

**THE CONCEPT AND APPLICATION OF
FIDUCIARY DUTY IN THE REALM OF
SECURITIES BROKERS AND THEIR CLIENT RELATIONS**

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THE CONCEPT AND APPLICATION OF FIDUCIARY DUTY IN THE REALM OF SECURITIES BROKERS AND THEIR CLIENT RELATIONS

by: Raymond F. Leach¹

The concept of a fiduciary relationship has been elusive of definition. In fact, as Wilson, J. noted in her often referred to dissent in *Frame v. Smith* in the Supreme Court of Canada²:

“Sir Anthony Mason (“Themes and Prospects”, in P. Finn (ed.), Essays in Equity (1985), p. 246) is probably correct when he says that ‘the fiduciary relationship is a concept in search of a principle’. As a result, there is no definition of the concept ‘fiduciary’ apart from the contexts in which it has been held to arise and, indeed, it may be more accurate to speak of relationships as having a fiduciary component to them rather than to speak of fiduciary relationship as such: see J.C. Shepherd, The Law of Fiduciaries (1981), pp. 4-8.”³

Madame Justice Wilson went on to note that:

“The failure to identify and apply a general fiduciary principal has resulted in the courts relying almost exclusively on the established list of categories of fiduciary relationships and being reluctant to grant admittance to new relationships despite their oft-repeated declaration that the category of fiduciary relationships is never closed.”⁴

That having been said, the Learned Justice goes on to list, in her view, the three [signal](#) features Courts have recognized as necessary to establish a fiduciary relationship. That categorization by Madame Justice Wilson, albeit in a dissenting judgment, has been approved of and followed by various Justices of the Supreme Court of Canada in subsequent decisions of that Court when faced with a determination of whether, in the circumstances before it, the application of the elusively defined relationship was appropriate.⁵

Wilson, J’s guideposts to the [imposition](#) of a fiduciary obligation are:

1. The fiduciary has scope for the exercise of some discretion or power;
2. The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary’s legal or [practical](#) interests; and

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2 1987 CarswellOnt 347 (S.C.C.)

3 *ibid.*, p. 18, para. 37

4 *ibid.*, p. 18 & 19, para. 37

5 See for example: *Lac Minerals Ltd. v. International Corona Resources Ltd.*, and *Hodgkinson v. Simms* (*infra.*)

3. The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.⁶

Once the relationship has been found to exist, the traditional remedy, of course, was constructive trust or [an accounting](#). More [recently, however](#), the [remedy](#) has developed to include more expansive and appropriate remedies as required. That whole expanse of remedies, whether traditionally equitable or common law, have even been said to be available regardless of whether the cause of action is equitable or at common law, save policy consideration to the contrary.⁷

As such, there has been a cross over in applying common law concepts, such as mitigation and foreseeability in what was previously thought to be the sacrosanct area of the equitable remedy.

There have been several instructive decisions in the recent past dealing with fiduciary duty which serve to give some instruction relative to the expansion or contraction of both the circumstances in which a “fiduciary relationship” can be said to have been established as well as how the remedy will be applied to the harm alleged.

These decisions have been rendered in various areas of the law, however, I intend to briefly canvass decisions which have explored the duties as they have arisen between investment brokers and their relationship with their clients in the area of securities law.

Before embarking on that review, however, I would like to first visit the concept of fiduciary duty as developed and applied in Canada previously in some of its most important aspects.

Any look at the concept of fiduciary duty in Canada must refer to the treatment the concept received in the Supreme Court of Canada in *Lac Minerals Ltd. v. International Corona Resources Ltd.*⁸. Specifically, the majority of the Court failed to hold that a fiduciary duty [arose](#) on behalf of International Corona Resources in favour of Lac Minerals Ltd. The facts of the Lac case briefly were the following:

International Corona Resources (“Corona”) explored properties which held good potential for gold mining and with that in mind thought it appropriate to acquire the “Williams Property” [adjacent to the](#) property it already owned. Lac Minerals Ltd. (“Lac”) suggested a joint venture to develop a gold mine on the Williams Property. Negotiations between the two proceeded for some time but no joint venture was ever concluded. Unbeknownst to Corona, however, Lac had acquired the Williams Property itself and proceeded to develop a gold mine on it which became ultimately successful. Corona sued Lac for breach of fiduciary duty and breach of confidence. The trial judge held that Lac had received the information concerning the Williams Property confidentially from Corona and Lac had breached the confidence in acquiring the Williams Property. The trial judge (R.E. Holland, J.) also held that Lac had a fiduciary duty to Corona since the information concerning the Williams Property had been revealed in the course of

6 supra 1, p. 19, paras. 40-42

7 see LaForest, J's judgment in *Lac Minerals Ltd. v. International Corona Resources Ltd.*

8 1989 CarswellOnt 126 (S.C.C.)

their joint venture discussions and there was a general custom in the mining industry that information revealed in confidence between potential joint venture partners could not be used by one party to the detriment of the other. The trial judge granted to Corona the Williams Property after Corona paid Lac for its expenses in developing the mine. The Court of Appeal for Ontario affirmed both the finding of liability and the remedy in favour of Corona. Lac appealed to the Supreme Court of Canada alleging no breach of confidence or fiduciary duty. Lac also appealed the remedy, submitting that the appropriate remedy was damages, not the return of the Williams Property even if there had been a breach. Corona cross-appealed to increase damages from the amount which the trial judge had awarded, in the alternative.

The Supreme Court of Canada dismissed the appeal and cross-appeal. In Justice Sopinka's mind, in his dissenting opinion, along with those of McIntyre and Lamer J.J., concurring, Corona's revealing of information regarding the Williams Property, although done in confidence, was not sufficient to establish fiduciary duty although it may have established a separate cause of action for breach of confidence. The fact that there may have been a well recognized industry practice that information revealed during the course of joint venture negotiations was confidential, that practice would not lead to a fiduciary duty falling on the recipient of that confidential information. Additionally, ongoing negotiations could not establish the fiduciary duty requested since ongoing negotiations are common in any commercial matter.

