SUPREME COURT OF NOVA SCOTIA
Citation: Shane v. Allen, 2010 NSSC 484

Date: 20100720
Docket: Hfx No. 316695
Pic No. 300385
Pic No. 306313
Registry: Halifax
Pictou

Between:

Ruth Shane and Wilma Lee Shane

Plaintiffs

v.

John Allen, Toronto-Dominion Bank, The Canada Trust Company, Keybase Financial Group Inc., B2B Trust, Global Maxfin Investments Inc., AGF Trust Company, and Dundee Private Investors Inc.

Defendants

And Between:

John Cameron and Linda Cameron

Plaintiffs

v.

Keybase Financial Group Inc., AGF Trust Company, and John Allen

Defendants

And Between:

Jeffrey H. Phillips and Denise Kowalski-Phillips

Plaintiffs

v.

John Allen, Keybase Financial Group Inc., B2B Trust, Global Maxfin Investments Inc., AGF Trust Company, and Dundee Private Investors Inc.

Defendants

Judge: The Honourable Justice John D. Murphy

Heard: July 19, 2010, in Halifax, Nova Scotia

Written Decision: May 31, 2011
{Oral decision rendered July 20, 2010}

Counsel: Jamie MacGillivray, for Plaintiffs: Ruth and Wilma Lee Shane; John and Linda Cameron; Jeffrey Phillips and Denise Kowalski-Phillips
Sandy Beveridge,Q.C. and Daniel Wallace for Defendant AGF Trust Company
Thomas Macdonald for Defendant B2B Trust
Brian Awad and Raman Khabra for Defendants Keybase Financial Group Inc. and Global Maxafin Investments Inc.
Matthew Pierce (*on behalf of* Roderick Rogers) for Defendant Dundee Private Investors Inc.

By the Court:

Introduction

[1] The defendant, AGF Trust Company, brings motions for summary judgment on pleadings to dismiss three related proceedings. The plaintiffs in each proceeding raise similar legal claims against AGF and are represented by the same counsel. The claims originally raised issues of negligence, breach of fiduciary duty, fraud, agency and vicarious liability. In the course of the hearing, the plaintiffs agreed to amend their pleadings to eliminate all claims against AGF other than negligence.

Background

[2] John Allen was a securities advisor employed by Keybase Financial Group, a licensed mutual funds dealer. Mr. Allen completed loan applications on the plaintiffs' behalf in order to secure investment loans from AGF. The loans were in amounts of $245,000 each. Mr. Allen used the proceeds of the loans to buy mutual funds, which he recommended to the plaintiffs. The plaintiffs allege that Mr. Allen misrepresented their net worth and their assets in completing the loan applications and that in some instances he forged their signatures on the applications. They

claim against him and his then-employer, Keybase, for negligence, breach of fiduciary duty and fraud.

[3] AGF is a trust company offering financial services, including loans to individuals for investment in mutual funds. Members of the public do not apply to AGF directly. Rather, AGF enters distribution agreements with dealers in investments and mutual funds, for distribution of products such as investment loans. AGF had a distribution agreement with Keybase (though not with Mr. Allen). This agreement provided, *inter alia*, that:

> [n]othing herein shall require AGF Trust to offer or to provide a Loan to a Customer and you or your Representative(s) may not bind AGF Trust. To the extent that a Customer is required to complete an application in connection with the provision of the Loan, AGF Trust shall retain the right in all instances to approve or reject a Customer's application or to provide such Loan to such customer.

[4] Mr. Allen submitted loan applications on behalf of the plaintiffs to AGF in June and July 2007, in each case seeking the amount of $245,000. The application contained, *inter alia*, the following terms and conditions, to form the loan agreement upon approval by AGF:

> Application For and Disbursement of Loan: You hereby apply for the Loan in the amount and upon the terms and conditions described in this application. Upon approval of the Application, you hereby irrevocably direct AGF Trust to advance and pay the proceeds of the Loan to purchase the Securities described in the purchase order, delivered by the Investment Advisor/Agent to AGF Trust, and to pay any fees/commissions incurred in connection therewith. Upon purchase, the Securities will form part of the Pledge, by you. If there is a sufficient Pledge of Securities, as AGF Trust may determine in its sole discretion, then the proceeds of the Loan shall be paid as you may direct. AGF Trust performs its principal obligations when, and if, the Application is accepted in accordance with the terms and conditions thereof. Any delay in the purchase of the Securities or any fluctuation in the unit price of the Securities will not be the responsibility of AGF Trust.
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> ....
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> Securities Disclosure. The Provincial Securities Commissions require that investors who consider borrowing money to buy Securities be made aware of the risks involved in borrowing to invest. Securities may be purchased using available

