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ESTATE, TRUST AND CAPACITY LAW BREAKFAST SERIES

Spousal Trusts

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Trust Experience™

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Introduction

A trust is created when there is a transfer of property to one or more trustees for the benefit of someone else, who is known as a beneficiary. There are various types of trusts that can be created. For example, the trust document can restrict the beneficiary to a fixed amount of money such as only the income on the capital assets of the trust. For more flexibility, the trustees may be given the right to pay to the beneficiaries a combination of both income and a portion of the capital, over a period of time.

There are significant tax consequences to the creation and administration of the trust and they should be considered when creating this type of estate plan. For example, creating a trust and a will can, in the right circumstances, reduce the taxes that will be paid on the income that is earned on an inheritance each year. The treatment of capital gains can also be beneficial in the trust context. Any capital gains realized on the trust fund can be paid to the beneficiary, and this is taxed in their hands, at their marginal rate, and used for their expenses. In many circumstances, proper estate planning can significantly reduce or even eliminate tax paid on investment income and capital gains.

Another example of a way to avoid paying probate fees on death, is to create a trust transferring property to a living spouse, through your will.

When you die, you are treated as having sold all of your property at fair market value for income tax purposes. This of course means that gains may be realized on your property and tax may be owing. By transferring your assets to a spousal trust, you can maintain control of the property and possibly obtain tax-free rollover benefits.

Another benefit of creating a trust is that you can leave assets in trust for your beneficiaries and it may also protect that inheritance from the beneficiaries' creditors.

If there are no creditors looking to the beneficiaries' assets, it still may be important to control the flow of money to the individual beneficiary. For

example, if a child inherits a large sum of money at a young and impressionable age, he may not be able to properly handle the money if it is controlled by an adult trustee the money can be spent properly until the child reaches a stage in life when he can look after the money in a responsible way.

Another benefit of creating a trust is that it can be drawn in a way that allows the estate plan to be extremely flexible. Therefore, in circumstances where you want to protect the young person from receiving too much money at too early a stage in life, a trust could provide that a portion of the money would be released to him at age 25 and then the final portion, for example, at age 35.

For a valid trust to be created, there are three elements, the so-called "three certainties" that must be established:

(1) certainty of beneficiaries;
(2) certainty of property given in the trust;
(3) intention to create a trust.

If any one of these elements are not present, the trust may be invalid.

While trusts have always been one of the most important and flexible tools of any estate planner, the law has become more complicated and tax minimization is more and more difficult to achieve.

There are specific rules in the *Income Tax Act* designed to prevent tax payers from diverting income to other related tax payers with lower marginal rates.

For example, in the *Income Tax Act* there are attribution rules that are intended to prevent the taxpayer from income splitting with family members to reduce the tax payable by the tax payer.

Essential to avoiding these attribution rules, is planning with the result that beneficiaries of a trust who could cause income attribution to the settlor (i.e. spouse, grandchildren, children, nieces and nephews under the age of majority) do not receive any income or capital gain, as the case may be.

The specifics of the spousal trust

Of course can be substantial tax advantages in providing for the transfer of appreciated capital property and depreciable property on death to a trust which complies with requirements in the *Income Tax Act*. In particular, Section 70(6) of the ITA advises as follows:

Transfer to a Spouse or a Spousal Trust [s. 70(6)]

- if capital property is transferred to a spouse or spousal trust, (see 5.4.1(b) for definition of "spouse") the tax on any capital gains and recapture is deferred until:
  - (i) the surviving spouse dies; or
  - (ii) the surviving spouse disposes of the property; or
  - (iii) the surviving spouse is deemed to have disposed of the property (for example: on becoming non-resident).
- in order to qualify for this rollover the following conditions must be met:
  - (i) the deceased was a Canadian resident at the date of death;

(ii) the property passes either under a will or on an intestacy or as a result of a disclaimer or renunciation or a court order under the dependent relief legislation of any province;

(iii) the property passes outright to the deceased's spouse who is a Canadian resident or to a spousal trust resident in Canada that provides that all the income of the trust be paid to or on behalf of the spouse (for example: to a nursing home) and no one else other than the spouse is entitled to use any of the trust's income or capital for the remainder of the spouse's life; and

(iv) the property vests within 36 months after the taxpayer's death (although there is a provision for a longer period as the Minister considers reasonable in the circumstances).