In the *Lac* decision, a fiduciary duty was found not to exist in the circumstances of the case by Sopinka, J. In his dissenting judgment Sopinka, J. referred to the previous decision of the Court in *Frame v. Smith*, referred to previously, as establishing, for Canadian law, when a fiduciary duty may be said to arise. Justice Sopinka referred to Wilson, J.'s dissent in *Frame v. Smith*, but said that the Court was not to presume or infer from a relationship in the ordinary commercial context that it was fiduciary unless there were "special circumstances".⁹

Justice Sopinka went on to determine that the Court should not presume fiduciary relationships in an ordinary commercial context as parties could and should easily protect themselves by contract.¹⁰

Although fiduciary duties were found to be an integral component of certain relationships as between directors and corporations, not every duty arising between directors and corporations are fiduciary. To Justice Sopinka, fiduciary duties might arise in other relationships where "dependency or vulnerability was found"¹¹. That to the learned Judge was a key element of a fiduciary relationship.

For Justice Sopinka and those supporting him the key element of "dependency" by either of the parties was not established.

According to Sopinka, J., "Dependency arises when the beneficiary of the fiduciary duty cannot prevent injury from the exercise of discretion by the fiduciary, and the beneficiary has no

9 *ibid*, p.4

10 *ibid*, pp. 4, 58, paras. 150 & 151

11 *ibid*, pp. 4, 58, paras. 148 - 150

practical remedy other than an action for breach of fiduciary duty”.¹² The dependency in this case was found to have been incurred by Corona gratuitously and Corona sought no contractual protection for its information. Additionally, Corona had other remedies available to it including breach of confidence on which it succeeded.

However, Justice LaForest, unsupported in his decision regarding fiduciary duties, found that, again relying on *Frame v. Smith*, a fiduciary duty had arisen in favour of Corona. According to LaForest, J. although certain relationships are not in their essence fiduciary, such as the relationship between Lac and Corona, that did not preclude a finding of fiduciary duty arising out of specific conduct.

In the circumstances, LaForest, J. held that the disclosure of the confidential information concerning Williams Lake made Corona vulnerable to Lac which, in Justice LaForest’s opinion then placed upon Lac a fiduciary duty not to misuse for its own benefit the information provided by Corona, which duty Lac had breached. In making their conflicting decisions concerning breach of fiduciary duty, Sopinka J. and LaForest J., got from the *Frame v. Smith* case different criteria.

That is, Sopinka, J. who carried with him on the issue of fiduciary duty Justices McIntyre and Lamer, J.J. in his otherwise dissenting judgment, approved of Wilson, J.’s three features exhibited by a fiduciary relationship enumerated by her in *Frame v. Smith*, as outlined above. He did, however, go on to observe that a fiduciary relationship may “...be found although not all of these characteristics are present, nor will the presence of these ingredients invariably identify the existence of a fiduciary relationship.”¹³ The one feature however, which, as noted previously, Justice Sopinka found to be “indispensable” to the existence of the relationship was the third feature described by Wilson, J., that is, the need for “dependency or vulnerability”¹⁴. Sopinka, J. quoted Dawson, J.’s analysis in *Hospital Products v. United States Surgical Corporation* (1984), 55 A.L.R. at p. 488 wherein Justice Dawson stated:

“There is, however, the notion underlying all the cases of fiduciary obligation that inherent in the nature of the relationship itself is a position of disadvantage or vulnerability on the part of one of the parties which causes him to place reliance upon the other and requires the protection of equity acting upon the conscience of that other”

Sopinka, J., however, went on to issue two exceptions regarding the finding of the fiduciary duty. That is:

1. Presence of the conduct that incurs the Courts censure cannot create the fiduciary duty (in other words if the Court finds that there was self-dealing that finding does not impose the fiduciary duty); and
2. The fact that confidential information is obtained and misused cannot create the fiduciary obligation (although an incident of a fiduciary relationship may be the exchange of confidential information the appropriate restraints on the use of such

¹² *ibid*, p. 4

¹³ *ibid*, p. 53, para. 131

¹⁴ *ibid*, p. 53, para. 132

information, where the essence of the complaint is misuse of that confidential information, the wronged party's remedy is breach of confidence, not breach of fiduciary duty)¹⁵

Accordingly, Sopinka J. determined that the trial judge and the Court of Appeal erred in concluding that a fiduciary relationship existed between Lac and Corona. The error, in the learned Judge's opinion was that neither of those Courts gave "sufficient weight to the essential ingredient of dependency or vulnerability and too much weigh to other factors".¹⁶

LaForest, J., with whom Wilson and Lamer, JJ., concurred in part found that a constructive trust over the Williams Property in favour of Corona was the appropriate remedy. That is "but for" the acts of Lac, Corona would have held the Williams Property and therefore the property should be restored to Corona. Damages would not properly compensate Corona for its loss, and damages would not deprive Lac of all that it had gained. Accordingly, restitution was the only remedy suitable in the circumstances. Justice LaForest went on to hold that, however, before a constructive trust could be imposed there needed to be:

- (a) an established claim for unjust enrichment; and
- (b) a constructive trust should be the appropriate remedy.¹⁷

In respect of the fiduciary duty issue LaForest, J., like Sopinka, J., approved the test for the determination of fiduciary duty set out by Wilson, J. in *Frame v. Smith*.

