SUPERIOR COURT OF JUSTICE

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Date: July 12, 2017

RE: BARRY LAVENDER v. MILLER BERNSTEIN LLP
COURT FILE NO.: 05-CV-300430

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CITATION: Lavender v. Miller Bernstein, 2017 ONSC 3958
COURT FILE NO.: 05-CV-300430-CP
DATE: 20170712

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: Barry Lavender Plaintiff / Moving Party

AND:

Miller Bernstein LLP, Defendant / Responding Party

BEFORE: Justice Edward P. Belobaba

COUNSEL: *Daniel Bach, Paul Bates and Serge Kalloghlian* for the Plaintiff

Robert Staley, Gavin Finlayson and Nathan Shaheen for the Defendant

HEARD: June 27 and 29, 2017

SUMMARY JUDGMENT ON COMMON ISSUES

[1] This class action against the auditor of a defunct securities dealer was certified as a class proceeding in 2010. The representative plaintiff now moves for summary judgment on five of the six common issues.

[2] There is no serious dispute about the availability or appropriateness of summary judgment on the facts herein. I am confident that the five common issues before the court can be decided summarily without trial.

Background

[3] Buckingham Securities was a securities dealer that held the investments and savings of 1002 retail clients. On July 6, 2001, the Ontario Securities Commission ("OSC") placed Buckingham into receivership because it failed to segregate investor (class member) assets and maintain a minimum net free capital in breach of regulatory requirements. BDO Dunwoody ("BDO") was appointed receiver and manager of Buckingham's assets. Although the OSC intervened as soon as it learned of these

breaches, it was too late. The unsegregated assets had been appropriated and used by Buckingham for its own purposes. The class members lost some $10.6 million.[1]

[4] In 2004, the OSC initiated proceedings against Buckingham and several of its principals. The principals admitted that they failed to comply with Ontario securities law by making materially untrue statements in its 1999 and 2000 Form 9 reports. Form 9 reports were to be audited and filed each year with the OSC confirming the segregation of assets and the minimum capital. The Form 9s for fiscal years 1998, 1999 and 2000 were audited and filed by Buckingham's auditor, the defendant Miller Bernstein.[2]

[5] Disciplinary proceedings were brought by the OSC and the Institute of Chartered Accountants against the defendant and Howard Kornblum, the partner who audited and filed the false Form 9s. Mr. Kornblum admitted his conduct including the falsity of the Form 9s for fiscal years 1999 and 2000, but not for fiscal year 1998.

The class action

[6] The plaintiff commenced this class action in November, 2005 on behalf of every person who had an investment account with Buckingham on July 6, 2001 when the securities dealer was placed into receivership. In addition to the main class, two sub-classes were also certified: the first for the class members who corresponded directly with the defendant about discrepancies in their investment accounts; and the second for class members who corresponded with the defendant without referring to any discrepancies in their investment accounts. The sub-classes do not figure in any of the analysis herein.

[7] The plaintiff says that in each of fiscal years 1998 to 2000 the defendant auditor negligently signed off on Form 9 reports that falsely stated that Buckingham was in compliance with the segregation and minimum capital requirements. In doing so, the defendant breached the duty of care that it owed to the class members (as clients of Buckingham) causing more than $10 million in foreseeable losses for which the defendant is now liable.

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[1] The actual amount of the loss will need further clarification because of a court-approved distribution by the Receiver to class members in 2005 in the amount of $2.3 million. There are questions about the interest owing at that point on the $10.6 million and the consequent value of the 2005 distribution. For the purposes of the narrative herein and for ease of reference, I will continue to use the $10.6 million amount to describe the class members' overall loss as of July 6, 2001.

[2] The defendant auditor at the time in question was Miller Bernstein & Partners LLP not the named defendant Miller Bernstein LLP. The parties have advised that they are trying to resolve the misnomer matter on consent and are optimistic that this will be done shortly.

[8] The defendant rejects the plaintiff's characterization of what happened and asks that the common issues be answered in its favour. The defendant says the plaintiff is attempting to dress up a negligent misrepresentation claim as something else because he is unable to establish reliance; that no duty of care ("to the defendant auditor's client's clients") can be imposed on the facts of this case; that neither breach nor causation nor even damages can be established on the evidence that is before the court. The defendant asks that this motion for summary judgment be dismissed.

The common issues

[9] The five common issues that provide the focus for this summary judgment motion can be restated as follows:

(a) Was Buckingham required to segregate the cash and securities of the class member investors from its own cash and securities?

(b) Did Buckingham fail to do so?

(c) Did the defendant owe a duty of care to class members when it audited and filed the Form 9s?

(d) Did the defendant breach this duty of care?

(e) Was this breach of duty a cause of damages to the class members? If so, can such damages be determined on a class-wide basis? How should the damages be calculated?

[10] There was no real dispute about the first two questions – Buckingham was required to segregate client assets and failed to do so. I will explain this in more detail shortly. Nor was there much disagreement about the causation or damages questions, once these questions were canvassed with counsel during the hearing of the motion. The primary area of disagreement was the duty of care question - whether the defendant auditor on the particular facts of this case owed a duty of care to the class members.

[11] Before I turn to the five common issues, I will set out the analysis relating to the core question of duty of care.

The core dispute – duty of care

[12] This is not a negligent misrepresentation case. The plaintiff is not saying that the class members relied on or even saw the Form 9s – they did not. The plaintiff's claim is in negligence *simpliciter* – that the defendant owed and breached a duty of care causing foreseeable losses for which it should now be found liable.

[13] