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In this article we discuss an interesting decision of the Québec Court of Appeal involving cheque kiting. The decision focuses on the duty of one bank to another when the first bank discovers fraudulent cheque kiting by its own customer. A general background discussion of cheque kiting is provided first for context.

Background

Cheque kiting is a form of cheque fraud that "plays the float" between accounts at two or more financial institutions. The process works by drawing more funds than are available from the first account. Those funds are then deposited into an account with another bank (also with insufficient funds), and are then immediately debited (by way of cheque deposit) back to the account with the first bank to cover the first transaction before that first account is noted as having insufficient funds. Now the second account will fall into a NSF position (because it also has insufficient funds to cover the first cheque), so another deposit must be made there to cover the payment back to the first bank, and so goes the circular pattern of payments that are characteristic of kiting. A kiting fraud can, in theory, continue on indefinitely so long as these circular payments continue. The fraud only

works with accounts where there are no holds placed on deposits and credits are given immediately, such as business accounts. The circular movement of funds creates a "float", being an appearance of funds that do not actually exist. Skilled kiters will layer real funds and legitimate transactions into the scheme to make the fraud more difficult to detect.

If the funds must continue moving in circles indefinitely, one wonders how the fraudster profits. There are a few ways to extract benefit. First, one can pay a debt owed to a third party by overdrawing one account, then covering the funds from a second account, with the hope that the float can eventually be covered with actual funds, once received. Second, kiting can inflate the account balance to earn interest on funds that do not exist. Third, the artificial funds may simply be transferred to a third account (presumably an offshore account or previously arranged means of money laundering), at which time the kiting will end and the fraud will be discovered by the victim(s) (the banks). Fourth, an indirect benefit is that the artificially inflated revenues of a corporation may be used as the basis of securing other financing.

The origins of kiting reach as far back as the late 18th century in the United States.[1] In those times, the fraud was referred to as "draft kiting" or "free riding" and was viewed as a "forced loan", capitalizing on the collection period for accommodation bills or notes between the accounts of two different banks. The problem became prevalent enough that it was made illegal in certain states of the U.S. by the early 1920s.

In Canada, there is currently no provision of the Criminal Code (the "Code") that specifically addresses kiting. Section 362, entitled "false pretence or false statement" is the most applicable provision. Subsection 362(4) actually provides for a presumption of a "false pretence", where cheques are dishonoured due to insufficient funds, unless the accused had an honestly held belief that the cheque would be honoured. However, that presumption was struck down as unconstitutional because the reversal of the burden of proof to the accused to rebut the presumption of a false pretence violates s. 11(b) of the Canadian *Charter of Rights and Freedoms*, which guarantees the right to be presumed innocent until proven guilty. With the elimination of the presumption, the Crown has the difficult burden of proving the requisite intent of the accused to obtain money by a false pretence in writing a bad cheque beyond a reasonable doubt. Other relevant provisions of the Code might include s. 390 (wilfully making a false statement in any receipt, certificate or acknowledgement for a purpose mentioned in the *Bank Act*)[2] or s. 380 (the general fraud provision).

Kiting still occurs today with paper cheques but may also be perpetrated with electronic wire transfers. Both forms were used in the case of *Bank of Montreal v. Bank of Nova Scotia* [*BMO v. BNS*].[3]

The Facts

In *BMO v. BNS,* the kiting fraud was perpetrated through a corporation called Paie Maître, a payroll processing company that handled the payroll for thousands of Quebec employers. The naturally large volume of transactions made Paie Maître a good candidate for being able to hide and profit from its kiting. Paie Maître had accounts with The Bank of Nova Scotia ("BNS") but was in the process of moving its accounts over to Bank of Montreal ("BMO") over a period of several months in 2001. Ultimately, Paie Maître retained accounts at both banks well into 2002, which provided the opportunity for kiting.