LaForest, J. parted company with Sopinka, J., however, in that in his view, the Courts below correctly found a fiduciary obligation in the circumstances and correctly found Lac to be in breach of that fiduciary duty. To LaForest, J., who agreed with the view of Sopinka, J. that rarely should fiduciary duty be found in the commercial context but went on to distinguish his analysis from Sopinka, J's analysis on the basis of his "reasonable expectation theory" which was the more important ingredient which for him, carried the day in establishing a fiduciary relationship owed by Lac to Corona. LaForest, J. agreed with the Court of Appeal in the finding of the imposition of a fiduciary duty was appropriate in the circumstances because Corona:

1. Reposed trust and confidence in Lac;
2. Industry practice disclosed that confidential information was not to be used without the permission of the party providing the confidential information;
3. Corona was vulnerable to Lac because of the disclosure to Lac of the confidential information.¹⁸

The application of the role of fiduciary for Corona was appropriate for LaForest, J. because, in his view, the Court could and should impose fiduciary duties where it was required to right a wrong that it views as one that should be righted. Justice Sopinka left the parties in a commercial context to make their own bargains, and took the position that Courts should only

15 *ibid*, p. 54, para.134 - 135

16 *ibid*, p. 54, para. 136

17 *ibid*, p.37, paras. 64 & 65

18 *ibid*, pp. 29 & 30, paras. 39 & 40

interfere in circumstances of severe abuse where the key element is vulnerability or dependency is present.

La Forest, J. took the position that confusion surrounded the term “fiduciary” because of “its undifferentiated use”¹⁹ in at least three distinct situations:

- (a) Where a certain class of relationships - e.g. solicitor and client, trustees and beneficiaries, directors and corporations, etc. (traditional relationships, if you will, exhibiting presumed factual or legal incidents wherein the presumption that a fiduciary duty is not irrebuttable but “strongly presumed”);
- (b) Where a fiduciary relationship arises as a matter of fact out of the specific circumstances of the relationship (as demonstrated to him satisfactorily in the case before him, where the obligation from Corona to Lac was established, not by the nature of their relationship *per se*, but as established by the particular facts of the relationship;
- (c) The final category, which is markedly different from the above two usages of “fiduciary” or “fiduciary duty”, where there is a perception by the Court dealing with the problem before it that the equitable remedy which appears appropriate to solve the complaint, would not be available unless there is a finding that a fiduciary relationship is present.²⁰ This “conclusion to justify a result, reads equity backwards” and to LaForest, J. was a “misuse of the term”²¹. In an approach which is still finding its own level, Justice LaForest expressed his opinion that this “misuse” of the term “fiduciary” would only be eliminated “...if the Courts give explicit recognition to the existence of a wide range of remedies, including the constructive trust, available on a principled basis even though outside the context of a fiduciary relationship”.²²

Justice LaForest subsequently did his best in a number of decisions in Canada’s highest Court to provide what he termed “a principled basis” to connect various remedies which theretofore had been viewed exclusively as equitable remedies in situations where common law causes of action arose (for example cases involving breach of contract and torts) and now applied equitable remedies and conversely also applied common law principles like mitigation and foreseeability in cases dealing with equitable remedies.²³

That is, in cases like *Canson Enterprises Ltd. v. Boughton & Co.*, 1991 CarswellBC 269 where the plaintiff client brought action against his solicitor for damages for deceit and breach of fiduciary duty, and *M.(K.) v. M.(H.)*²⁴ where the plaintiff, an incest victim, brought action against her father for damages for assault and battery and, in the alternative, for compensation for

19 *ibid.*, p. 24, para. 28

20 *ibid.*, p.25, para. 30

21 *ibid.*, p. 28, para.33

22 *loc.cit*

23 See the excellent article on this topic by Professor McCamus, “Equitable Compensation and Restitutionary Remedies: Recent Developments” in 1995 L.S.U.C. Special Lectures “Law of Remedies” at p.295.

24 1992 CarswellOnt 841 (S.C.C.)

breach of fiduciary duty for perpetrating the abuse, Justice LaForest who wrote the judgment concurred in by the majority of the Court, in both cases, gave interesting Judgments.

He found in the former decision that common law limitations like remoteness and causation were applicable to limit the Plaintiff's damages in a situation where a fiduciary duty was found when it had been previously thought that such common law principles were irrelevant to equitable compensation and which had made the fiduciary put the beneficiary of the of the duty in the same position he would have been in had the loss not occurred. In the latter case LaForest, J., again speaking for a majority of the Court found that the father's sexual assault in addition to being a tort was also a breach of his fiduciary duty. In joining with McLachlin, J.'s (as she then was) previous holding in *Norberg v. Wynrib* [1992] 2 S.C.R. 226, (that sexual assault by a physician to his patient constituted a breach of his fiduciary duty in that he did not act in the patient's best interests but his own - for sexual gratification and did not therefore avoid this obvious conflict of duty and self-interest which could be compensated) LaForest, J., allowed as to how the absence of previous authority did not foreclose the extension of fiduciary duties of parents to include obligations to protect the child's health. He and McLachlin, J. did, however, part company on the issue of remedy. LaForest, J. re-iterated his position in *Canson* that absent policy consideration differences between common law and equitable remedies, the same remedies should be available to best provide the appropriate remedy for the circumstances.²⁵

Finally, in *Hodgkinson v. Simms*²⁶, LaForest, J., writing for a bare majority on the point, found that a fiduciary relationship had been established between the defendant accountant who was giving investment advice to the plaintiff stockbroker and who did not disclose that in recommending certain MURB investments to the plaintiff (which the plaintiff invested in and lost his investment due to the collapse of the real estate market), that he, the accountant, would receive extra commission from the MURB developers. Justice LaForest opined on the issue of whether there was any difference between the compensation available for the fiduciary breach and breach of contract, although strictly speaking it was not required. He continued his expansion of the idea that absent some policy considerations the appropriate remedy, whether equitable or common law should be available. He went on, however, to determine that "damages in contract follow the principles stated in connection with the equitable breach."²⁷. This effectively made the defendant liable in full for the plaintiff's loss, although it was argued that the accountant could not have foreseen the collapse of the real estate market and that loss had nothing to do with the breach of the fiduciary duty - the failure to disclose the connection with the MURB developers. While the minority disagreed with his "but for" approach to damages, they did agree that the principles applicable to the application of damages for breach of contract or fiduciary duty were the same, even though they disagreed on the way the majority calculated those damages.

