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SCC Decision: *Teva Canada Ltd v TD Canada Trust*

Bank Liability for Fraud

A: Introduction

On October 27, 2017 the Supreme Court of Canada (the "SCC") released *Teva Canada Ltd v TD Canada Trust,* 2017 SCC 51. The SCC decided that banks had to pay more than $5 million dollars in damages as a result of fraudulent cheques cleared by the banks.

B: Factual Background

Teva Canada Ltd. ("Teva"), a pharmaceutical company, was the victim of a fraudulent cheque scheme implemented by one of its employees. The fraudster employee requisitioned numerous cheques from Teva made out to companies he had registered with names similar to Teva customers or to actual Teva customers to whom no debt was owed. Teva was the drawer of the cheques, but did not participate in the fraud. The cheques were negotiated by the banks through accounts opened by the fraudster in the name of the companies he registered. The fraud resulted in a loss of $5,483,249.40.

Teva sued the banks to have the banks repay the $5 million loss to Teva. The banks attempted to defend the claim using s. 20(5) of the *Bills of Exchange Act* ("*BEA*"), which provides a defence for banks if the fraudulent cheques are made out to "fictitious or non-existing" payees.

The SCC had to decide, as between two "innocent" parties (Teva and the banks), who should bear responsibility for the loss.

C: Decision

The SCC decided that the banks were responsible and had to pay the $5 million to Teva.

The SCC held that banks are *prima facie* liable when they transfer funds to the improper recipients, unless the statutory defence succeeded. Because the *prima facie* liability is "strict liability", it does not matter that the banks did nothing wrong or that Teva may have been contributorily negligent. The SCC decided that the banks' defence failed. The cheque payees were not "fictitious or non-existing" within the meaning of s. 20(5) of the *BEA.*

The SCC applied a two-step process to determine whether the payees were fictitious or non-existing within the meaning of s. 20(5) of the *BEA.*

Step One:

Here, the SCC looks at whether the payees were "fictitious". A payee is fictitious if Teva did not actually intend to pay the payee. Intent to pay is presumed, so the bank must prove that Teva lacked the intent to pay the payee (e.g. Teva had some fraudulent intent) in order to find that the payee is fictitious and Teva liable. The intention that is important here is the intention of the account holder (Teva), not the intention of the person requisitioning the cheque (the fraudster).

The SCC accepted that Teva was an innocent party and did not participate in the fraud. Even though the cheques themselves were fraudulent, Teva did not know that and assumed they were legitimate, so they intended to pay. As a result, none of the payees were "fictitious", and the SCC moved on to Step Two.

Step Two:

Here, the SCC looks at whether the payees were either (1) a legitimate payee of Teva or (2) a payee who could reasonably be mistaken for a legitimate payee of Teva. If the answer to either is "yes", then the payee exists and the banks are liable. If the answer to either is "no", then the payee does not exist and Teva is liable.

The SCC decided that all the payees were either known customers of Teva or companies whose names could reasonably have been mistaken for Teva's actual customers. Therefore, it could not be said that the payees were "non-existing".

The banks defence under s. 20(5) of BEA failed.

D: Implications

Although invited to, the SCC elected not to alter existing law with respect to the liability of banks in these circumstances. The deck remains stacked against banks in corporate fraudulent cheque schemes where the company is not complicit in the fraud.

Fidelity insurers remain in an excellent position to look to banks (and their insurers) as subrogation targets after paying out on corporate fraud claims.

Please contact us should you wish to discuss the implications of this decision in more detail.