The kiting took place for almost a year, between September 2001 and July 2002. On a daily basis, Paie Maître would order electronic transfers from its BNS account to itself and related company accounts at BMO, and also to certain of its clients' accounts at various financial institutions. The transfers of funds out from BNS' account to BMO were received at BMO on the afternoon of the same day the orders were issued. However, they were not recorded as

deposits to the BMO accounts until just before 7:00 a.m. on the next day. The identical transfers ordering the funds back to BNS from BMO were received at BMO just after 7:00 a.m. on the day after the orders were issued. In the BNS account, the orders to transfer funds back (from BMO) were recorded *before* the orders to transfer funds *from* that account, thereby creating the float. Presumably, the fraudster had detailed knowledge regarding the timing of the two respective banks' recording and processing practices. This decision reminds us that not all electronic transfers are guaranteed. Some require time to clear and can be returned NSF, just like paper cheques. Modern technology has not yet eliminated kiting.

By July 2002, the total daily volume of the transactions orchestrated by Paie Maître exceeded $10 million, with $6 million of those funds being transferred between BNS and BMO.

On June 20, 2002, BMO's kiting management system ("KMS") flagged suspicious transactions between Paie Maître and one of its subsidiaries. By June 27, BMO suspected fraudulent activity and the next day contacted BNS, seeking its cooperation and advising that it suspected kiting. After several communications, BNS refused the request, citing confidentiality obligations, but advised that Paie Maître was a good client that it would take back. Ironically, BNS had the same KMS as BMO; however, each bank had set different parameters for their respective systems, and as a result, BNS did not detect any issue through its KMS.

In July 2002, BMO stepped up its investigation and began tracking the daily transactions of Paie Maître between its accounts with BMO and those at BNS. By July 16, BMO had become certain that the transactions were circular, noting daily transfers between the two banks that always totalled about $6 million. On July 23, a client of BMO, for whom Paie Maître managed payroll, reported that Paie Maître had debited sizeable amounts in its account that morning and then re-deposited the same amounts that evening. BMO was then sure that Paie Maître was kiting. However, rather than immediately freeze its accounts, BMO devised a plan to freeze them when they were in a credit position. This plan was set out in an internal BMO memo dated July 17. As of July 23, BMO's accounts with Paie Maître showed an overdraft of $3.6 million.

On July 24, BMO froze the accounts of Paie Maître and its subsidiaries, rejecting both debits and credits and sending them to a suspense account. However, BMO waited to implement the freeze until after it had received $6,317,331 in credits from BNS that morning. Despite the freeze, the next day on July 25, BMO temporarily lifted the freeze in order to accept incoming credits from BNS in the amount of $6,317,739. BMO transferred the funds totalling $12,635,070 to a new account (opened specifically for that purpose). After using approximately $8 million to cover claims regarding the accounts of Paie Maître and its affiliates (including clearing $3.6 million in overdraft), BMO was left with a net excess of $6,461,035. This amount was eventually delivered by BMO to the trustee in bankruptcy for Paie Maître. BNS sued BMO for its loss of $12,635,070.

Trial Decision

At trial, BNS argued that once BMO discovered the fraud, the actions it took were performed illegally, in bad faith, and constituted extra-contractual "fault" under the *Civil Code of Québec*.[4] Central to BNS' claim was its argument that BMO failed to comply with the Canadian Payments Association ("CPA") rules, which establish national systems for the clearing, settlement and exchange of payments. Membership in the CPA is mandatory for chartered banks like BMO and BNS.

The CPA rules applicable to this case imposed a requirement on a drawee to return each item to the negotiating institution no later than the business day following receipt by the "first organizational unit" of the drawee able to dishonour the item. In other words, a bank receiving a cheque

drawn on an account with that bank must accept and pay the cheque or return it on the basis of "non-sufficient funds" within one business day of receiving it. BNS alleged that BMO failed to dishonour the transfers within the one business day as provided by the CPA rules.

The trial judge also considered Articles 6, 7, 1375 and 1457 of the *Civil Code of* Québec. These provisions recognize the basic principle of Quebec civil law that all persons (banks included) are bound to exercise their rights in a reasonable manner, in good faith and diligently.