All that having been said, how, if at all have the principles of fiduciary duty been applied in the relationship between stock brokers and their clients, a relationship that would have to come within Justice LaForest's second class of fiduciary relations, if at all - that is not one of the traditional relationships that admit of a fiduciary association, but one "where a fiduciary relationship arises as a matter of fact out of the specific circumstances of the relationship"²⁸

25 *ibid*, p. 46, para. 106

26 1994 CarswellBC 438 (S.C.C.)

27 *ibid*, p. 44, para. 96

28 see reference herein at p. 6 to LaForest, J.'s decision in *Lac Minerals*

Until the Supreme Court of Canada addresses the matter again, the latest word on the situation, at least as far as we in Ontario are concerned, has been had by the Court of Appeal for Ontario in *Hunt v. TD Securities Inc.*²⁹ That decision, upon which leave to appeal to the Supreme Court of Canada was just recently refused, overturned the trial judge, His Honour Judge Hambly, of Kitchener on a number of issues, including his finding that the stock broker was not in a fiduciary capacity to his clients, who were elderly and retired. At the time of the trial, the male Plaintiff, Mr. Hunt was 75 years of age and his wife was 72. The facts of the case were briefly the following:

The trial judge found that the Plaintiffs, Melvin and Maryann Hunt, had transferred a Mutual Fund Account to TD Evergreen ("T.D.E.") where the Defendant Schram acted as an investment advisor. Money was held in a non-discretionary cash account the terms of which only allowed T.D.E. to make transactions authorized by the Hunts. On March 3, 1997, T.D.E. sold a number of BCE shares without authorization. The trial judge found that the Hunts became aware of the sale within 10 days of March 6, 1997 and in following weeks instructed the Defendant Schram to purchase other securities with the proceeds of the sale from the BCE shares. The BCE share price rose and in July 1998 the Hunts sued T.D.E. and Schram for the loss in the value of the BCE shares. Judge Hambly, at trial, found on behalf of the Plaintiffs, on the basis that there had been:

- (a) A breach of fiduciary duty between the Hunts and the Defendants;
- (b) That Schram breached the fiduciary duty through the unauthorized sale;
- (c) The Hunts were awarded the loss in value of the stock plus interest plus solicitor and client costs.

T.D.E. and Schram appealed and asked for leave to appeal the costs order. The Plaintiffs cross-appealed to reflect the loss of opportunity to sell as the price increased.

The Court of Appeal (Gillese, JA. speaking on behalf of the Court comprised of herself, and Justices Sims and Armstrong) allowed the appeal and dismissed the cross-appeal. The Court of Appeal determined that:

- (a) The relationship between and stock broker and client is not by virtue of their relationship a fiduciary one but could be depending on the facts;
- (b) The trial judge made a palpable and overriding error by finding that Schram did have a fiduciary relationship with the Hunts;
- (c) The trial judge misapplied the legal principles in conducting in concluding that Schram was a fiduciary of the Hunts. Specifically in his finding that Schram had discretion or power to unilaterally

affect the Hunts interest, the Court held that while Schram was in the position to conduct and did conduct an unauthorized sale that was not the end of it because the ability to do that did not characterize the relationship. That is, the trial judge's finding that the Plaintiffs placed their trust in their brokers Schram, could not be supported because:

- (i) Hunt opened a non-discretionary account and operated it as such, they had the final call on the decisions with respect to the purchasers sale of the securities;
- (ii) It seems that the Court determined that had there been a pattern of Schram acting without instructions it would have been possible to find a fiduciary relationship, however, one unauthorized trade was not enough to establish the relationship;
- (iii) The unauthorized sale of the BCE was a breach of contract and the Plaintiffs had a duty to mitigate their loss;
- (iv) The Court held that since the Plaintiffs knew about the trade within 10 days of the knowledge of the actual trade (March 6, 1997) the Court of Appeal gave the Hunts 16 days – until April 2, 1997 to mitigate their loss by buying more shares in BCE which, of course they did not do. The Court held that the period of mitigation must be reasonable in all of the circumstances. Factors to be considered in the period of mitigation as established by the case law: were
 - (1) Ease of the purchase of replacement shares;
 - (2) The degree of sophistication and experience of the investors;
 - (3) The degree of trust reposed in the broker;
 - (4) Whether the broker was obliged to follow the customers instructions in making transactions; and
 - (5) Whether the relationship between the investor and broker had broken down to the point that the client had lost confidence in the broker.³⁰

Surprisingly, in applying this [mitigation](#) principle the Court of Appeal determined no damages had been suffered, that is, the Court determined that in this brief period of mitigation the prices of BCE stock had declined so that no damages had been suffered by the Plaintiffs. The Hunts were only entitled to obtain the costs associated with the sale of the shares (i.e. the tax paid on the capital gains

30 *ibid*, p. 502, para. 97

of the unauthorized sale of the BCE shares plus the costs of the transaction itself and the commission on the sale of the BCE shares). As the Hunts had purchased CIBC and Chrysler shares with the proceeds of the BCE sale, which the Courts determined would not have happened without the unauthorized sale of the BCE shares those costs to purchase and commissions were also entitled to be reimbursed to the Hunts.

Importantly, however, the Court held that result would have been the same if the fiduciary relationship had been established. The Court of Appeal held that mitigation applies to equitable remedies;

- (a) By referring to LaForest, J.'s decision in *Hodgkinson v. Sims*, and *Canson*, noting that where an equitable remedy would apply, if policy concerns are not raised which would militate against imposing a duty to mitigate, equity will impose a duty to mitigate³¹; and
- (b) When the rationale behind the common law duty to mitigate is applicable, then "equity will impose the same obligation to mitigate in order to avoid unnecessary loss"³². [my emphasis]

The Court of Appeal obviously has fallen in line with the direction that LaForest, J. started in the Supreme Court of Canada in mixing of the availability of common law remedies with equity and vice versa.