> cash, or a combination of cash and borrowed money. If you only use cash to pay for your Securities purchase, your gain or loss will be equal to the increase or decrease in the value of your Securities. Using borrowed money to make the purchase magnifies the gain or loss. This effect is called leveraging.... It is important to understand that a leveraged purchase of Securities involves greater risk than a purchase made only with your own cash. Based on your own financial circumstances and which Securities you are purchasing, you need to determine whether a leveraged purchase creates undue risk. This agreement may contain margin provisions, therefore a portion of the Loan may be required to be repaid solely as a result of a decrease in the value of the Securities purchased with the loan proceeds. Investors who leverage their investments are advised to have adequate financial resources available to pay the interest as well as to reduce the Loan if the borrowing arrangements require such a payment. The Securities sold are subject to market fluctuations and are not guaranteed by AGF Trust nor are they insured by the Canada Deposit Insurance Corporation or by any other government deposit insurer. You hereby acknowledge that AGF Trust has not made any representations or warranties as to the value, liquidity, or future prospects of the securities.

The terms and conditions also addressed the question of potential liability of AGF:

> AGF Trust Liability. AGF Trust shall not be responsible for any loss incurred by exercising any of the rights conferred upon it under the terms herein nor shall it be bound to collect or see to the payment of any interest or dividend thereon. AGF Trust is not responsible for the investments in the Securities purchased with the proceeds of the Loan and AGF Trust does not in any way guarantee the performance of those investments. You acknowledge that you have had the opportunity to seek independent professional advice and have done so. You acknowledge that you have not relied on any advice, representation or warranty by AGF Trust or any of its employees or agents in making the investments in the securities purchased with the proceeds of the loan. AGF Trust is not responsible for the actions of any promoter, underwriter, broker or salesperson or any other person acting in respect of this Agreement. You acknowledge that your obligation to repay the Loan and other amounts required under this Agreement is an obligation to AGF Trust, separate and independent from your relationship with the investment advisor/agent, without right of set-off for any defence based on advice received from the investment advisor/agent or any third party.

[5] All three applications were approved. The plaintiffs applied the loans to purchase mutual funds, which were assigned to AGF as collateral for the loans. In September 2007 Keybase informed the plaintiffs that it no longer employed Mr. Allen, and that it was possible that he had misrepresented their net worth to AGF. The Plaintiffs claim to have suffered economic and other losses as a result

of the actions or inactions of Mr. Allen, Keybase and AGF (and of additional Defendants in the claims brought by the Phillips and Shane Plaintiffs).

Allegations of Negligence

[6] The Cameron plaintiffs state, at para. 17 of their Amended Statement of Claim, filed 13 February 2009:

> The Plaintiffs also say that AGF was negligent in issuing and rewriting the loans requested by John Allen. In particular, the Plaintiffs say that AGF negligently failed to make all reasonable and necessary inquires concerning the alleged authorization of the Plaintiffs to enter into leveraged loans, and failed to warn the Plaintiffs that such loans were not an appropriate investment decision. Also, AGF did not make any attempt to confirm the information listed on the application which was totally unsupported by documentation.

The plaintiffs no longer maintain that AGF had a duty to advise them as to the risks related to the investment decision.

[7] The Phillips Plaintiffs, at para. 24 of their Statement of Claim filed 16 January 2009, and the Shane Plaintiffs at para. 29 of their Statement of Claim, filed 10 September 2009 state:

> The Plaintiffs also say that AGF and B2B were negligent in issuing and rewriting the loans requested by John Allen. In particular, the Plaintiffs say that AGF and B2B negligently failed to make reasonable and necessary inquiries concerning the alleged authorization of the Plaintiffs to enter into leveraged loans. Also, B2B and AGF did not make any attempt to confirm the information listed on the application which was totally unsubstantiated by any documentation. Similarly, the management at Keybase failed to properly oversee these transactions in accordance with industry standards.

[8] The essence of the plaintiffs' claims in negligence against AGF is that AGF failed to verify information on the loan applications, including signatures and identification of the plaintiffs, as well as information concerning their assets and net worth.

Issue

[9] The issue is whether the plaintiffs' negligence claims against AGF should be dismissed for disclosing no cause of action.

