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The Supreme Court of Canada Holds Banks Liable for Conversion: *Teva Canada Ltd. v. TD Canada Trust*

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On October 27, 2017, the Supreme Court of Canada released its decision in *Teva Canada Ltd. v. TD Canada Trust.*[1] The Court split 5:4 in the decision to overturn the Ontario Court of Appeal's ruling that the banks were not liable for converting cheques to non-existing or fictitious payees.

Factual Background

The case revolves around a $5.4 million fraud perpetrated against Teva Canada Ltd. ("Teva"), a large pharmaceutical company, by an employee in the finance department, Neil McConachie ("McConachie").[2]

Over the course of four years, 63 fraudulent cheques in the amount of $5,483,249.40 were deposited into accounts at TD Canada Trust ("TD") and the Bank of Nova Scotia ("Scotiabank").[3] The cheques were made out to six separate payees. The names of two of the payees were entirely invented by McConachie. The names of the other four payees were also names of legitimate Teva customers or service providers. However, none of the cheques requisitioned by McConachie for these payees was for a legitimate debt owed by Teva.[4]

At the time, Teva believed that each cheque was generated to satisfy a legitimate obligation to a customer, did not intend or authorize McConachie to possess or use the cheques for personal use, and the actual account holders were not intended by Teva to be the payees of the cheques.[5]

Teva discovered the fraud in 2006, fired McComachie, and commenced a lawsuit in 2007 against five banks, including TD and Scotiabank, for the tort of conversion. When Teva moved for summary judgment in 2013, only the claims against TD and Scotiabank remained.[6] The motions judge held the banks liable for conversion. [7] This holding was overturned in a unanimous decision by the Ontario Court of Appeal, and Teva appealed to the Supreme Court.[8]

The Tort of Conversion

The tort of conversion is a strict liability tort involving the wrongful interference with the goods of another.[9]

If a cheque is made payable to a specific payee, then it is ordinarily payable to order. This means that the bank may only negotiate the cheque if it is both delivered and validly endorsed. If a cheque payable to order is paid out and has a forged or missing endorsement, the bank will be liable for conversion.[10] As the tort is one of strict liability, both a bank's negligence and the contributory negligence of the person on whose account a cheque is drawn (also referred to as the "drawer") is irrelevant.[11]

A bank can avoid liability for conversion by the application of section 20(5) of the *Bills of Exchange Act* (the "Act")[12], which states:

Fictitious payee

(5) Where the payee is a fictitious or non-existing person, the bill may be treated as payable to bearer.

If a cheque is payable to bearer, the bank may negotiate the cheque by simple delivery to the bank, with or without a valid endorsement.[13] Though TD and Scotiabank had raised other defences before the motions judge, [14] only the application of section 20(5) was at issue on the appeal to the Supreme Court.

The Decision of the Supreme Court

Writing for the majority,[15] Justice Abella outlined the current state of the law by providing an extensive history of the section 20(5) defence and its interpretation in both U.K. and Canadian jurisprudence, including the Supreme Court's most recent authority, *Boma Manufacturing Ltd. v. Canadian Imperial Bank of Commerce* ("Boma"). [16]

To demonstrate that a payee is fictitious or non-existing under section 20(5), a two-step framework is followed.

The first step is the "subjective fictitious payee inquiry", which looks to whether the drawer intends to pay the payee:

If the bank proves that the drawer lacked such intent, then the payee is fictitious, the analysis ends and the drawer is liable. If the bank does not prove that the drawer lacked such intent, then the payee is not fictitious, and the analysis proceeds to step two.[17]

Justice Abella explained:

A payee is fictitious when the drawer does not intend to pay the payee, meaning that the payee's name is inserted by way of pretence only. The underlying rationale behind the fictitious payee rule is that if the drawer did not intend that the payee receive payment, such as in cases of fraud, the drawer should not be able to recover from the bank.[18]

However, a specific intention to pay the payee may be presumed or attributed, in accordance with the realities of the cheque-issuing process in many large corporations, where "a specific intention by the guiding mind(s) of the corporation is not directed to each individual cheque".[19]

The second step is the "objective non-existing payee inquiry", which considers the legitimacy of the payee:

Step two… asks if the payee is either (1) a legitimate payee of the drawer; or (2) a payee who could reasonably be mistaken for a legitimate payee of the drawer. If neither of these is satisfied, then the payee does not exist, and the drawer is liable. If either is satisfied, then the payee exists and the bank is liable.