- if these conditions are met:

  (i) non-depreciable capital property is deemed to have been disposed of for proceeds of disposition equal to the adjusted cost base of the property which amount is the spouse's or spousal trust's acquisition cost; and

  (ii) depreciable capital property is deemed to have been disposed of for proceeds of disposition equal to the lesser of un-depreciated capital cost or the cost amount which amount is the spouse's or spousal trust's acquisition cost.

- for more information see special instruction 58 [IT-305R4]

- a deceased taxpayer's legal representative may elect not to have the tax-free rollover apply and therefore cause the recognition of capital gains or losses on death

- rollovers to spousal trusts may fail if the trust is tainted because:

  (i) the spouse is not the sole beneficiary of the trust (the other beneficiaries may disclaim their interest and cure this defect); or

  (ii) the will provides that debts are paid out of the trust. (A special election may be filed by the personal representative to cure this defect);

  (iii) where the will permits funds to be loaned to anyone other than the spouse for inadequate consideration (see Technical Interpretation 2003-0019235, at Special Instruction 59).

- in order to "untaint" a tainted spousal trust see special instruction 58 [IT-305R4]

Obviously there are technical requirements that must be met and the deemed disposition rules need to be considered in the context of the right to "roll over" the deceased's assets to his spouse.

Generally speaking, paragraph 70(5)(a) of the ITA provides that if a testator owns shares that had a cost base of $10.00 and were worth $100.00 at his death, generally, the tax effect of this growth is that the shares will be deemed to have been disposed of immediately before his death at their fair market value, giving rise to a capital gain and those who inherit the shares from him will be deemed to have acquired them at a cost of $100.00 per share.

The Deemed Disposition rules under the ITA provide as follows:

Deemed Disposition Rule [s. 104(4), (5)]

- the Act provides that, unless the trust is a spousal trust, there is a deemed disposition of capital property twenty-one years after January 21, 1972 or the date of death of the deceased, whichever is the later
- following that there is a deemed disposition every twenty-one years
- the deemed disposition takes place for proceeds of disposition equal to
- the fair market value of the property of non-depreciable capital property
- for proceeds equal to the midway point between fair market value of the property and un-depreciated capital cost to the trust for depreciable capital property deemed disposed prior to January 1, 1993. For deemed dispositions occurring after 1992 the proceeds of disposition of depreciable capital property are equal to the fair market value
- a qualifying spousal trust is deemed to dispose of its property on the death of the surviving spouse and every twenty-one years thereafter
- Current proposals to amend the Income Tax Act provide that a pre-1972 testamentary spousal trust is not subject to the January 1, 1993 deemed disposition unless the beneficiary spouse was alive on January 1,1976.

Under the same proposal, a pre-1972 inter vivos spousal trust is also not subject to the January 1, 1993 deemed disposition unless the beneficiary spouse was alive on May 26, 1976. In both cases, the deemed disposition would occur 21 years after the death of the beneficiary spouse.

- see T1055 [Form 119A] and T1015 [Form 119B]

The spousal trust rollover provides the testator the opportunity to transfer the shares into a trust for his spouse's exclusive benefit during her lifetime and no other person except the spouse can receive or otherwise obtain the benefit of any income or capital from the trust before her death. Therefore, the deemed disposition tax payable on the death of the testator is essentially delayed or deferred until the death of the surviving spouse.

