Quebec ruling changes class action rules

By LUIS MILLAN

The possible impact of three related class action rulings by the Quebec Court of Appeal is causing concern among the province's business and legal community, as well as consumer protection advocates. Some fear that motions seeking class action authorization will be more easily granted, while others are worried consumers will pay the price following the court's interpretation of what is included in the cost of credit.

In a series of complex and controversial rulings, the appeal court in part overturned a lower court's ruling that ordered nine different financial institutions to pay damages amounting to almost $200 million for improperly disclosing and charging fees for currency conversions in credit card transactions under the Quebec *Consumers Protection Act* (*Act*).

In dismissing class actions against four financial institutions and reducing damages against five others, the appeal court notably revised its stance over a petitioner's required standing to sue in multi-defendant proceedings, adopted a "novel interpretation" over credit charges under the province's consumer protection legislation, and provided guidance on punitive damages.

"The rulings raise a very important constitutional issue for the banks that was not clearly resolved by the decision," remarked Laurent Nahmiash, a class action expert with Fraser Milner Casgrain LLP in Montreal. "[It] raises a very significant consumer protection issue in Quebec dealing with currency conversion fees, and deals with the issue of standing in a multi-defendant context and whether in the name of judicial efficacy, the banks were entitled to question representative plaintiffs they actually had dealings with."

The class action suits were filed in Quebec in 2004, a couple of years after a series of similar class actions across North America challenged the imposition and disclosure of conversion fees in credit-card agreements. Credit-card holders who make purchases or who make cash withdrawals in foreign currency are charged a fee by issuers. The fee consists of a percentage (between 1.5 per cent and 2.5 per cent) of the amount of the purchase price, and is rolled into the currency conversion rate reported in the monthly statements issued to the cardholder. Up until the early 2000s, the existence of the fee and the fact that it was rolled into the reported conversion rate was not disclosed. The plaintiff classes contended that the conversion fees billed by the banks were credit charges. Under Quebec consumer's protection legislation, if these fees are deemed to be credit charges, they must be disclosed as a fixed annual rate in the credit agreement and in periodic statements of the account. In 2009, the Quebec Superior Court determined that the non-disclosure of the conversion fees on the credit-card agreements, and even the subsequent disclosure of the fees, failed to comply with the *Act*.

The financial institutions appealed, arguing that the class actions should not have been authorized since the representative plaintiffs did not have a cause of action against each defendant. The institutions also argued that the *Act*, a provincial statute, was not applicable given that under Canada's *Constitution Act, 1867*, banking falls within the exclusive jurisdiction of Parliament rather than provincial legislatures.

The Quebec Court of Appeal granted in part the appeal, reducing damages against five financial institutions to approximately $13 million in total. More significantly, in *Banque de Montréal v. Marcotte* [2012] J.Q. no 7428, the appeal court sought to reconcile two seemingly contradictory rulings it issued more than five years ago that provided guidance over the standing of representative plaintiffs in class actions suits. In the landmark judgment *Bouchard v. Agropur Coopérative* [2006] J.Q. no 11396, the appeal court held that proposed representative plaintiffs in class action suits must have a contractual relationship with defendants in order to be able to have standing to sue. In 2007 the Court of Appeal cast doubt on the bright-line test it spelled out the year before, and held that a direct cause of action against each defendant was not necessary where the same fault was alleged against each of the other defendants.

The appeal court, acknowledging the inconsistencies between the two judgments, held in *Marcotte* that it is not necessary for a representative plaintiff in a multi-defendant class action to have a direct cause of action with each of the defendants. However, the appeal court held that representative plaintiffs must nevertheless show that a class of individuals exists that do have a direct cause of action against the defendants and that they are capable of adequately representing the members of the proposed class with respect to their claims against the defendants.

"This is a conundrum that has occupied a lot of courts in the

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Adventures in e-trading: income or capital?

AIRD & BERLIS TAXLINE

By Marni Pernica

A determination of whether or not a taxpayer is either a "trader" or is engaged in an adventure in the nature of trade is fact-specific and will ultimately be determined on a case-by-case basis.

