## Financial Institution Litigation Bulletin

*Summer 2006*

### When lending to investors, Lenders must make sure they are not acting as Advisors

The Ontario Superior Court of Justice recently held that lenders are not responsible for the unfortunate results of borrower's failed investments in situations where the lender is not acting as an advisor. In *Baldwin et al. v. Daubney et al.*,[1] a number of financial institutions (the "Lenders") brought a motion for summary judgment in response to an action initiated by several investors. These investors had borrowed money in order to invest in mutual funds recommended to them by their financial advisors. The mutual funds faired poorly, and the investors alleged that the Lenders breached their fiduciary, and other duties, owed to the investors.

It has long been established that the ordinary relationship of lender and borrower does not give rise to any special duty on the part of the lender. However, in the investor's view this case was different because of a "margin call" feature in the loan agreements. The investors claimed that the Lenders should have taken more care to warn them of the feature's risks.

The margin call feature required the investors to keep their debt obligations to the Lenders below a certain percentage of the investment value. As a result, if the value of the investment fell, the "margin call" from the bank required the investor to pay down the debt and bring it back into the margin. Despite this potentially onerous feature, the Court unequivocally rejected each of the investors' claims.

First, the Court confirmed that a fiduciary duty is inapplicable to the standard commercial relationship between a lender and borrower. Fiduciary duties, the Court explained, arise where the nature of the relationship between the parties is such that one party has the responsibility to look out for the best interests of the other.[2] Such a relationship did not exist in this case. Indeed, the margin call feature was designed to enable the lenders to look out for their own best interests rather than the best interests of the plaintiff.

Second, the Court upheld the generally accepted legal principle that there was no general duty of care owed by lenders to borrowers. In this case the Court stated that no such duty arose because the Lenders were not closely connected to the cause of the investor's loss.[3] The fact that the borrowers had independent financial advisors and that the Lenders never made any recommendations to the borrowers regarding the loans was important to the Court's finding.

This case is an important reminder that lenders must be very careful not to provide any investment related information to a borrower which could be considered investment advice. If a lender does provide investment advice to a borrower, even if the lender has no involvement in the investment, this may be enough to have a Court find that it has some duty to the borrower

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[1] 78 O.R. (3d) 693.

[2] *Ibid*. at para. 67.

[3] *Ibid*. at para. 78.

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*The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.*

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