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Report on Business: Canadian

Ponzi victims dragging banks into court; Financial institutions are inevitably accused of failing to catch fraudsters. Now investors are demanding payback

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In sentencing Earl Jones, the Montreal fraudster who pleaded guilty to a \$50-million Ponzi scheme, a Quebec judge pulled few punches.

"Some victims call him a liar, a demon, a parasite, a snake, [and] a financial predator," Madam Justice H  l  ne Morin wrote in her judgment last February, sentencing Mr. Jones to 11 years in prison.

"The accused not only robbed the victims of their money, he robbed them of their freedom and self-esteem and of a decent life they expected in their retirement. All of them trusted him. For many, this word has no meaning any more."

The desperate fight for those made destitute after entrusting their life savings to Mr. Jones has not stopped with his criminal conviction, however. In a class-action lawsuit – given a green light by a Quebec judge last month – they accuse the Royal Bank of Canada of turning a blind eye to Mr. Jones's fraud and demand that the bank repay them \$40-million in losses, plus interest. The bank denies the allegations, which have not been proved in court, and says it was also a victim of Mr. Jones.

His investor victims are not alone in seeking Ponzi payback from a bank. In almost every high-profile alleged Ponzi scheme, lawsuits soon emerge accusing banks either of failing to catch customers that may be up to no good – or even colluding in the scheme.

The Toronto-Dominion bank faces a lawsuit (not a class action) from a group of Canadian investors accusing it of negligence in its handling hundreds of millions of dollars for Allen Stanford, the alleged head of a \$70-billion (U.S.) Ponzi scheme. TD is also named in a lawsuit in Florida that blames the bank for treating Scott Rothstein, a lawyer sentenced to 50 years for a \$1.2-billion fraud scheme, as a "VIP" customer. A TD spokesman says that in both cases the bank acted lawfully and appropriately.

The \$50-billion fraud case of Bernie Madoff – easily the king of the Ponzi scheme and now serving a 150-year prison term – has spawned scores of lawsuits across the globe, including several against financial institutions. Last month, lawyers for JPMorgan Chase & Co. persuaded a New York judge to toss out a lawsuit that alleged the bank had discovered the fraud in 2008 and colluded with Mr. Madoff.

The case filed by Earl Jones's victims in Montreal accuses the Royal Bank of allowing Mr. Jones to use a personal account as a trust account for his clients, into which he deposited double-endorsed cheques, in some cases forged. For years, the bank never verified the cheques.

"Earl Jones would never have been able to perpetrate such a massive fraud were it not for the negligence, lack of prudence and vigilance, and willful blindness on the part of the Royal Bank of Canada," the motion introducing the class action reads.

Mr. Jones, who was customer of the bank since 1981, was also treated with extra care, the court documents allege. While telling clients that his investments were making their money grow – even providing false account statements and using bank letterhead – Mr. Jones made payments to existing clients from the investments of new ones, and withdrew \$13-million to finance a "life of luxury."

The lawsuit alleges that "the Royal Bank of Canada attributed a VIP client status to Earl Jones, affording him numerous and inappropriate privileges, which facilitated Earl Jones in perpetuating his Ponzi scheme."

The lawsuit says the Royal Bank allowed Mr. Jones to call his account a trust account and knew he was administering the money of his clients, but allowed him to operate it as a personal account. In 2001, a bank employee even flagged the account, warning Mr. Jones that he could "get himself in trouble," the lawsuit says, citing a bank document. The bank also reviewed the account again in 2008, eventually changing his account into a business account and ending the practice of accepting double-endorsed cheques.

Neil Stein, a Montreal lawyer representing Earl Jones's victims, acknowledges that the current wave of lawsuits going after banks to recoup the losses of Ponzi scheme victims are something new.

"There's not a lot of precedent in the sense of dealing with Ponzi schemes, but there are a lot of precedents where banks are liable, as a result of their actions, to third parties," Mr. Stein said in an interview, declining to comment in detail on his case, since it is before the courts.

He points out that in his lawsuit – unlike in many Madoff lawsuits against financial institutions around the world – the Royal Bank itself was not a custodian for investors' money: "Our case is really much more simple. What we say is the bank had an obligation as any other person, to third parties to act in a reasonable and prudent manner."

"Obviously, the bank takes the position that they did nothing and they were a victim, as everybody else was a victim," Mr. Stein said. "The only problem is, they didn't lose any money. It's hard to be a victim when you don't lose money."

He also said that given the advanced age of many of Mr. Jones's victims, he hopes a settlement will be reached to get some compensation to his clients without a lengthy trial.

Toronto lawyer Jim Patterson of Bennett Jones LLP, who represents a group of Canadian investors in their case against TD related to the Stanford allegations, said he could not comment on his case. Last month, the Ontario Court of Appeal upheld a lower-court ruling that dismissed the part of the lawsuit's complaint that argued the bank owed a "duty of care" to investigate Mr. Stanford's accounts and ensure they were above board.

Both banks say they did nothing wrong. "We really do feel like we conduct our business in an appropriate way," TD spokesman Matthew Fortier said.

Gillian McArdle, a spokeswoman for the Royal Bank, said it will defend itself vigorously against the allegations made by Earl Jones's victims at trial: "We were deceived by Earl Jones, just as his clients were. Until 2009, there was nothing to signal that Mr. Jones was anything other than a legitimate and successful businessman – he used his long-standing reputation in the community to take advantage of both clients and companies."

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