One can also consider placing depreciable property into a spousal trust. For example, if the testator owns a commercial building which costs him $1,000,000.00, which has been depreciated to $400,000.00 and which is worth $900,000.00 at his death, the general rule is that he will be deemed to have disposed of it at its fair market value, giving rise to the recaptured depreciation of $500,000.00. However, if the testator leaves this asset in a spousal trust the building will be disposed at its depreciated value of $400,000.00, therefore avoiding any recaptured depreciation at death. The trust will be treated as having acquired it at a capital cost of $1,000,000.00, with an allowed capital cost allowance of $600,000.00, so its undepreciated capital cost is $400,000.00.

One must remember that the spousal trust rules allow one to deal with assets in a comprehensive and tax deferred manner.

Meaning, typically, tax as an individual, a trust is obliged to pay tax on all income including taxable capital gains, which arises after the trust has been created and property transferred to it. The capital gains tax is typically triggered when the property is transferred into a trust and therefore payable by the transferor at the moment of the transfer. In the normal course of events, dispositions while the property is held in trust will occur when trust investments are sold and others are purchased. However, in order to ensure that the payment of tax on such capital gains is not postponed for an unacceptable period, the ITA deems a disposition of virtually all the trust assets to take place every 21 years unless all interest are vested indefeasibly[1].

These general rules will be so unless the trust is exclusively in favour of the spouse or common law partner of the creator of the trust or (2) the creator of an alter ego trust, or (3) the creator and spouse or common law partner or joint partner trust.

There are two typical scenarios where a spousal trust will be created.

The first is in the context of a testamentary trust which is referred to above.

Another example is a situation where an irrevocable trust is established for the spouse or common law partner either *inter vivos* or through a testamentary trust.

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[1] Waters, Law of Trusts in Canada (3rd Edition) Carswell at page 584.

Again, the key ingredient is tax deferral and the ITA allows for the capital value of the assets to be transferred into such trusts without triggering tax payable at that moment in time.

The whole purpose of these provisions of the ITA, is to allow the spouse or common-law partner of the transferor, who may be supposed to have spent his or her life with the other and to have been associated through his or her efforts with the wealth owned by the transferring spouse or common-law partner, to enjoy that property as the transferor did. This object is achieved by postponing the deemed realization of capital gains until the death of the surviving or transferee spouse or common-law partner. At that point in time capital gains are then paid and borne by the next generation, typically the children.[2]

Another option available in the context of a spousal trust is the use of alter ego or joint spousal or common-law partner trusts.

Consistent with the rollover provisions in the ITA, there is a rollover of property to the trust of this nature and again the rollover provisions essentially neutralize what would otherwise be the tax consequences of disposing this property by the tax payer into a trust.

These types of trusts can serve as flexible alternatives to a will or continuing power of attorney. However, there can be disadvantages to these

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[2] IBID. at page 608.

planning choices as they are taxed as *inter vivos* trusts at the top marginal rate for individuals.

Tainting of the spousal trust

As I noted above, the fundamental consideration in the administration of the spousal trust is to ensure that all of the income and capital is used exclusively for the benefit of the surviving spouse.

When this important condition of a spousal trust is violated it is described as "tainting" the trust. A tainted trust is one which other persons do have such an entitlement, in which case tax is levied on the death of the creator of the trust. An untainted spouse trust is one in which advantage is taken of the general rollover concession.[3]

Conclusion

The use of trusts generally can be an essential estate planning tool and as long as clearly articulated rules under the ITA are followed, successful estate planning techniques can be relatively easily employed.

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[3] IBID. at page 35-36.

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SUPPORT CLAIMS BY THE NON-MARRIED SPOUSE

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Non-Married Spouses and Support Claims

by David M. Smith of Hull & Hull LLP

1. Introduction

The lawyer acting for a non-married spouse who is cut out of his or her spouse's will must deal with special challenges. Such a support claimant may well be met with the allegation that he or she was not a spouse of the deceased. A typical scenario will see the children of a first marriage propounding the last Will and defending the support claim, thereby giving rise to a significant emotional element and the likelihood of particularly acrimonious litigation. The purpose of this brief paper is to consider the elements of a support claim and, in particular, those issues that are somewhat unique to non-married spouses.