In its defence, BMO argued that the cause of BNS' loss were the flaws in its own electronic banking system. BMO claimed that it acted in good faith and in accordance with recognized banking practices and the applicable CPA rules. BMO also relied on the fact that it had sought BNS' cooperation when it informed BNS that it suspected kiting, but BNS did not cooperate. BMO added that BNS had itself not been forthcoming with BMO, in light of the fact that BNS had asked Paie Maître to find another banker based on some concerns and unanswered questions BNS previously had regarding certain events and transactions (although it appeared BNS had not actually suspected fraud or kiting). Finally, BMO also argued that it had not been enriched at the expense of BNS, given that it eventually turned over the excess funds to the trustee in bankruptcy for Paie Maître.

Regarding the CPA issue, BNS submitted that the BMO branch that received Paie Maître's debits on July 24 and 25 was the "first organizational unit" pursuant to the CPA rules, meaning that the items should have been returned within the following respective business days. Since they were not, BNS argued that BMO should be held liable for the total value of the credits from BNS on both days. The trial judge found that the BMO branch that processed the transactions was not the "first organizational branch" of BMO able to dishonour the transactions. Rather, it was the BMO administrative office that received reports from Symcor (a third party payment processor) on subsequent days, with the result that this requirement of the CPA rules was satisfied.

The trial judge held that BMO had committed an abuse of contractual rights to BNS when it unfroze the account to accept credits on July 25, thereby subverting the spirit of the CPA rules. Although BMO could select the right time to freeze the accounts to minimize its losses (allowing BMO to escape liability for the July 24 credits), it could not profit from the fraud it had uncovered. Accordingly, the July 25 credits of $6,317,739 BMO accepted from BNS by "unfreezing" the accounts were the direct and immediate result of BMO's wrongful actions. Once it had made a decision to freeze the accounts of Paie Maître, BMO had an obligation to reject all transactions. BNS therefore succeeded only partially at trial, obtaining judgment for $6,317,739. BMO appealed the decision and BNS cross-appealed, seeking judgment for its full $12,635,070 loss.

Issues on Appeal

The issues on appeal were whether the trial judge was correct that (1) BMO complied with the CPA rules, (2) BMO committed a fault in processing the July 25 transactions, (3) BMO did *not* commit a fault in processing the July 24 transactions, and (4) whether Paie Maître's fraud or BNS' own negligence exonerated BMO from liability if BMO did commit any fault.

On its cross-appeal, BNS argued that the trial judge should have applied the same standard of conduct to BMO for the transactions on both July 24 and 25. Given the finding that BMO had knowledge of the fraud as of July 23, the trial judge should not have allowed BMO to profit in any regard. BNS also argued that BMO should be held contractually liable because it did not return the transfers to BNS within the timeline prescribed by the CPA rules.

Court of Appeal's Analysis and Decision

The Court of Appeal disposed of the CPA issue in short order. The evidence established that the

freezing of the accounts by BMO brought about a change in the processing of the transactions relating to those accounts. The transactions in question were not being processed by the BMO branch as before. Rather, the transactions were redirected to a suspense account, following which Symcor would prepare reports. As noted above, the Symcor reports went to the administrative office of BMO, rather than the branch. After that, it was indisputable that BMO had returned the items to BNS on the following business day in accordance with the CPA rules.

Regarding BNS' claim that BMO was liable to it under the *Civil Code* for a "fault", BMO argued that (1) accepting a deposit from Paie Maître was not a fault, as freezing the account is not tantamount to closing it, and (2) the amounts received from BNS did not belong to BNS, but to Paie Maître. The Court of Appeal rejected the first argument, citing that BMO knew of the fraud and its objective was to put an end to its relations with Paie Maître. It did not matter whether the accounts were closed or only frozen. Second, there was no basis for BMO to believe that the funds belonged to Paie Maître.