To complete the total reversal of Judge Hamly's decision, the Court of Appeal also determined that Judge Hambly had made a reversible error in determining that solicitors and client costs were payable. The Court of Appeal held that the solicitor and client costs are payable when they are due to misconduct that the facts of this case did not warrant solicitor and client costs and the usual award to the successful party should have been obtained i.e. party and party.

As the Supreme Court of Canada just recently refused the leave to appeal application by the Hunts, the Court of Appeal's remarks regarding fiduciary duty of the stock broker are the last word on the subject.

As an aside, it is interesting to note, that the male Plaintiff was 80 years of age at the date of his trial and the female was 77. The trial judge noted that Mr. Hunt's health was so bad that his evidence had to be taken at home. In the circumstances, however, the Court of Appeal determined principally, it seems, because a non-discretionary agreement had been signed (which is the case with the vast majority of accounts with stock brokers) a fiduciary relationship could not be established.

In some respects it is difficult to understand how the Court of Appeal denied a fiduciary relationship because of the non-discretionary agreement. The Court took the position that since the breach, (the one unauthorized trade which was a sole exception to the normal pattern of trading), was contrary to the non-discretionary agreement a fiduciary relationship could not be

31 *ibid*, p. 506, para. 114

32 *loc.cit*

established. It appears that great emphasis was placed by the Court on the non-discretionary trading agreement rather than the incidents of dependence and vulnerability which the trial judge found. Perhaps the Court of Appeal is intimating that the only time a fiduciary relationship will be established in a brokerage situation between broker and client is when there is a pattern of discretionary trading such that the clients rely on the expertise and decision making of the broker. As a practical matter, however, those of you who are involved in securities law to any extent will realize that discretionary accounts are the exception, not the rule, with most brokerage houses, with such accounts usually having a minimum asset value of significant wealth and loads of regulatory provisions in place regarding the brokers right to conduct trading.

Other cases of recent interest dealing with stock broker's liability to the client are:

1. *Labricciosa v. TD Waterhouse Investor Services (Canada) Inc.*³³, decision of Mr. Justice Sutherland released February 13, 2004 where there was no discussion of fiduciary principles and wherein the learned trial judge dismissed the action of the Plaintiff who sued the Defendant discount brokerage firm for damages alleged to have been caused by material misrepresentations or non-disclosure and negligence of the Defendant in the opening and operation of a self directed margin account. Sutherland, J. indicated that as the Defendant was a "discount brokerage firm for persons having self directed accounts" it offered no investment advice to its clients and that trades are conducted on an unsolicited basis, discount commissions far less than "full service" brokerage firms. For Justice Sutherland the documents executed by the Plaintiff sealed his fate. The Plaintiff had signed the certification that he had read the appropriate sections of a booklet allegedly provided by the Defendant called "Account and Service Agreements and Disclosure Documents" which he had agreed to be bound by. Although the Plaintiff alleged that he had not read those documents, which were available, the Court determined that by not reading the documents he could not be in a better position than he would have been if he had in fact read the documents. The learned Judge relied upon the decision of Wilkins, J. in *Janic v. TD Waterhouse Investment Services (Canada) Inc.*³⁴ where, in a similar fact situation the Plaintiff, like the Plaintiff before Justice Sutherland, alleged that he did not understand the margin account.

Justice Sutherland agreed with Wilkins, J.'s finding in *Janic* concerning his allegations about failure to read the document not affecting the outcome but also the observation by Wilkins, J. that "in a rising market, there would be no suggestion that the broker should share in any of the profits Mirjana Janic might have obtained. The basis on which they might now be expected to share in the losses escapes me. I can see no reason where Mirjana Janic should not be bound by the provisions of the agreement".³⁵

An interesting observation also made by Justice Sutherland in the *Labricciosa* decision was that the Defendant was a discount brokerage firm, just "an order taker" but a member of the Investment Dealers Association. In dealing with the submission of the Plaintiff that the applicable "know your client" rules of the

33 2004 CarswellOnt 608 (Ont. S.C.J.)

34 2001 CarswellOnt 1268 (Ont. S.C.J.)

35 *ibid.*, p. 13, para. 58

Investment Dealers Association of Canada provided that information as to the client's overall investment objectives and to his risk tolerance is required to be obtained and recorded, Sutherland, J. rejected the submission saying "...where, as here the account is self directed and the client admits that the discount broker does not give advice for or against the particular investment, such disclosures must be of less importance than they are where the dealer is giving investment advice"³⁶. In summary Judge Sutherland found that the Plaintiff did not establish that any misrepresentation had been made with respect to the operation of his margin account or that the Defendant was negligent in any way in dealing with the margin account application or the Plaintiff's margin account.

2. In a further recent case, *Abrams v. Sprott Securities Ltd.*³⁷ a decision of Stinson, J. at trial which was appealed to the Ontario Court of Appeal., that Court has appeared to have exacted a rather high standard on brokers and their duties of disclosure of risk. The Court of Appeal (composed of McCarthy, Rosenberg and Cronk JJ.A. the later of whom rendered the decision) dismissed the appeal of the Defendant broker and brokerage house from a finding of Justice Stinson that they were to pay the respondent half of his loss on the investment plus interest and costs. The Court of Appeal determined that the appeal raised two issues:
 - (a) The duties of a securities brokerage to retail clients and in particular the duties associated in client's investments and special warrants and special shares of private companies not traded on the public market; and
 - (b) The entitlement of the brokerage firm to raise the defence of estoppel by representation against the client based on the client's written representations in subscription agreements for the aforesaid shares as a prerequisite in participating in those investments.