The majority of the Court found that the banks were prima facie liable for conversion, as McConachie was not lawfully entitled to the cheques, the banks dealt with the cheques "under the direction of one not authorized", and made "the proceeds available to someone other than the person rightfully entitled to possession".[21]

The application of section 20(5) then depended on whether the six payees on the cheques were fictitious or non-existing. In allowing the appeal and restoring the motions judge's decision, Justice Abella wrote:

In this case, Teva was not complicit in the fraud. Though only four of the names used were those of existing customers, the other two names used were very similar to names of Teva's real customers. The motions judge found that there was "a rational basis for concluding that cheques were apparently made payable to existing clients", and that "the payees could plausibly be understood to be real entities and customers of the plaintiffs".

As a result, the payees were not fictitious or non-existing.[22]

Recognizing that the jurisprudence on section 20(5) had critics, Justice Abella stated that "compelling reasons" are required for the Supreme Court to overrule its own decisions in order to ensure certainty, consistency, and institutional legitimacy, and that such reasons did not exist in this case.[23] Referencing public policy on the allocation of risk, Justice Abella observed:

Banks are well-situated to handle the losses arising from fraudulent cheques, allowing those losses to be distributed among users, rather than by potentially bankrupting individuals or small businesses which are the victims of fraud.

The dissenting judges, in reasons written by Justices Côté and Rowe,[25] would have dismissed the appeal and overturned two of the Court's previous decisions: Boma and *Royal Bank of Canada v. Concrete Column Clamps (1961)* Ltd. [26] The dissent endorsed returning to objective tests for "non-existing" and "fictitious" in the context of section 20(5).[27]

Conclusion

In upholding previous jurisprudence and finding TD and Scotiabank liable for conversion, the Supreme Court held that, under section 20(5) of the Act, a specific intention to pay a payee may be presumed or attributed to a large corporation with a mechanical and/or computerized cheque-issuing process, in accordance with commercial realities.[28]

Notably, while Teva had an express policy requiring specific approval for the cheques issued to the payees, the policy was not followed with the fraudulent cheques. McConachie did not have signing authority, nor authority to even requisition cheques or approve the payments for which the cheques were requisitioned. Teva's former chief financial officer admitted that the accounts payable department knew that McConachie did not have authority to approve the payments, but nevertheless issued the cheques.[29]

Banks should especially take note of this aspect of the decision, as it suggests that the intention to pay will be presumed or attributed even in situations where the corporation's cheque-issuing policy is not followed.

[1]2017 SCC 51 [Teva, Supreme Court of Canada].
[2]Ibid at para 9.
[3]Ibid.
[4]Ibid at para 10.
[5]Teva Canada Ltd. v. Bank of Montreal, 2014 ONSC 828 at paras 16-18.
[6]Ibid at para 1.
[7]Ibid at para 39.
[8]Teva Canada Ltd. v Bank of Montreal, 2016 ONCA 94 [Teva, Court of Appeal].
[9]Teva, Supreme Court of Canada, supra note 1 at para 3.
[10]Ibid.
[11]Ibid.
[12]RSC 1985, c B-4.
[13]Teva, Supreme Court of Canada, supra note 1 at paras 5-6.
[14]The banks also argued: (1) that the cheques were deposited to the credit of the account holder, with the account holder being the named payee of the cheques, and the banks were the holders in due course pursuant to section 165(3) of the Act. No endorsements were therefore required; and (2) the claim was statute-barred under the Ontario Limitations Acts, 2002, SO 2002, c 24, Sch B.
[15]Justices Moldaver, Karakatsanis, Gascon and Brown concurring.
[16]Teva, Supreme Court of Canada, supra note 1 at paras 19-71; [1996] 3 SCR 727.
[17]Teva, Supreme Court of Canada, supra note 1 at para 7.
[18]Ibid at para 51.

[19]Ibid at para 53.
[20]Ibid at para 7.
[21]Ibid at para 72.
[22]Ibid at paras 74 and 75.
[23]Ibid at para 65.
[24]Ibid at para 67.
[25]Chief Justice McLachlin and Justice Wagner concurring.
[26][1977] 2 SCR 456.
[27]Teva, Supreme Court of Canada, supra note at paras 80, 83.
[28]Ibid at para 53.
[29]Teva, Court of Appeal, supra note 8 at paras 14-16.

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