The trial judge's findings regarding the July 25 transactions were supported by the evidence. When it accepted the credits on July 25, BMO knew that Paie Maître was involved in kiting. It knew that the movement of funds was circular, the daily credits and debits each day were identical, and there did not appear to be any legitimate business purpose for the transactions. BMO decided to "unfreeze" the accounts to accept further funds from BNS. BMO knew or ought to have known that doing so would harm BNS. After reviewing the relevant provisions of the *Civil Code* of Québec, the court noted that people (including banks) can incur liability toward others if they fail to act reasonably, prudently and diligently.

The Court of Appeal found that a bank that becomes aware of fraudulent, illegal or criminal conduct has an obligation to intervene and stop the illegal activity. This is particularly so when the bank knows or ought to know of the resulting impact on a third party that also deals with the client. A bank cannot profit from a client's illegal activities. BMO could not lift the account freeze without first clarifying the situation with BNS. In lifting the freeze, BMO profited from a fraud that it uncovered. Once it froze Paie Maître's accounts, BMO had to dishonour *all* transactions that it knew were part of the fraudulent scheme—it could not "cherry pick". Accordingly, BMO's appeal relating to the July 25 transactions was dismissed.

The Court of Appeal allowed BNS' cross-appeal regarding the July 24 transactions. In doing so, it considered that the trial judge had found that BMO was within its rights to wait to freeze the accounts, on the basis of an appellate level decision in *Banque Toronto-Dominion v. Banque Nationale de Paris (Canada)*.[5] In that case, it was held that a banker cannot be criticized for selecting the right time to realize on security to minimize a loss, even if it harms another less alert banker. The Court of Appeal distinguished the *Banque Toronto-Dominion* case on the basis that BMO's actions relating to the fraudulent acts of a client were quite different from a bank realizing on security. The Court of Appeal therefore concluded that the trial judge had erred in law by applying that decision to this case.

The Court of Appeal focused on the fact that the timing of the July 24 account freeze did not come about by chance. It was planned and documented in BMO's July 17 memorandum that stated "we want to close its accounts…
we will wait for the right time of day when the balance is positive and we will then freeze the accounts". BMO also opted to disregard the advice of its own legal counsel, who testified that his recommendation to the bank was to stop the transactions as soon as possible, no matter what the consequences were to BMO (it is unclear why apparently privileged communications were given in evidence at trial).

BMO's argument that it did not know the scope of the fraud was rejected. According to the

court, any uncertainty would actually have imposed a requirement to act *more* quickly, not less quickly. Mere knowledge of the fraud was sufficient to require immediate action, meaning that the duty to act does not vary with the intensity or scope of the fraud.

It is important to note that, like the trial judge, the Court of Appeal also placed emphasis on Articles 6, 7, 1375 and 1457 of the Civil Code of Québec, finding that BMO's actions were contrary to the duties of good faith in contractual performance (under the CPA Rules) imposed by the provisions. Until very recently, these general requirements of good faith appeared to be unique to Quebec, as the common law provinces of Canada do not have such overarching statutory duties of general application. The relevance of the decision of the Québec Court of Appeal in *BMO v. BNS* therefore appeared questionable. However, on November 13, 2014, the Supreme Court of Canada released its decision in *Bhasin v. Hrynew*,[6] establishing a duty of honesty of contractual performance and confirming that the concept of good faith is an organizing principle underlying the law of contract. In light of this recent decision, the *BMO v. BNS* decision may now have much more relevance to the rest of Canada.

Regarding the final issue (BNS' own carelessness), although it was true that BNS' own actions were not a "model of vigilance and cooperation", once BMO uncovered the fraud, the steps it took were the direct and immediate cause of BNS' losses. BNS' lack of cooperation could not justify BMO waiting to freeze the accounts on July 24 and unfreezing them the next day. BNS' own shortcomings and any deficiencies in its kiting detection system only provided the *opportunity* for damages to be sustained, but were not the direct and immediate cause of the loss. BMO was therefore liable to BNS for the consequences of its actions. As a result, BMO was ordered to pay BNS the full amount of its loss of $12,635,070, even though $6 million of that amount had been given by BMO to Paie Maître's trustee in bankruptcy.