The facts briefly of that case were that the Plaintiff was an elderly semi-retired business man (apparently 82 at the age of the trial) with a personal net worth of about 2 million dollars, who was experienced in investments made on the stock market. His investments, however, were usually mortgages, fixed income, trust units and mutual funds initially, but he later became quite active in initial public offering ("IPOs") of companies whose shares had not previously traded on the market. The evidence was that prior to his subject investment with the defendant company he had used the services of 9 different brokerage firms to facilitate his trading. Prior to the two impugned transactions the Plaintiff had made several successful investments through the Defendant, but which did not involve the securities of private companies, specifically, the purchase of special shares or special warrants. The Plaintiff was not familiar with either concept. The Defendant broker told the Plaintiff that two private companies in which he could purchase the special warrants and special shares under Private Placement Exemptions of the *Securities Act* would make IPOs down the road whereby common shares would be offered. She did not tell the Plaintiff that the IPOs might never come to pass and the company might never be listed on any exchange [my emphasis]. Before allowing the Plaintiff to invest, the broker

³⁶ Supra 31, p. 17, para. 55.

³⁷ 67 O.R. (3d) 368 (Ont. C.A.)

required the Plaintiff to sign two written subscription agreements which, by signing he warranted that he was experienced in financial matters, capable of evaluating risks, that he realized he might lose all his investment and that he was able to bear the risk. The Plaintiff signed the subscription agreements but did not read the details, he testified, and, in fact, testified, that he had inserted the word "janitor" regarding his position in the subscription agreements as he testified later so that he could "qualify" his signature on the risk disclosure provided for in the subscription agreement. After his investment of approximately \$300,001.00 neither company proceeded with the IPO and the Plaintiff's total investment was lost.

The Plaintiff sued the Defendant for negligence, breach of fiduciary duty and negligent misrepresentation.

At trial, Stinson, J. found that there was no fiduciary duty established but the broker was not simply "an order taker". The broker sometimes provided advice which the Plaintiff sometimes followed. The trial judge found that the Plaintiff's relative sophistication did not negate the duty of the broker to explain the risks of the investment and make a balanced presentation. The trial judge relied on the Security Institutes "Conduct and Procedures Handbook" which is the course book for anyone wanting to obtain his brokers licence for guidance as to the duties of the broker. Stinson, J. determined that the book assisted and "informed the Court the duties which should be applied but did not govern" the Court. Finally the trial judge held that the Defendants were estopped from relying on the subscription agreement because of the broker's conduct in failing to inform the Plaintiff fully of the risks, but found the Plaintiff to be 50% contributorily negligent because of his failure to take reasonable care in signing the subscription agreements. The Defendants appealed.

The Court of Appeal dismissed the Defendant's appeal. The Court of Appeal held the Plaintiff's damages sounded in tort, not contract, relying on Justice Colin Campbell's decision in *875121 Ontario Ltd.*, where it was noted by Cronk, J.A., that:

"As was more recently observed by Colin Campbell, J. in 875121 Ontario Ltd. [v. Nesbitt Burns Inc. (1999), 50 B.L.R. (2d) 137 (Ont. S.C.)] at 156: "[The] fact that [the broker] did not have a fiduciary duty to [the client] in respect of the investment advice does not relieve [the broker] of a duty to take care in respect of the advice given, duty which sounds in negligence".

In dealing with the standard of care applicable, Cronk, J.A. addressed the issue that an inexperienced investor would have a much higher duty of care than that existing between a broker and an experienced investor and, in fact, referred to the comment by Hesler, J. in *Refco Futures (Canada) Ltd. v. Fresaid Enterprises Ltd.*³⁸ where the learned Judge said at paragraph 146 that "Certainly the obligations of the broker have to be adversely proportional to the experience and

38 [1993] R.J.Q. 2359, aff'd [1998] A.Q. No. 403

skill of the client and the degree of independence the latter asserts in decisions regarding investments." The Court of Appeal went on to dismiss the appeal, agreeing that there was no fiduciary duty but also upholding the trial judge's decision on the finding of negligence on behalf of the broker. The negligence as far as the Court was concerned, was that the broker had failed to outline the risk associated with purchase of the shares, circumstance with which the client was not familiar. Specifically the Court of Appeal picked up on the fact that although there were a number of risks in making the purchase including a liquidity risk, the "material risk"³⁹ was that the IPOs would not proceed because there would be no public trading market for the shares he was purchasing.

To Cronk, J. then the "...likelihood of the actual occurrence of the IPOs was thus a critical factor and the liquidity of Abrams' invested funds was a component of the 'level of risk' of the Investments."⁴⁰ As there was no evidence that the broker had advised the client of that risk or that the business of the two private companies might fail (which in fact happened) she did not meet her professional obligations under the CP Handbook to make sure that Abrams was made aware of both the positive and negative factors in the investments. The failure therefore was in the "duty to warn"⁴¹ of the risks associated with the investments. The Court went on further to deal with the argument that since the client had signed the subscription agreements, notwithstanding his "janitor" description of his position which he knew to be false" he did, by the terms of the subscription agreements agree that he was aware of the risks of the investment, that his finances were such that he could stand to lose the whole investment, etcetera. The Court of Appeal had to deal with a few issues in respect of the subscription agreement.

Firstly, Cronk , J.A. said that the Plaintiff's "signing of the subscription agreements is most troubling"⁴² The learned justice disapproved of his conduct in executing the subscription agreements and then trying to abandon the consequences by saying that he did not read them and relied on the decision of the court delivered by Robins, JA. in *Fraser Jewellers (1982) Ltd. v. Dominion Electric Protection Co*⁴³ where Robins, JA. said:

"The fact that [the signatory] chose not to read the contract can place him in no better position than the person who has. Nor is the fact that the clause is in a standard pre-printed form and was not subject to negotiations sufficient in itself to vitiate the clause."