2. Jurisdiction of the Court

The jurisdiction of the court to provide for dependants is set out at the *Succession Law Reform Act* ("SLRA"), s. 58(1):

> Where a deceased, whether testate or intestate, has not made adequate provision for the proper support of his dependants or any of them, the court, on application, may order that such provision as it considers adequate be made out of the estate of the deceased for the proper support of the dependants or any of them.

3. Definition of Spouse under the Succession Law Reform Act

Under section 57 of the SLR A, a person with whom the deceased was cohabiting continuously for a period of not less than three years is a spouse for the purposes of Part V of the Act.

The term "cohabit" is generally defined as meaning to live together in a conjugal relationship either within or outside marriage.

There are a number of elements which are involved in considering "cohabitation" and the extent to which the different elements of the relationship will be taken into account must vary with the circumstances of each case. In *Thauvette v. Malyon* (1996), 23 R.F.L. (4th) 217 (Ont. Gen. Div.), Justice Roy listed seven components involved in considering cohabitation:

1. **Shelter**:
    a. Did the parties live under the same roof?
    b. What were the sleeping arrangements?
    c. Did anyone else occupy or share the available accommodation?

2. **Sexual and Personal Behaviour**:
    a. Did the parties have sexual relations? If not, why not?
    b. Did they maintain an attitude of fidelity to each other?
    c. What were their feelings toward each other?

d. Did they communicate on a personal level?

e. Did they eat their meals together?

f. What, if anything, did they do to assist each other with problems or during illness?

g. Did they buy gifts for each other on special occasions?

3. **Services**: What was the conduct and habit of the parties in relation to:

    a. Preparation of meals;

    b. Washing and mending of clothes;

    c. Shopping;

    d. Household maintenance; and

    e. Any other domestic services?

4. **Social**:

    a. Did they participate together or separately in neighbourhood and community activities?

    b. What was the relationship and conduct of each of them toward members of their respective families and how did such families behave towards the parties.

5. **Societal**:

    What was the attitude and conduct of the community toward each of them and as a couple?

6. **Support (Economic):**
   a. What were the financial arrangements between the parties regarding provision of or contribution toward the necessities of life (food, clothing, shelter, recreation, etc.)?
   b. What were the arrangements concerning the acquisition and ownership of property?
   c. Was there any special financial arrangement between them which both agreed would be determinant of their overall relationship?

7. **Children**

   What was the attitude and conduct of the parties concerning children?

"Support" as used in the SLRA includes not only furnishing food and sustenance and supplying the necessities of life, but also the secondary meaning of giving physical or moral support. The word "support" in the SLRA extends that meaning to include what might by some be considered as non-essentials or luxuries. (***Re Davies*** (1979), 6 E.T.R. 127, 27 O.R. (2d) 98, (sub nom. Davies v. Davies) 105 D.L.R. (3d) 537 (H.C.J.).

The maintenance of separate residences is not inconsistent with a spousal relationship, particularly if the deceased and the support claimant in all other aspects carry on their relationship as husband and wife. In ***McEachern v. Fry Estate*** ([1993] O.J. No. 1731 (Ont. Gen. Div.), the support claimant and the deceased maintained separate residences, had no joint bank accounts, owned separate vehicles, did not live together at all times, and never referred to each other as "Mrs. Fry' or "my husband" or "my wife." The Court nonetheless found that the support claimant and the deceased were spouses of one

another. After considering the fact that: (i) the deceased and the support claimant regularly vacationed together with the deceased footing all of the bills, (ii) the support claimant performed all domestic chores for the deceased, (iii) mutual friends considered them to be "a couple", and (iv) they were constant companions for over fifteen years, the Court made a finding that the support claimant was a dependant in need of support:

> "I do not see that the fact that each maintained a separate residence throughout their relationship as terribly significant when one looks at the fact that when they first established a relationship, she was 48 and he was 62 and each had been married and had children. Obviously they found love and companionship in each other...
>
> "Whether or not a couple have cohabited continuously is both a subjective and objective test. What was the intention of the parties as gleaned from the facts and how they were regarded by others? Intention of the parties is important. In today's world, where often both spouses work sometimes in different cities and where work can keep them apart for often long periods of time, one must look at the relationship generally and not specifically item by item to see if the parties were cohabiting in the legal sense or merely living together for the time being for whatever purpose. When you find as here a fifteen year period of companionship and commitment and an acceptance by all who knew them as a couple, surely you must have continuous cohabitation...."

In *Craddock v. Glover Estate* (2000), 32 E.T.R. (2d) 52 (Ont. Sup. Ct.), the Court considered a support claim advanced by a non-married spouse. Again, the parties maintained separate residences and bank accounts. There was some question as to whether they met the three year period required for a finding that they were spouses. Over the last three weeks of his life, the deceased was hospitalized. Crucial to the finding that they were spouses were: (i) a note that he left with his executive assistant which stated a clear intention to leave the

support claimant $100,000.00 by way of a life insurance policy and (ii) a statement made by the deceased to his son to "look after [the support claimant]." The Court found that such evidence was corroborative of the support claim and an indication of the appropriate quantum of support that the deceased would have intended the support claimant to receive, but for the fact that such insurance proceeds could not be realized.

4. Legal Obligation of a Spouse to provide support to his or her Spouse

Under s. 57 of the SLRA, a spouse to whom the deceased was providing support or was under a legal obligation to provide support immediately before her death is a dependant.

All spouses (non-married and married) have a legal obligation to support one another to the extent that they are capable of doing so. This principle is enshrined in s. 30 of the *Family Law Act*. Accordingly, once a support claimant satisfies the Court that he or she is a spouse within the meaning of both the SLRA and the *Family Law Act*, there is no necessity to demonstrate that support was being received immediately before death. Rather, the existence of the spousal relationship is sufficient to meet the second branch of the test; namely, that a legal obligation to provide support existed immediately before death.

5. The impact of Re Cummings Estate

The moral duty on the part of a deceased to adequately provide for his or her dependants has been recognized by the Ontario Court of Appeal in ***Re Cummings Estate*** (2004), 181 O.A.C. 98, 5 E.T.R. (3d) 97, 235 D.L.R. (4th) 474, 69 O.R. (3d) 397).

Accordingly, in addition to examining the support claimant's need, once his or her spousal status has been accepted, the Court should determine whether a dependant has received her "fair share of the family wealth".

The finding in ***Re Cummings Estate*** suggests that Dependant Support legislation, like family law legislation, ought to reflect society's expectations that spouses are entitled not only to proper support but also to a share in each other's estate when the other spouse dies.

On a hearing with respect to competing support claims, the Judge hearing the application should give consideration to the effect of his or her order on *all* dependants. The moral claims of a spouse arising from financial and other contributions to the relationship during the period of cohabitation should be recognized to the extent that beneficial ownership of the matrimonial home should not be disturbed or substantially encumbered by an order for the support of another dependant.

6. Requirement for Corroboration

Section 13 of the *Evidence Act* requires that claims against the estate be corroborated by material evidence. More specifically, section 13 provides that: "in an action against an executor of a deceased person, an opposite or interested party shall not obtain a judgment or decision on his or her own evidence in respect of any matter occurring

before the death of the deceased person unless such evidence is corroborated by some other material evidence."

As noted at the outset, the claimant may have to corroborate his or her contention that he or she was a spouse of the deceased. While in some cases the spousal nature of the relationship will be admitted with the quantum of support being the only issue in dispute, the reality is that the bitter and emotionally charged nature of the dispute often leads the executor of the estate to deny even the most basic issue of whether the claimant even cohabited with the deceased.