Summary judgment on the pleadings: Rule 13.03

[10] AGF's motions in respect of the plaintiffs' claims in negligence are brought pursuant to *Rule 13.03* (summary judgment on pleadings). *Rule 13.03* provides, in part:

> 13.03 (1) A judge must set aside a statement of claim, or a statement of defence, that is deficient in any of the following ways:
>
> (a) it discloses no cause of action or basis for a defence or contest;
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> ....
>
> (c) it otherwise makes a claim, or sets up a defence or ground of contest, that is clearly unsustainable when the pleading is read on its own.
>
> (2) The judge must grant summary judgment of one of the following kinds, when a pleading is set aside in the following circumstances:
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> ....
>
> (b) dismissal of the proceeding, when the statement of claim is set aside wholly;
>
> ....
>
> (d) dismissal of a claim, when all parts of the statement of claim that pertain to the claim are set aside.
>
> (3) A motion for summary judgment on the pleadings must be determined only on the pleadings, and no affidavit may be filed in support of or opposition to the motion....
>
> ....
>
> (5) A judge who hears a motion for summary judgment on pleadings, and who is satisfied on both of the following, may determine a question of law:

> (a) the allegations of material fact in the pleadings sought to be set aside provide, if assumed to be true, the entire facts necessary for the determination;
>
> (b) the outcome of the motion depends entirely on the answer to the question.

[11] On an application under *Rule 13.03*, the pleaded facts must be taken to be true in determining whether a cause of action is disclosed by the pleading. The test on a motion under *Rule 13.03* was recently restated in **Body Shop Canada Ltd. v. Dawn Carson Enterprises Ltd.**, 2010 NSSC 25, at paras. 10-12, where the Court noted that authorities decided under the former *Rule 14.25* are applicable to motions under *Rule 13.03*, and said:

> The Court of Appeal has recently re-affirmed the rule for the striking of pleadings, which I find is still applicable to motions under new *Rule 13.03*. Writing for the Court in *Cape Breton (Regional Municipality) v. Nova Scotia (Attorney General*), 2009 NSCA 44 (N.S.C.A.), MacDonald, C.J.N.S. writes at para. 17 as follows:
>
>> [17] Rule 14.25 offers a drastic remedy. It provides for an action to be dismissed summarily, thus denying litigants their "day in court". Understandably, therefore, any defendant seeking such relief bears a heavy burden. The Chambers judge would have to consider this claim at its highest, by assuming all allegations to be true without the need to call any evidence. Then even with this assumption, it must still remain "plain and obvious" that the pleadings disclose no reasonable cause of action.
>
> The Court further, reaffirms the standard as articulated by the Supreme Court of Canada in *Hunt v. T & N plc*, [1990] 2 S.C.R. 959 (S.C.C.), writing at para. 18 as follows:
>
>> [18] In following *Hunt*, our court has recently confirmed that in order to strike pleadings under Rule 14.25 (1) (a), they must appear to be either "certain to fail" (2007 NSCA 70 at para.13) or "absolutely unsustainable" (*CGU Insurance Co. of Canada v. Noble*, 2003 NSCA 102 at para. 13).

[12] *Rule 38.02* requires a pleading to provide information sufficient that "the other party will know the case the party has to meet when preparing for, and participating in, the trial or hearing" (*R. 38.02(2)(a)*), and stipulates that material facts (but not evidence) must be pleaded (*R. 38.02(3)*). As to what constitutes a cause of action, in **3021386 Nova Scotia Ltd. v. Barrington (Municipality**), 2010 NSSC 173, the Court cited **Letang v. Cooper**, [1964] 2 All E.R. 929 (Eng. C.A.), where Diplock J. said, at p. 935, that a cause of action "is simply a factual situation the existence of which entitles one person to obtain from the court a remedy against another person" (**Barrington** at para. 13).

The claims

[13] The plaintiffs' claims in negligence raise the question of whether they have causes of action against AGF on the basis of AGF's failure to verify the information on the loan applications, including verification of their identities and, in some instances, whether they even knew such an application had been made. In essence, the question is whether AGF owed the plaintiffs a duty of care to verify the information and to confirm their identities. The plaintiffs do not allege that AGF was acting as an investment advisor, or that it owed them a fiduciary duty.

[14] AGF says it did not owe a duty of care to the plaintiffs. It maintains that the plaintiffs have not pleaded material facts to support the allegation that there was a "special relationship" between themselves and AGF, or that "exceptional circumstances" existed. As such, AGF submits, the Statements of Claim do not disclose a cause of action. AGF relies on **Pierce v. Canada Trustco Mortgage Co.** (2005), 254 D.L.R. (4th) 79, [2005] O.J. No. 1886 (Ont. C.A.), application for leave to appeal dismissed, [2005] S.C.C.A. No. 336, and **Baldwin v. Daubney** (2006), 83 O.R. (3d) 308, [2006] O.J. No. 3824 (Ont. C.A.), application for leave to appeal dismissed, [2006] S.C.C.A. No. 475. According to AGF, these cases establish that a lender does not owe a duty of care to a borrower.