Marni Pernica, Aird & Berlis

With the advent of the Internet, things that were once out of reach to the everyday person are fast becoming part of their everyday lives.

Take, for example, the stock market. You no longer have to be on the floor at the Toronto Stock Exchange to make a trade or follow the market as it fluctuates throughout the day. In the age of the Internet, everyday investors have the freedom to control their own portfolio without having to heed the advice of their stockbroker.

Although this freedom may sequences of managing one's own stock portfolio may ultimately impact how the gains earned from trading activities are treated for income tax purposes. In the recent decision of *Zsebok v. Canada* [2012] T.C.J. No. 79, the Tax Court of Canada addressed the issue of whether losses incurred as a result of online share trading activities were business or capital losses.

James Zsebok had claimed business losses resulting from his online trading activities in certain taxation years. The Minister of National Revenue disallowed the losses on the basis that they were on account of capital. To succeed in his appeals, the Zsebok had the onus of proving that he was either a "trader" as defined in subparagraph 39(5)(*a*) of the *Income Tax Act* or alternatively, that he was engaged in an adventure in the nature of trade.

By way of background, a determination of whether a taxpayer is either a "trader" or is engaged in an adventure in the nature of trade is fact-specific and will ultimately be determined on a case-by-case basis. In order to assist with such an endeavour, the court will conlight of the factors enumerated by the Federal Court of Appeal in *Vancouver Art Metal Works Ltd. v. Canada* [1993] F.C.J. No. 152, including (1) the frequency of the transactions, (2) the duration of the holdings (whether, for instance, it is for a quick profit or a long-term investment), (3) the intention to acquire for resale at a profit, (4) the nature and quantity of the securities held or made the subject matter of the transaction, and (5) the time spent on the activity.

In turning to the issue of whether the appellant was a "trader," Justice Georgette Sheridan noted that, in addition to the factors enunciated in *Vancouver Art Metal Works*, the appellant had the onus of proving that he had "a particular or special knowledge of the market in which he trades." In dismissing the argument in its entirety, Justice Sheridan noted that, while the appellant had some education in economics and accounting and experience in fiscal matters through his employment, he had no professional training in share trading, and no specialized knowledge of the shares being traded. Zsebok used to conduct the trades was available to the general public simply by paying a subscription fee.

In turning to the issue of whether Zsebok was engaged in an adventure in the nature of trade, the judge focused on the taxpayer's intention in conducting the trades, the frequency of his transactions, the amount of time he held the shares for and the time spent on the transactions.

Having accepted the appellant's stated intention to make a quick profit as being consistent with his overall conduct (an intention typically associated with a determination of business income), Justice Sheridan turned her attention to the frequency of the transactions and duration of his holdings. Although the appellant only traded shares between 10 and 25 days in any given taxation year, the fact that he rarely held on to shares for more than a few days was persuasive evidence that these were not capital holdings, as there was no hope of earning dividends or waiting for the investments to mature.

Next, Justice Sheridan examlant on the activity in question. She found that the Zsebok's employment-related duties of monitoring the stock market were not an impediment to his personal trading but instead allowed him to simultaneously monitor employment and personal investment data. Further, the appellant's periods of inactivity were not viewed as a lack of intention to trade, but rather as periods where he simply did not have funds available with which to trade.

Lastly, Justice Sheridan addressed the fact that the appellant filed amended tax returns for the taxation years 1999 and 2000, in which he did not object to the Minister of National Revenue's treatment of his trading gains and losses on account of capital. The judge gave this fact short shrift, simply stating that the Zsebok's approach to these activities could change over the course of time.

In allowing the appeal, Justice Sheridan concluded that the balance of probabilities favoured a determination that the appellant was engaged in an adventure in the nature of trade. Accordingly, the Zsebok's trading losses were properly characterized as being on account of income, and not on account of capital.

This case highlights the fact that for taxpayers engaged in online share trading endeavours, the boundary between income and capital is not easily determined. A factual inquiry is required to determine how gains or losses will categorized.