To prove his or her claim and meet this first hurdle, corroborative evidence of the cohabitation will have to be introduced. This may take the form of witness evidence. In many cases, telephone records are tendered to support or challenge the claimant's position.

7. The Effect of a Cohabitation Agreement

The existence of a cohabitation agreement is but one factor to consider in determining the quantum of support to which a non-married spouse will be entitled as a claimant for dependant's relief. If the circumstances are such that the claimant has a very strong support claim but for the existence of a cohabitation agreement, it is by no means certain that a Court will disqualify the support claim.

8. Competing claims for support by ex-wives or ex-husbands

It is not unusual for the surviving non-married spouse to be faced with competing support claims made against the estate of the deceased by ex-wives or husbands of the deceased. The typical scenario is one in which there is a spousal support order in place obligating the deceased to make monthly support payments or alimony to the ex-wife or ex-husband as the case may be. For such a support claimant, it is very simple to assert a claim against the estate which can not be meaningfully contested. The deceased, in such a case, was under a legal obligation to provide for the support of the ex-spouse and, if adequate provision is not made in the will or under a life insurance policy, the deceased's estate will be liable to satisfy the obligation.

9. Alternative Claims

If a non-married spouse cannot satisfy the court of his or her standing as a spouse within the meaning of Part V of the SLRA, alternative remedies are available. The equitable remedies of constructive trust and unjust enrichment can be asserted as can a claim for damages on the basis of proprietary estoppel. Such alternative claims are, however, not afforded the special statutory remedies provided by the SLRA, specifically those relating to interim support and the recovery of assets itemized in s. 72 of the Act.

10. Conclusion

Support Claims are often hotly contested disputes. This reality is often more pronounced when the support claimant is a second wife or a non-married spouse of the deceased.

ELDER FRAUD: WHEN IS THE BANK LIABLE?

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Elder Fraud: When is a Bank Liable?

By Justin de Vries
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Introduction

Financial fraud against the elderly is becoming an all too common occurrence. In our practice, we often see cases of elder fraud or abuse, particularly by family members, caregivers or other trusted individuals.

The motivation ranges from outright greed to a mistaken sense of entitlement. In cases of elder abuse by family members, it is often the case that they expect to receive substantial inheritances and accordingly, may see nothing wrong in helping themselves now to some or all of their elderly relative's money, with or without the proper authorization.

As with all types of fraud, the method employed is only limited by the fraudster's imagination. One common method is the misuse of powers of attorney for property to facilitate the process of elder fraud or abuse. The misuse can range from individuals abusing powers of attorney granted to them in good faith, to confused and/or incapable seniors unknowingly signing a power of attorney that is then abused for personal financial gain, to outright forgeries of powers of attorney and other related documents.

For the purposes of this paper, I have chosen to focus on fraud perpetrated against the bank accounts and other financial assets held by capable, but elderly and vulnerable, individuals through financial institutions. Such fraud can be perpetrated through the improper use of a power of attorney. It can also be perpetrated through the improper use of cheques or Automated Banking Machine (ATM) withdrawal cards to gain access to an elderly person's bank accounts, held jointly with the fraudster or otherwise.

In cases where there are a series of suspicious transactions or withdrawals in respect of an elderly person's bank accounts, what is the responsibility of the financial institution

to monitor, report and/or stop such abuse? Conversely, to what extent is the elderly client responsible to monitor, report and/or stop such abuse?

Verification Agreements

It is standard practice in the Canadian banking industry for customers to sign a verification agreement, usually when an account is first opened. Such an agreement is usually set out or referred to in the account opening documentation.