Notwithstanding that the Court of Appeal approved of that general proposition, in the circumstances, it found that the Defendants were not entitled to rely on those subscription agreements "...thereby escaping all liability to him."⁴⁴ As such,

39 Supra 37, p. 381, para. 48

40 loc.cit

41 *ibid*, p. 382, para. 51

42 *ibid*, p. 382, para. 54

43 (1997) 34 O.R. (3d) 1, at p. 10

44 Supra 35, p. 383, para. 56

Cronk J.A., held that the brokerage firm and the broker could not rely by way of estoppel on the statements included in the subscription agreements, as the signing of the statements was induced by their own misrepresentation about the nature of the investment (i.e. not providing with all of the risks). Interestingly enough Cronk, JA. held that:

"Although the trial judge found that Abrams did not repose trust and confidence in Spork (the broker) sufficient to create a fiduciary relationship between them he expressly held that Abrams was entitled to and did rely on Spork to provide information to him concerning the investments. He further held that, without that information, Abrams was not in a position to make an informed decision about whether to invest in the special warrants and special shares. It is significant in that regard that Spork was bound under the Professional Standards of Conduct set out in the CP Handbook to 'display absolute trustworthiness since the clients interest' must be the foremost consideration in all business dealings'." [emphasis added]⁴⁵

Accordingly, the Court of Appeal upheld the trial decision including the finding of contributory negligence by the Plaintiff in execution of the subscription agreements. No leave to appeal to the Supreme Court of Canada was sought in that case.

3. Another brokerage case of recent vintage, dealing with a number of interesting issues including that of the relationship of broker to client is the recent decision of Himel, J. in *Venture Capital USA Inc., et al. v. Yorkton Securities Inc.*⁴⁶

In that case, Justice Himel again found that no fiduciary duties were present. The case has been appealed by the Defendants so that what is said in the case must be regarded charily until the appeal has been heard but we can indicate that in regard to the fiduciary duty issue, Justice Himel reviewed many of the recent cases including *Blackburn v. Midland Walwin Capital Inc.*⁴⁷ wherein a fiduciary duty was also found not to exist (more about that case later hereunder). Basically, however, the learned Judge found that in the circumstance there was no fiduciary duty. In his review of the law, Judge Himel referred to the earlier decision regarding stock brokerage matters in *Varcoe v. Sterling*.⁴⁸ There the Court of Appeal affirmed the decision of Justice Keenan who wrote his decision after an extensive review of the law concerning the relationship of broker to client:

"The relationship of the broker and client is elevated to a fiduciary level when the client reposes trust and confidence in the broker and relies on the broker's advice in making business decisions. When the broker seeks or accepts the

⁴⁵ *ibid.*, pp. 384, 385, para. 61

⁴⁶ 66 O.R. (3d) 760

⁴⁷ 2003 CarswellOnt 684 (Ont. S.C.J.)

⁴⁸ 1992 CarswellOnt 976 (Ont. C.A.)

clients trust and confidence and undertakes to advise, the broker must do so fully, honestly and in good faith. Any case where a broker has an interest in a particular transaction, the broker must make full disclosure and assume the onus of proving that no advantage was taken of that client, that the transaction was entered in perfectly good faith and after full disclosure. It is the trust and reliance placed by the client which gives the broker the power and in some cases, discretion, to make a business decision for the client. Because the client has reposed that trust and confidence and has given over that power to the broker, the law imposes a duty on the broker to honour that trust and respond accordingly. If a broker fails to honour that trust or betrays that trust by taking advantage of the client, the broker has breached that fiduciary duty.⁴⁹

In the particular circumstances of the Varcoe case, however, the learned judge held that there was no fiduciary relationship. The Client had invested in highly speculative commodities futures and traded on margin. He also had an American account. The defendant brokerage firm manual provided that there was a trading limit of 10% of the total net worth or 40% of the liquid net worth in commodities futures trade. These limits were regularly broken by the broker who never discussed the trading limits and changes with the trader. Although the trader was highly sophisticated, the action was allowed, not on breach of his fiduciary duty but by negligence on behalf of the broker. The Broker had violated industry standards and statutory regulations respecting of trading limits, margin calls and transferring funds between accounts. Accordingly, the violation or breach of the broker's duty of care. This finding, including that there was no fiduciary relationship, was upheld by the Court of Appeal.

In the circumstances of the *Venture Capital Case*, the case was really about, as the parties agreed, "reasonable notice" to freeze the trading accounts of the Plaintiff. Yorkton's new compliance officer learned that the Plaintiffs trading representative was someone who had a criminal record and determined that he was someone with whom they should not trade. As a result of the freezing of the accounts, the Plaintiffs sustained damages because of inability to deal with outstanding positions that had to be dealt with but could not be because of the trading freeze. The Defendants took the position that there was no fiduciary relationship and relied on a clause in the standard form of agreement with its clients that allowed the Defendant to refuse to accept purchaser's sale instructions when it deemed it necessary for its "...protection or otherwise" and which agreement included a clause wherein the client waived any losses or damages arising from the refusal to trade by the Defendant. Judge Himel took the position that the broad construction taken by the Defendant of its own agreement undermined the very nature of the brokerage bargain and, as such it was analogous to an exclusion clause and had to be interpreted strictly since the clause "for its protection or otherwise" on which the Defendant relied was ambiguous. The Defendant, in the circumstances, could refuse certain activities

⁴⁹ *ibid.*, p. 24, para. 90

but such refusals had to be done in good faith and with notice. The Judge implied a term that he determined should or would have been in the agreement had its absence been drawn to the parties attention, (i.e. that the account would be operated, unless the transactions proposed were illegal or involved other significant malfeasances, which was not the case in this situation), otherwise reasonable notice of the trading had to be given. We will see what transpires with that case in the Court of Appeal.

4. In *Blackburn v. Midland Walwin Capital Inc.*⁵⁰ referred to above, a decision of Judge Gordon in January of 2003, the Plaintiffs, who were husband and wife sued their broker and the investment firm for which he was employed for approximately \$190,000.00 losses in the market from 1993 to 1995. In assessing the issue of fiduciary relationship, Judge Gordon reviewed the case law and found in the circumstances, based on the male plaintiff's relationship with the broker, that he did not "possess the requisite degree of vulnerability"⁵¹. With respect to the female Plaintiff according to Judge Gordon, her case was "more complex" as she had no investment knowledge and did not participate in the transaction. She signed the usual documents but "delegated responsibility for all her investment matters to her husband." Judge Gordon found that the delegation of authority to her husband "prevents a finding of fiduciary relationship between [the broker] and Gail Blackburn"⁵². In the end, although this decision is as well, under appeal, liability was found against the brokerage firms for 75% liability with the Plaintiff Mr. Blackburn being 25% contributory negligent.

