements, TD argued that the plaintiffs *would* have signed such agreements so that TD should still be entitled to rely upon the notification provisions in both the cheque and the payroll claims. Second, TD contended that the action was commenced outside of the applicable limitation period, since plaintiff ought to have been able to discover the losses, in both types of claim, years earlier, but for plaintiff's negligence.

In respect of its first defence, TD submitted evidence as to TD's normal practice when a business account is opened and noted that there was in fact an account agreement for one of plaintiffs' companies. TD asked the court to infer that similar agreements would have existed for the other accounts. TD relied on ***Bunan v. TD Bank*** 2015 ONCA 226. In that case, the bank had: (i) produced evidence of the standard procedures relating to account agreements; (ii) produced a signature card, signed by plaintiff, which confirmed receipt of the relevant agreement; (iii) provided evidence from an individual who testified that he had seen plaintiff sign agreement; and (iv) demonstrated that plaintiff had opened other accounts on the same day as the account at issue for which signed agreements *could* be found. In these circumstances, the court in ***Bunan*** was prepared to accept that such agreement must have been in place, and therefore, it dismissed plaintiff's claim. In the present case, the court was not so

accommodating and the motions judge found that there was insufficient evidence to establish that plaintiff had signed a business agreement. She therefore rejected TD's defence on this point.

The second issue was the limitations defence. Plaintiffs had no actual knowledge of the fraud until 2015, 3 years after the defaulter had left the plaintiffs' employ. The ***Limitations Act, 2002*** ("the Act") provides that the limitation period will start on the earlier of, among other things, "the day in which a reasonable person with the abilities and in the circumstances of the person with the claim first ought to have known" of the claim. If plaintiffs "first ought to have known" of the loss while rogue was still working, then clearly their claims were out of time. TD asserted that, by abandoning all scrutiny over the rogue's activities, and by not segregating her accounting duties, plaintiffs were negligent and that, but for this negligence, they "ought to have" discovered the thefts earlier.

This was a tricky argument by TD; one that I have not yet seen succeed in a case where there is no account agreement to impose a contractual obligation on the client to check its account statements on a monthly basis. Where an agreement exists, I think this can be a strong argument. Thus, in ***Manor Windsor v. Bank of Nova Scotia*** 2011 ONSC 4515, Mesbur J. found that where an agreement imposed an obligation on the client to check his statements monthly, and where client conceded that he could have discovered the fraud if he had done so, then the limitation period for each particular fraudulent cheque commenced as of the date of each relevant account statement. In our case, there was no enforceable agreement so the contractual obligation did not exist. In ***CP Hotels v. BMO*** from 1987, SCC said that in the absence of an enforceable agreement, a bank client has no obligation to examine its account statements to check for errors. Meanwhile, while not cited in the ***Service Mold*** decisions, I have US case law which states that, in the absence of suspicious circumstances, an employer is entitled to assume that his employees are honest. Keep in mind too that fraudsters generally take active steps to conceal their frauds. Thus, if TD were to succeed with this defence in these circumstances, I think it would break new ground. Ultimately, after a "mini-trial" on this issue, judge rejected TD's argument and granted judgment in favour of plaintiffs.

The ONCA overturned the overall result - without commenting on the merits of TD's defences - on the basis that the judge applied the wrong legal tests both in determining that a motion for partial summary judgment was appropriate, and on the basis that she misunderstood the "modified objective test" for discovery. First, the CA found that there was overlap with the applicable evidence for TD's defences in both the cheque loss claim, and the payroll claim. TD was relying on the contractual and the limitations defences in *both* claims. Since the payroll claim was not considered in the motion for partial judgment, this created a risk that a subsequent trial judge in the payroll claim might make a different – and inconsistent - finding re TD's defences. In addition, the same witnesses who provided evidence in the motion for judgment would inevitably have to re-attend to provide evidence in the subsequent trial. This, said the CA, was inappropriate and inefficient.

On the "discoverability" point, the CA noted that the Act provides for a modified objective test which looks at what the proverbial reasonable man "with the abilities and in the circumstances" of the person with the claim ought to have known of the claim. The motion judge in this case applied instead "a purely subjective inquiry" by looking into how the principal of the plaintiffs *actually* organized his businesses and by his *actual* personal characteristics (i.e., "he was overly trusting and gullible"). By considering this guy's actual characteristics (i.e., a subjective view), rather than the type of characteristics that a person of his background and education *might* or *would* have had (i.e., an objective view), the motions judge misinterpreted and misapplied this modified objective test.

R. Lester October 4, 2019