Practical Significance

This decision is of particular significance for Canadian banks and other financial institutions faced with the criminal activity of their clients, where there is a risk of harm to third parties. *BMO v. BNS* makes it clear that a bank has a positive obligation to take immediate action to stop the activity, even where it will suffer financial loss. To do otherwise in order to protect its own interests at the expense of others risks exposure to liability, both in tort and potentially in contract (the CPA Rules).

This is in sharp contrast to the approach taken by courts in the United States in cheque kiting cases. In the U.S., banks are effectively permitted to act in self-interest, regardless of the consequences to another bank. For example, in one case, a bank discovered a kite and was aware of another bank's potential losses. It discretely closed its own account without notifying the other bank. The second bank's lawsuit brought on the basis of a common law duty of disclosure failed.[7] If such an attitude was ever prevalent in Canada, it is now clear that it should be discarded.

The impact the *BMO v. BNS* decision will have in the common law provinces of Canada remains to be seen. Until the very recent release of the Supreme Court's decision in *Bhasin v. Hrynew* creating a new duty of honesty in contractual performance and confirming that the doctrine of good faith is an organizing principle of contract law, an argument could be made that *BMO v. BNS* was of limited application in common law provinces because much of the decision rested on the application of good faith contractual obligations found in the Civil Code of Québec. Furthermore, the common law tort principles relied upon by the court in *BMO v. BNS* seem far from settled. In its decision in *BMO v. BNS*, the Québec Court of Appeal cited with approval the case of *Dynasty Furniture Manufacturing Ltd. v. Toronto-Dominion Bank* [*Dynasty v. TD*],[8] an Ontario decision in which Justice Wilton-Siegel commented that a bank

with actual knowledge (including willful blindness or recklessness) of the fraudulent activities of a customer may be subject to a duty of care to third parties dealing with the same customer. The Ontario Court of Appeal affirmed Wilton-Siegel J.'s decision. However, the *Dynasty v. TD* decision was made on a pleadings motion to strike a claim of negligence against the bank, and therefore the nature and extent of the duty of care owed by a bank to third parties was never considered on a full factual record. With the recent release of *Bhasin v. Hrynew*, the common law was brought much closer to Quebec's civil law as it relates to good faith, and the *BMO v. BNS* decision therefore warrants further consideration.

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1 Thomas E. McCurnin and Peter A. Frandsen, "Grounding Check Kiting with Check 21: The Civil and Criminal Ramifications of Check Kiting in the 21st Century", 125 Banking L.J. 295, 2008, at 312.

2 S.C. 1991, c. 46.

3 *BMO v. BNS*, [2013] Q.J. No. 11447, 2013 QCCA 1548.

4 LRQ, c C-1991.

5 [2005] J.Q. no 4694, 2005 QCCA 426 (in French).

6 *Bhasin v. Hrynew*, [2014] S.C.J. No. 71, 2014 SCC 71.

7 *Mid-Cal National Bank v. Federal Reserve Bank of San Francisco*, 590 F.2d 761, 763 (9th Cir. 1979).

8 *Dynasty Furniture Manufacturing Ltd. v. Toronto-Dominion Bank,* [2010] O.J. No. 2703, 2010 ONSC 436.

• DERIVATIVES SOUND PRACTICES: DRAFT GUIDELINE RELEASED FOR FEDERALLY REGULATED FINANCIAL INSTITUTIONS IN CANADA •

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On October 1, 2014, the Office of the Superintendent of Financial Institutions ("OSFI") released draft *Guideline B-7 Derivatives Sound Practices* (the "Guideline"). The Guideline applies to federally regulated financial institutions ("FRFIs"). OSFI first set out its expectations for FRFIs regarding their derivative activities in the guideline that it published in May 1995. The current updates to the Guideline are intended to enforce reforms for the over-the-counter derivatives market introduced by G-20 leaders.