In an interesting post script the Judge referred to the object of the Investment Dealers Association Constitution which detailed the usual platitudes about the objects of the Association, i.e. to being there to enforce compliance with high standards of business conduct, education, etcetera. At the conclusion of the action in allowing the Plaintiffs claims the Judge noted:

*"The Plaintiffs were never informed of this publication. The Defendants or their employees involved in the Blackburn affair obviously never read or understood their own associations objects. Instead the game was played to make money. And the final analysis, they all lost."*⁵³

The Blackburn case does follow the line of cases with respect to stock brokers which very rarely sets out a fiduciary duty as being owed by the broker to the client. In his decision Judge Gordon did refer to the case of *Ryder v. Osler, Wills, Bickle Ltd.*⁵⁴. That decision of Mr. Justice Holland provided that the 78 year old Plaintiff was owed a fiduciary duty, however, as described by the Judge, such a vulnerable client might be difficult to emulate as:

50 2003 CarswellOnt 684 (Ont. S.C.J.)

51 *ibid.*, p. 16, para. 54

52 *ibid.*, p. 16, para. 57

53 *ibid.*, p 51, para. 258

54 1985 CarswellOnt 1423 (Ont. H.C.J.)

*"Mrs. Ryder had no business experience whatever. She got married soon after she left high school and she never dealt with a stock broker before her husband's death. She really does not know the difference between a stock and a bond and never read the stock market quotations."*⁵⁵

It may be that in view of the decisions reviewed herein and in view of the Court of Appeal decision in *Hunt* referred to earlier, that it will take that type of client before the Courts will venture a finding a fiduciary relationship and requisite duty on the basis of the broker.

5. I also refer you to the following cases for your further review which deal with various stock broker issues including the Supreme Court of Canada's decision in *Laflamme v. Prudential Bache Commodities Canada Ltd.*⁵⁶ Although that case is based on the *Quebec Securities Act* and the issues of the *Quebec Civil Code*, including the imposition on the creditor of a duty to mitigate damages (also contained in the Code) Gonthier, J. with whom all the other Justices hearing the Appeal concurred, found that the Quebec Court of Appeal had placed too heavy and onus on the clients in finding that they had failed to mitigate loss properly. In a much more relaxed decision concerning the duty to mitigate than was evidenced by the Ontario Court of Appeal in the *Hunt* case, Justice Gonthier noted that:

*"In the case of injury resulting from mismanagement of a securities portfolio, a flexible approach must be taken in determining what constitutes a reasonable period of time to act and mitigate the damages. In particular regard must be had to the clients level of experience and knowledge of investments and to the complexity of the situation."*⁵⁷

Gillease, J.A., who gave the judgment of the Court of Appeal in *Hunt* referred to the *Laflamme* case, she also referred in her review to cases which had reviewed *Laflamme* regarding mitigation, including the British Columbia Court of Appeal in *Secord v. Global Securities Corp.*⁵⁸. There that Court allowed the Plaintiff a period of time to "come up to speed" so to speak, as she had to learn what had happened and, in the circumstances "acted reasonably in taking a period of time to assess the situation herself and then proceed to find a new advisor in which she would have confidence."⁵⁹. Although Justice Gillease reviews all the law dealing with mitigation, it appears in the circumstances that a very limited period of mitigation was allowed (16 days in total) from the date the consequences of the unauthorized trade were discovered. It should be noted that the 16 day period also was not "business days" but included a couple of weekends.

55 *ibid*, p. 3, para. 4

56 2000 CarswellQue 647 (S.C.C.)

57 *ibid*, p. 19, para 53

58 2003 CarswellBC 332 (BC. C.A)

59 *ibid*, p. 16, para. 41

One further case which I would suggest you refer to for a useful summary of the principles involved in these types of cases is the Court of Appeal's decision in *Zraik v. Lavesque Securities Inc.*⁶⁰ That case reaffirmed the trial judge's decision that there was no fiduciary duty attached to the brokerage relationship, although the clients action against the broker succeeded on the basis that the broker breached his contract by ignoring its own Supervisory Guide for Commodities Futures Accounts as well as other instructions. The trial judge found that there were a number of breaches of duty which constituted negligence. On the issue of fiduciary duty Finlayson, J.A. on behalf of the Court of Appeal found that:

*"The trial judge's findings destroy any basis for applying the criteria...to establish a fiduciary relationship in whole or in part. There was no relationship with the Defendants of dependency or vulnerability. Zraik monitored his own account closely and gave instructions for every trade. He sought advice but as we have seen he did not always follow it."*⁶¹

Further, the allegation that the brokerage firm should have closed down the Plaintiff's account before all of the losses were suffered and the trial judge should have constituted the brokerage firm a fiduciary with respect to the 'blue chip stocks' in his regular account was described by Finlayson, JA. as 'novel'.⁶²

According to Finlayson, JA.:

*"The consequences of contractual negligence cannot change the contractual relationship into an equitable one"... "there is no merit to this argument"*⁶³

The Court of Appeal did, however, allow the appeal by varying the Judgment to increase the damages to include his entire commodity trading loss.

We await the decisions of the Court of Appeal in the cases which I have noted are under appeal and hope that you will obtain some guidance regarding this interesting branch of the law from the review of the various authorities presented herein.

April 30, 2004

60 2002 Carswell Ont. 4468 (Ont. C.A.)

61 *ibid.*, p. 7, para 28

62 *ibid.*, p. 7, para. 29.

63 *loc.cit*