Articling student Kevin Wentzel assisted with this article.

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Appeal court reduces penalty

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country," noted Nick Rodrigo, a class action litigator with Davies Ward Phillips & Vineberg in Montreal. "Some provinces have resolved it either through legislation or they have really clear jurisprudence that has undercut the ambiguity."

In Ontario, following *Ragoonanan Estate v. Imperial Tobacco Ltd.* [2000] O.J. No. 4597, representative plaintiffs must have a cause of action against each defendant. In British Columbia, the cause of action must be held by class members, not necessarily the representative plaintiff.

"I think the *Marcotte* ruling is largely driven to render class action procedure as judicially efficient as possible," added Rodrigo. "There is no point in the judgment where the appeal court points to some logical flaw in the *Agropur* decision because the *Agropur* decision is frankly well-grounded. Because of this desire for judicial efficiency, the court is essentially saying we should not apply the *Agropur* judgment as strictly as it has been applied. The court is really making a plea for a more flexible application of interest."

Nahmiash concurs. The Montreal lawyer believes that representative plaintiffs should have a direct cause of action with each of the defendants because "you are entitled to face off with somebody who you had dealings with." Nahmiash asserts that the efficacy argument is "overplayed," and that having representative plaintiffs with a cause of action against each defendant would not have led to lengthy delays in court proceedings. "It would not have changed a thing but it would have ensured that substantive law is protected and given those banks the right to question the representative plaintiffs," said Nahmiash.

The Quebec Court of Appeal sidestepped the constitutional question raised by the banks by adopting a "novel interpretation" of the notion of credit charges under the Act, said Nahmiash. The appeal court found that the conversion fees were not charged to allow the extension or reimbursement of credit, and therefore were not required to be calculated in the credit rate. However, the appeal court found that conversion fees are subject to disclosure under the *Act*, a requirement that is similar under the federal *Bank Act*. Since this is the case, judicial harmonization exists between the federal and provincial legal frameworks, wrote Justice Pierre Dalphond, who penned the related class action rulings.

"It's a welcome and practical interpretation but many consumer protection advocates will find that it does not dovetail with previous rulings, which have consistently said that there are two basic types of charges under the *Act* for the purpose of disclosing credit – there is capital and everything else is a credit charge," noted Nahmiash.

Indeed, according to Marc Migneault, a lawyer who argued the case for the l'Office de la protection du consommateur, the appeal court has with these rulings created a third kind of charge for "accessory services" such as conversion fees. "We're still evaluating the impact of the ruling but it's clear that it has changed the long-standing interpretation of the law," said Migneault. "It says there are now three types of charges – net capital, credit charges and charges for accessory services. If we have to live with this position, we are going to have to determine what accessory services are."

Raynold Langlois, widely recognized as one of the country's top litigators, has a completely different take over the importance of *Fédération des caisses Desjardins du Québec c. Marcotte* [2012] J.Q. no 7427, the ruling that dealt with credit charges. The ruling is "significant" in terms of consumer protection law in the province because it applied the fundamental principle behind the interpretation of statutes – that "you must construe statutes that are ambiguous in favour of the objective pursued by the legislation," said Langlois, of Langlois Kronström Desjardins in Montreal.

The rulings also provided guidance regarding punitive damages in class actions. In *Amex Bank of Canada v. Adams* [2012] Q.J. No. 7426, the third related class action ruling, Justice Dalphond points out that class action "often comprises an important punitive aspect as compared to individual recovery." However, he does add that this does not imply that punitive damages cannot be awarded in a class action when collective recovery is ordered.

But the message is clear, and likely to attract attention by plaintiff's bar as Justice Dalphond appears to be suggesting that class actions by their nature are punitive, says Rodrigo. "He's telling the lower courts, and the plaintiff's and defence bar, that punitive damages are not something that is an automatic even in cases of breaches in the *Consumer Protection Act,* which it had pretty much looked like it was starting to become. Other things need to be considered and the award of punitive damages will also turn on the gravity of the fault."

Lawyers representing other financial institutions involved in the suits declined to comment.