Scope of Applicability

Effective November 1, 2014, the Guideline will apply to all FRFIs and their subsidiaries as well as to the Canadian branch operations of foreign institutions. FRFIs include banks, bank holding companies, federally regulated trust and loan companies, co-operative associations and federally regulated insurers. FRFIs may use derivatives as end-users, active position-takers and dealers. Depending on the categorization of an individual FRFI, there are different guiding principles that apply. The Guideline considers a FRFI as (1) an end-user when it uses derivatives to take positions as part of its proprietary trading or for hedging, and (2) a dealer when it quotes bids and offers and commits capital to meet customers' demands for derivatives.

Risk Management for Derivatives

The Guideline reflects sound practices that FRFIs should adopt with respect to the risk management of derivatives activities, some of which are highlighted below:

- A FRFI's derivatives activities should be consistent with its Risk Appetite Framework[1] and be subject to risk limits approved by its board of directors.

- A FRFI should clearly define the nature and types of incidents that would require escalation to senior management or to its board of directors.
- A FRFI should have a strong governance process concerning the valuation of derivatives, including control processes and document procedures.
- The sophistication of a FRFI's approach to risk measurement and stress testing should match its activity in the derivatives market and the complexity of its positions.
- The assumptions and parameters of a FRFI's measurement of market risk should be frequently reviewed against actual experience and updated market information.
- FRFIs should take all relevant valuation adjustments into account when pricing derivatives.
- Enterprise-wide credit risk management function of FRFIs should be independent of individuals and units that conduct trades and create risk exposure, with clear authority and responsibilities as outlined in the Guideline.
- FRFIs should apply binding limits regarding counterparty exposures for derivatives trading and settlement.
- Internal credit risk ratings and counterparty credit limits should be established for central counterparties on a risk-adjusted basis.
- All central clearing of standardized derivatives by FRFIs should be done through qualifying central counterparties ("QCCPs"), including recognized global QCCPs.
- Bilateral and multilateral netting agreements with counterparties should be put in place in order to reduce counterparty credit risk exposure.
- Reasonable steps should be taken by FRFIs dealing in derivatives to identify and address potential material conflicts of interest.
- FRFIs should maintain systems infrastructure that meets the size and complexity of its derivatives activities.
- FRFIs should periodically engage in portfolio compression as well as in portfolio reconciliation of uncleared derivatives with counterparties with whom the FRFI has a material number of derivatives outstanding, in order to resolve any discrepancies.

The Guideline provides an updated internal measurement model that should be used by dealers and active position takers to identify and aggregate risk. Furthermore, a FRFI is required to fully support its risk exposures in its derivatives activities by having sufficient capital. A FRFI should engage in a capital adequacy analysis, which should address its potential for material loss resulting from derivatives-related risks.

Reporting to Trade Repositories

The Guideline requires each FRFI to report, or cause to be reported, derivatives transactions to a recognized trade repository ("TR") in accordance with provincial securities regulation. OSFI will monitor a FRFI's compliance with these local reporting requirements, and each FRFI should include an assessment of such compliance in its annual compliance report to the OSFI.

OSFI recognizes that global aggregation of TR data is a complex issue and continues to follow international developments regarding the access to data by authorities. Meanwhile, a FRFI should use its best efforts to enable OSFI to access derivatives data reported to a TR.

Other Guidance

The Guideline should be read in conjunction with other relevant OSFI guidance, which is referred to in the Guideline.

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[1] A Risk Appetite Framework should specify (1) the aggregate level and type of risk that a FRFI is willing to accept in order to achieve its business objectives, (2) a FRFI's risk limits, and (3) the roles and responsibilities of the overseers of the implementation of the Risk Appetite Framework.