[15] In **Pierce**, *supra*, Pierce and her husband obtained a mortgage. The husband later committed suicide, the mortgage went into arrears and the bank commenced an action against his estate. Commencing her own action, Pierce claimed the bank was negligent in failing to ensure that she had legal advice before co-signing the mortgage, as well as in granting the loan despite her husband's insufficient income, contrary to the bank's own policy. Pierce's action was dismissed for disclosing no cause of action, because there was no misrepresentation by the bank. On appeal,

the Court held that the bank's failure to follow its own policies did not constitute negligent misrepresentation. MacPherson J.A. stated that:

> [g]enerally speaking, the relationship between a financial institution lender and its customer borrower is a purely commercial relationship of creditor and debtor. Absent any special relationship or exceptional circumstances such as would give rise to a fiduciary duty ... the courts have consistently held that the lender owes no duty to the borrower in connection with the making of the loan. In particular, the bank owes no duty to its customer to advise the customer not to undertake the loan (para. 27).

Nor did the bank have a duty "to advise her that it was departing from its internal guidelines in making the loan" (para. 28).

[16] In **Baldwin**, *supra*, a group of customers appealed from a motions judge's order dismissing their claims against several financial institutions. The appellants had bought mutual funds on the strength of advice from financial advisors, and had obtained loans from the financial institutions in order to make the purchases. The advisors invested the funds at the appellants' direction. The loans had margin requirements, so that the funds purchased with the loan proceeds had to maintain a certain value. Otherwise, the institution could demand that the customer pay down the loan, failing which the institution could call the loan. Each appellant faced a margin call. They then took action against (*inter alia*) the financial institutions, alleging that the institutions owed them a duty to ensure that they had been advised of and understood the risks associated with their loans, including the possibility of margin calls. The institutions obtained summary judgment on the basis there was no cause of action against them.

[17] Affirming the motions decision by endorsement, the Ontario Court of Appeal repeated the law as stated in **Pierce**, to the effect that " barring a special relationship or exceptional circumstances, the relationship between a bank and its customer is that of debtor and creditor" (para. 12). The Court adopted (at para. 13) the reasoning by the motions judge (at [2005] O.J. No. 5330 (Sup. Ct. J.), paras. 81, 83-84 and 87-88) in support of a finding that there was no duty of care in negligence:

> It is undeniable that if a person cannot borrow money, that person cannot incur a risk of being unable to repay it and that person cannot incur a risk of agreeing to borrow without adequately understanding and assessing the advisability of the

risk. But if the mere fact of lending made a lender liable in respect of such risks, it would seem to follow that in virtually all circumstances a lender would have a duty to advise a borrower about such risks. That position is the exact contrary of the position set out in the *Pierce* decision and the cases referred to in that decision.

....

With these additional factors of agreement and disclosure, the situation between the parties as regards the proximity of the alleged tortfeasor to the prospective risk of harm is materially altered. It remains true that the harm could not occur without the making of the loan. But the making of the loan requires the consent of two parties, the lender and the borrower. And the lender cannot impose the loan on the borrower. So where, as here, the borrower has received disclosure of the terms of the loan and has been placed in a position to make an assessment of the risk (and is in a better position than the lender to do so, because the borrower has knowledge of the proposed investment program which the borrower received from his or her financial advisor) the analysis of proximity must take these relative positions into account. "Proximity" has to do with closeness (and its opposite, lack of closeness or "remoteness") with respect to the cause of the harm. The foreseeable harm here would seem to be the loss incurred by the occurrence of a margin call (or, perhaps, the unrealized but prospective loss where a loan goes out of margin). But the person who is closest to the causing of that harm is the person who decided to borrow funds to make the investments that could result in that loss. That person is the borrower. In the terminology of *Anns*, the borrower has proximity to the cause of the loss. Next in proximity would be the financial advisor. Compared to the borrower and the financial advisor, the lender does not have proximity. Its loan is necessary but not sufficient for the harm. The borrower's action is necessary and sufficient for the harm.