Under the terms of a standard verification agreement, the onus is placed on a customer to verify their bank records, whether in the form of monthly account statements or passbooks, within a specified period and report any errors or discrepancies. Usually, a customer is required to examine any returned cheques, vouchers and all credit and debit entries of each bank statement or passbook within 30 days. Notice of any errors or discrepancies must usually be provided to the bank in writing within 30 days of the account statement date or passbook update. In addition, it is standard to require that passbooks be presented for updating on at least a monthly basis. After the expiry of 30 days (or other set period of time), it is usually "conclusively settled" as between the bank and its customer that the balance shown on a statement or in a passbook is correct.

The language of a verification agreement can often be arcane. Therefore, depending on the sophistication of a customer, a bank likely has a positive obligation to explain the intent and purpose of a verification agreement to its customer, as well as its effect. I would argue that this is certainly the case involving elderly individuals signing verification agreements for the first time. In fact, a bank may have to revisit a verification agreement with a customer, if a verification agreement was signed when the account was originally opened some time ago and the customer is now elderly. An elderly customer may no longer understand or grasp what is required.

The leading Canadian case regarding a bank's liability to a customer and the customer's corresponding duty to a bank is the Supreme Court of Canada's decision in *Canadian Pacific Hotels Ltd.* v. *Bank of Montreal* (1987), 40 D.L.R. (4th) 385 (S.C.C.) [hereinafter *Canadian Pacific Hotels*].

In this case, the accountant for *Canadian Pacific* forged the signature of a manager on 23 cheques. Canadian Pacific recognized these errors a year after the first cheque was forged. Canadian Pacific had not signed a verification agreement with Bank of Montreal, although its daily bank statement contained the following statement: "Please check this statement promptly. Any errors, irregularities or omissions found therein should be reported within 30 days of delivery or mailing, otherwise it will be considered correct."

The Supreme Court of Canada held that a customer of a bank does not, in the absence of a verification agreement, owe a duty to the bank to examine its bank statements and vouchers with reasonable care and to report any discrepancies within a reasonable time. It also held that a customer, sophisticated or otherwise, does not owe a duty to its bank to maintain an adequate system of internal account controls for the prevention and minimization of loss through forgery. The court went on to hold that if a bank considered it necessary for a customer to examine bank statements or passbooks with reasonable care and report discrepancies within a reasonable time, it could insist on a verification agreement.

As already stated, it is now standard practice for Canadian banks to require customers to sign verification agreements. In cases of fraud against the bank accounts of elderly customers, a bank's potential liability to the elderly victim will depend, in part, on whether or not there is a verification agreement, and if so, whether such an agreement was adequately explained to the elderly victim. A bank's potential liability will also likely depend on what it knows of an elderly victim's physical and mental health.

In cases of fraudulent transactions not caught within the usual 30-day notification period, a bank will obviously try to rely on any verification agreement in place. A bank will argue that because an elderly victim failed to report irregularities to the bank within a reasonable timeframe, the bank cannot be liable for losses incurred as a result of fraudulent transactions. A bank could further argue that it is too onerous a duty to ensure that every client fully understands every aspect of banking agreements, or that it is required to do anything more than make reasonable accommodations for an elderly client's physical or mental impairments, if actually known to the bank. Moreover, a bank will likely claim that the elderly victim was, in any event, contributorily negligent in that

s/he failed to take steps to review his/her accounts within a reasonable time with a trusted advisor or friend. Of course, it is sometimes the case that the trusted advisor or friend is the actual fraudster.

Of course, assuming a favourable set of facts, an elderly victim could argue that the bank failed to adequately explain its verification agreement in terms s/he could understand, such that any verification agreement in place would not be applicable. Accordingly, the rule in *Canadian Hotels* regarding a customer's duty to a bank would apply, as the verification agreement would be rendered invalid. An elderly victim could also argue that a physical impairment, such as seriously impaired vision, should exempt him/her from the 30-day notification rule.

A Bank's Duty to Investigate

A separate issue to consider is whether financial institutions have a duty, independent of any verification agreement, to investigate fraudulent transactions and advise customers accordingly. In other words, is it up to a bank to identify suspicious and/or fraudulent transactions and prevent any further such transactions from occurring?

