BANKS BEWARE OF FRAUD: BC COURT OF APPEAL CONSIDERS WHETHER FINANCIAL INSTITUTIONS HAVE A DUTY TO WARN CUSTOMERS ABOUT SCAMS

Posted on April 4, 2023

Categories: Insights, Publications

The decision of the British Columbia Court of Appeal in *Zheng v Bank of China (Canada) Vancouver Richmond Branch*, 2023 BCCA 43, suggests that financial institutions may be liable where they have knowledge of financial scams if the institution fails to warn a customer about the scam. Even with a liability waiver, financial institutions may be exposed if their customers fall victim to financial scams.

Background

The plaintiff in this case received a call from an unknown number from a person claiming to be with the Chinese consulate. The unknown caller told the plaintiff that an arrest warrant had been issued against her and that if she did not transfer funds to Hong Kong, she would be arrested and sent to jail in China. She was told the funds would be returned to her after the investigation and that she needed to keep the investigation confidential otherwise she would be sent to jail.

The plaintiff went to a branch in Richmond, British Columbia of the defendant bank and asked a teller to transfer $69,000 (nearly all the money in her account) to another person's account at a Hong Kong branch of the bank.

When the plaintiff requested the transfer, a control and compliance officer at the branch inquired as to the plaintiff's relationship with the intended recipient and, at the time, the plaintiff did not answer the question.

The branch then had the plaintiff sign an application for remittance that included an exclusion of liability clause.

The plaintiff learned about the scam shortly thereafter, and commenced a claim arguing that the bank had a duty to warn her about the potential fraud.

Procedural History

The bank applied to dismiss the plaintiff's claim on the basis that there was no triable issue.

The chambers judge found that there was a potential claim that the bank had a duty to inquire further and warn the plaintiff about the potential for fraud.

Ultimately, however, the chambers judge found that the exclusion clause in the application for remittance applied, which meant the plaintiff's claim was bound to fail and dismissed.

The Court of Appeal Decision

On appeal, the court considered two issues:

1. whether the chambers judge was correct in finding that there was a potential claim that the bank had a duty to warn the plaintiff of the fraud; and
2. whether the chambers judge was correct in finding that the plaintiff had no claim based on the exclusion clause.

The court agreed with the chambers judge that there was a potential duty on the bank to warn the plaintiff of the fraud. However, the court reached a different conclusion on the exclusion clause. It determined that the claim should be revived because there was a genuine issue for trial as to whether the exclusion clause applied and whether it was unconscionable and unenforceable.

Duty to Warn

The court rejected the bank's argument that it had no general duty to inquire of a customer when taking instruction to transfer funds or a contractual obligation to accept the instructions of its customer. The bank cited a number of cases in favour of this argument. The court, however, distinguished each case relied on by the bank on the basis that these authorities involved factual scenarios where the banks had no knowledge of potential fraud or scams.

The court found that the following factors supported an argument that there might be a potential duty on the bank to warn the plaintiff of the fraud:

1. The bank knew that there were frauds of this nature affecting people in the community; and
2. The bank knew that this type of transaction was unusual for the plaintiff.

Interestingly, the court suggested that while the duty to warn may apply where a customer has face to face interaction with a bank representative such that the bank has the ability to warn the customer, this duty would not extend to circumstances where the customer is using a self service portal.

Inapplicability of Exclusion Clauses

The court relied on the analysis in *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*,

2010 SCC 4 to determine the applicability of the exclusion clause. This test requires that the exclusion clause: (1) applies in the circumstances; (2) is not unconscionable; and (3) is not void for policy reasons.

The exclusion clause may not apply in the circumstances

The court found that the plaintiff may argue that the exclusion did not apply in the circumstances because it applied only to the processing of the transfer instructions and the duty to warn arose as soon as the plaintiff informed the teller of the proposed transfer. Crucially, the plaintiff did not sign the application for remittance containing the exclusion clause until after she had given her instructions to the teller.

The exclusion clause may be unconscionable

On the second branch of the *Tercon* analysis, the court found that there may be an argument that, if the exclusion clause did apply, it was unconscionable based on the following factors:

1. The plaintiff was not a sophisticated person with a large income and was vulnerable to this type of fraud;
2. The transaction was highly suspicious given the large sum involved;
3. The funds to be transferred consisted of almost all of the plaintiff's money in her accounts; and
4. The bank knew that the plaintiff's purpose for the account was for her long-term savings.

Further, the exclusion clause was contained in a standard form contract that the plaintiff had no ability to negotiate. Unconscionable and unenforceable bargains can arise where there is an inequality of bargaining power and standard form contracts are more susceptible to being found unconscionable.

Takeaways

It bears keeping in mind that this decision is not determinative and only raises *potential* arguments for the plaintiff, as the outcome of the appeal was merely that the plaintiff's claim against the bank was not bound to fail. Nevertheless, this case raises a number of important considerations for financial institutions:

1. Financial institutions may have a duty to warn their customers about potential financial scams in situations where the financial institution has knowledge of these types of scams.
2. Financial institution representatives would be well-advised to pay close attention to the particular circumstances of a transfer they are assisting with, asking themselves whether the transfer is unusual based on their knowledge of the particular customer, obtaining further details if they suspect something unusual, and providing a warning if the transfer seems like it may be part of a financial scam.
3. This potential duty to warn may not exist where the transaction that gives effect to the scam is completed by the unwitting customer in circumstances where the financial institution has no ability to provide an in-person warning (i.e. the customer makes the transfer at a self-service portal).

4. Liability waivers signed by customers after giving transfer instructions will not necessarily apply where there is a duty to warn of potential fraud.
5. Even where a liability waiver has been obtained, there is the potential that a standard form waiver will be found to be unconscionable and void.

by Melanie J. Harmer, Gray Morfopoulos

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.