The fact that a loan transaction is made by way of an agreement between the parties strongly affects the two critical elements of duty of care that are identified in *Anns*: the nature of the relationship between the parties and the degree of proximity between them. Where the relationship between the parties is only contractual, the contract necessarily determines the reasonable expectations of the parties with regard to each other. Where the contract itself does not give the lender a duty to advise, there is no reason to consider that such a duty is part of the relationship unless there is a special relationship or circumstance which would reasonably give rise to such a duty. Similarly, where the relationship is only contractual, there is no reason to view the parties as having a proximity to the prospective harm that is different from the reasonable expectations created by the terms of their contract.

> ...
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> The plaintiffs submit that their cause of action in negligence falls into a recognized category of circumstances where a duty of negligence has been held to exist. How that category might be properly described requires consideration. The plaintiffs say in their factum that a duty of care in negligence arises when a person's conduct creates a foreseeable risk of harm to foreseeable persons. But for this formulation to be applicable in this case, it is necessary to conclude that the conduct of lending creates a foreseeable risk of harm to foreseeable persons. This position ignores the point that it is the borrower who decides to take the loan and so creates whatever foreseeable risk may thereby arise. The position also ignores the fact that it is contrary to what the case law has concluded in the case of lending. The case law recognizes that advisors have a duty of care in respect of advising, but it has not recognized that lenders are advisors. The plaintiffs say that the Court ought to discern or draw an analogy between advisors and lenders in this case on the basis of the similarity of their circumstances vis-à-vis the plaintiffs and the prospect of harm to them. But the differences between the circumstances of the advisors and the lenders are more instructive than any similarities. The plaintiffs dealt with the financial advisors to obtain their financial advice and they say they relied upon that advice. The plaintiffs went to the financial institutions, not for advice, but for loans. There is no evidence that the plaintiffs placed any reliance on the financial institutions with respect to their borrowing and investment decisions other than the self-serving evidence, discussed earlier, that they "trusted" the financial institutions. The financial advisors knew the intended investment programs of the plaintiffs and they were in a position under the applicable regulatory requirements to develop and recommend and implement those investment programs for the applicants and to monitor them over time. The financial institutions were not in this position. No basis for an analogy between the advisors and the lenders is apparent.
>
> On this basis, the relationship between the financial institutions to the plaintiffs in this case does not fit within an existing category that is recognized as giving rise to a duty of care and it is not analogous to an existing category of that kind. So the claim that the lender has a duty of care to advise is a claim to recognize a new duty of care. A new duty of care could be recognized only if it satisfied, first, the *Anns* test as to proximity. For the reasons given above, that test is not satisfied here....

The Court of Appeal agreed with the motions judge's conclusion that "the promotion of the investments by the respondent financial institutions did not create a special circumstance as those promotional efforts were directed to the financial advisors, not to the appellants" (para. 14).

[18] AGF says none of the plaintiffs' pleadings offer material facts to establish that there were exceptional circumstances, or that the plaintiffs had special relationships with AGF. Absent any special relationship between AGF and any of the plaintiffs, AGF submits, the relationships were limited to those as between lender and borrower, and no duty of care arose. The plaintiffs argue that it was reasonably foreseeable that the loan application process could be compromised by fraud, leading to loans being granted without their authorization or in circumstances where a loan should not be granted. As such, they submit that a failure by AGF to use reasonable diligence in processing loans would expose potential borrowers to increased risk. They argue that the phenomenon of "identity theft" provides a basis for the law of negligence to adapt to changing times.

[19] I am satisfied that the law is as set out in **Baldwin**. The **Pierce** and **Baldwin** cases, unlike this one, involved a determination of whether the lender owed a duty of care to advise the borrower about the risk associated with the investment, not, as is the case here, the extent of the duty of care when reviewing the borrowers' applications. However, I am not convinced that this factual distinction provides adequate basis for a legal distinction, as the plaintiffs argue. The principle that the lender does not owe the borrower a duty of care still governs. It is not confined to situations where the lender is advising on risk. As a result, there is no duty of care, and thus no cause of action in negligence made out on the pleadings. The claims in negligence are absolutely unsustainable. AGF is entitled to summary judgment pursuant to *Rule 13.03*.

[20] I make no comment on any possible contractual claim. I find it unnecessary to deal with the proposed amendments to the pleadings, as that issue has been superseded by the granting of summary judgment.

Costs

[21] This was a relatively complicated summary judgment motion, though not in the most complex range. It determined the outcome of the proceeding in respect of one litigant. Tariff C applies. The hearing required more than a half-day, and less than a full day. There was an efficiency created by dealing with all three proceedings at once. AGF shall have costs of $1,500 in each proceeding, plus taxable disbursements relating to the motion, for a total of $4,500 plus disbursements.

J.