I *Groves-Raffin Construction Ltd et al. v. Bank of Nova Scotia et al.*(1975), 64 D.L.R. (3d) 78 (B.C.C.A.) [hereinafter *Groves-Raffin Construction*], Scotiabank honoured a company cheque that had been signed by Groves, an officer of the construction company, who had bank-signing authority. The cheque was made payable to Groves personally. The cheque was for a very large amount, which constituted almost the entire balance in the bank account. The bank honoured the cheque without making any inquiry. The British Columbia Court of Appeal held:

> [A] banker's duty to his customer involves not only the primary and axiomatic obligation to carry out its function as a banker to honour and pay its cheques when funds are on credit, but to exercise such care as a reasonable banker would consider requisite to ensure that what is suspicious or questionable is queried. So, duty of care [to the customer] may involve in circumstances a duty to make inquiry. The test is an objective one, that of a "reasonable banker".

Accordingly, the standard of reasonable care is an objective one applicable to bankers. Each case involving a banker's duty and whether the standard of care has been met will turn on the relevant facts. In *Groves-Raffin*, the British Columbia Court of Appeal concluded that the bank did not discharge its duty to the construction company to exercise reasonable care and skill for a number of reasons. For example, the Court noted that the transaction was unusual and out of the ordinary course of business for the construction company, the cheque was for almost the entire balance in the company's account, and the cheque was in favour of the signatory.

In *J & F Transport Ltd. et al. v. Markwart e al.* (1982) 136 D.L.R. (3d) 204 (Saskatchewan Court of Queen's Bench) [hereinafter *J&F Transport Ltd.*], the court applied what is sometimes referred to as the principle of two innocents. That is, where two parties suffer due to the fraud of a third party, the party who most contributed to creating a situation conducive to the fraud will bear the loss.

In *J & F Transport*, the company employed Markwart as its bookkeeper. Markwart was responsible for depositing cheques payable to the company in the company bank account. The bookkeeper fraudulently opened a second account in the company's name at another bank, the Bank of Montreal ("BMO"), and designated himself as the only individual with signing authority. He then began to misappropriate cheques payable to the company by depositing them into the second fraudulent account at BMO and subsequently withdrawing the proceeds. Once the fraud was discovered, the company issued a claim against, Markwart and BMO, for allowing the second fraudulent account to be opened.

In granting judgment against BMO, the applied the principle of two innocents and found BMO liable for negligence in opening an account for an individual in the name of a company, without making any inquires. For example, BMO had not obtained any evidence as to the incorporation of the company or the names of its signing officers, and did not obtain any identification or even a business telephone number.

In applying the case law to elder fraud, it would seem evident that a bank has a duty to investigate suspicious/fraudulent transactions, although the extent of such a duty will

turn on the specific facts of a case. For example, how notorious was the fraud. However, a bank may well try and argue that its duty to inquire does not relieve a customer of his/her duty to report any suspicion transactions under a verification agreement. A bank may further argue that its duty to inquiry only arises where a customer advises the bank of its suspicions within the time period for notification as set out in any verification agreement.

Conclusion

If a bank fails to make reasonable inquiries, which will be determined by the circumstances of a particular case, it should not be entitled to rely on its verification agreement to defeat liability. Of course, depending on the circumstances, a bank may be able to argue that even though it failed in its duty to an elderly customer, that customer was contributorily negligent because s/he failed to verify their accounts and report any irregularities within a reasonable time frame.

The interplay between a customer's duty under a verification agreement on the one hand, and a bank's duty to take reasonable care on the other hand, will likely turn on the facts. In my view, the case law on this point is somewhat uncertain and requires clarification. What is clear is that the problem of elder fraud is not going away and financial institutions may be on the hook for fraud perpetrated against an elderly person's bank accounts.