• SUPREME COURT ADDRESSES PROVINCIAL REGULATION OF BANKS AND CLASS ACTION STANDING IN *BANK OF MONTREAL v. MARCOTTE* TRILOGY •

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Introduction

The Supreme Court of Canada recently released its decision in *Bank of Montreal v. Marcotte* [*Bank of Montreal*][1] and its companion cases, *Marcotte v. Fédération des caisses Desjardins du Québec* [*Desjardins*][2] and *Amex Bank of Canada v. Adams* [*Amex*].[3] It held that (1) certain provincial consumer protection legislation imposing fee disclosure requirements on credit card issuers, and remedies for their breach of these requirements, can constitutionally apply to banks, and (2) a representative plaintiff in a multi-defendant class action in Quebec does not need to have a direct cause of action against each defendant to have standing to pursue the class action.

Background

Three class actions were brought in Quebec, based on the disclosure requirements of the Quebec *Consumer Protection Act* [*CPA*].[4] The plaintiffs alleged that issuers of credit cards had not disclosed the charges levied for foreign currency conversion and, when disclosing them, had failed to treat the fees as "credit charges" under the *CPA*, which would require increased disclosure and a 21-day grace period.[5] All but one of the issuers were federally regulated banks. The bank issuers argued that, because of exclusive federal authority under the Constitution to regulate banking, and the federal regulations governing bank-issued credit cards, the constitutional doctrines of interjurisdictional immunity ("IJI") and federal paramountcy rendered the *CPA* disclosure requirements inapplicable or inoperative to the banks' activities.

The Superior Court found for the plaintiffs. The Quebec Court of Appeal reversed in part, holding that the conversion charges were not credit charges; however, the issuers remained liable because for several years they had failed to properly disclose the fees. The constitutional doctrines of IJI and paramountcy did not apply. The Court of Appeal also found that the representative plaintiffs had standing to proceed with the class actions despite lacking direct causes of action against each defendant.

The Supreme Court Decisions

Justices Rothstein and Wagner wrote the trilogy of decisions for a unanimous court. The heart of the legal analysis is contained in *Bank of Montreal*. The court denied the issuers' appeals, allowed the plaintiffs' appeal in part, and restored punitive damage awards against certain issuers for the breach of their disclosure obligations.

Conversion Charges under the Quebec *Consumer Protection Act*

The court determined that conversion charges are not "credit charges" under the *CPA*. Conversion charges are incurred when a purchase is made in

a foreign currency. Under the *CPA*, credit charges, which include interest and most administrative fees, are subject to additional disclosure requirements and a 21-day grace period. The court held that conversion charges are not fees that a consumer must pay to access credit but are instead additional fees charged for an optional service and thus cannot be interpreted as credit charges.

Interjurisdictional Immunity

The court held that IJI did not render the *CPA* inapplicable to credit cards issued by federally chartered banks. The doctrine of IJI renders provincial law inapplicable to the extent that it impairs the core of a federal power. The bank issuers argued that bank lending and foreign currency conversion lie at the core of the exclusive federal power over banking and that the *CPA*'s disclosure and remedial regime substantially impaired that jurisdiction.

The court assumed, without deciding, that the *CPA* touched on the core of the federal banking power. But it held that the application to banks of the *CPA* as the court had interpreted it did not meet the impairment requirement. A disclosure regime for ancillary charges—and the civil remedies when such a regime is breached—does not impair the exercise of federal jurisdiction over banking because the provisions do not limit the banks' activities by restricting lending or currency conversion. The court reiterated the limitations it placed on IJI in *Canadian Western Bank v. Alberta*: the doctrine must be applied with "restraint" because "[a] broad application of the doctrine is in tension with the modern co-operative approach to federalism".[6]

Paramountcy

The court likewise held that the doctrine of paramountcy did not render the relevant sections of the *CPA* inoperative. Under paramountcy, where a conflict exists between provincial and federal law, the federal law prevails and the provincial law is inoperative to the extent of the conflict. A conflict may arise when the provincial law either directly conflicts with or frustrates the purpose of the federal scheme. However, the court noted that "care must be taken not to give too broad a scope" to the concept of frustration of purpose, holding that the "mere fact that Parliament has legislated in an area does not preclude provincial legislation from operating in the same area".[7]

The court found no direct conflict between the federal regulations governing disclosure and the provincial disclosure requirements as it had interpreted them. It also rejected the argument that the *CPA* frustrated the purpose of the federal regulatory regime. First, the court characterized the relevant sections of the *CPA* as articulating a contractual norm in Quebec, analogous to the substantive rules of contract found in the *Civil Code of Québec*.[8] Even if the purpose of the federal regime was to create exclusive and comprehensive national standards, rules regarding disclosure and accompanying remedies "support rather than frustrate the federal scheme", similar to the relationship between contract law in a province and the federal regulations.[9] Second, although the federal legislation does not provide for civil remedies for breach of bank disclosure requirements, employing, instead, review by the Financial Consumer Agency of Canada and monetary sanctions, the legislative silence does not mean that civil remedies are inconsistent with the federal scheme. The court noted that banks are not immune from provincial laws of general application, pointing to the variety of civil claims that may be brought against banks under provincial law.

Representative Plaintiff Standing

In upholding the decisions below, the court held that under the Quebec *Code of Civil Procedure* [*CCP*], a representative plaintiff in a multi-defendant class action does not need to have a direct cause of action against each defendant to have standing to proceed with the action. In this case, the representative plaintiffs in *Bank of Montreal* held credit cards with only two of the defendant banks.

The court concluded that the *CCP* "permits an entity or person without a direct and personal interest in the claims against some of the defendants to represent the class in various circumstances".[10] Rather than focusing on whether the representative plaintiff has a cause of action against every defendant, in considering whether a class action should be permitted, courts should focus on, among other factors, whether the class action presents identical, similar or related questions of law or fact and whether the representative plaintiff can adequately represent the class. In determining the latter question, the court emphasized a flexible and proportional approach, which includes a consideration of the balance between litigants, questions of good faith and judicial economy. In this case, the court held that the representative plaintiffs had standing because largely the same legal issues were present in the cause of action against each issuer.

The court also held that this standing analysis must be the same whether undertaken before or after the class action is authorized. This holding clarifies the former distinction under the *CCP* between challenges to the standing of representative plaintiffs before or after authorization.[11]

Implications of the Decisions

These cases may prove significant developments in both class action proceedings and the provinces' jurisdiction to regulate banking and other federally regulated industries. Depending on the nature of the provincial regulation, the court's reiteration of its narrow interpretation of IJI and its restrictions on paramountcy based on frustration of federal purpose may expand the ability of provinces to regulate federal undertakings.

Further, the holding on standing in multi-defendant class actions may facilitate industry-wide class actions. While the decisions discuss only Quebec civil procedure, they could affect case law in the rest of Canada, which is currently split on this issue.[12]

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1 *Bank of Montreal*, [2014] S.C.J. No. 55, 2014 SCC 55.

2 *Desjardins*, [2014] S.C.J. No. 57, 2014 SCC 57.

[3] *Amex*, [2014] S.C.J. No. 56, 2014 SCC 56.

[4] CQLR, c. P-40.1.

[5] The grace period required that an issuer waive any credit charges if paid within the 21-day period.

[6] *Bank of Montreal*, *supra* note 1, para. 63 (citing *Canadian Western Bank v. Alberta,* [2007] S.C.J. No. 22, 2007 SCC 22).

[7] *Ibid*., para. 74.

[8] LRQ, c C-1991.

[9] *Bank of Montreal*, *supra* note 1, para. 79.

[10] *Ibid.,* para. 34.

[11] See *Bouchard v. Agropur Coopérative*, [2006] J.Q. no 11396, 2006 QCCA 1342 (in French) and *Regroupement des CHSLD Christ-Roy (Centre hospitalier, soins longue durée) v. Comité provincial des malades*, [2007] J.Q. no 8308, 2007 QCCA 1068.

[12] See, *e.g.*, *MacKinnon v. National Money Mart Co.*, [2004] B.C.J. No. 1960, 2004 BCCA 472; *Ragoonanan Estate v. Imperial Tobacco Canada Ltd.*, [2000] O.J. No. 4597, 51 O.R. (3d) 603.

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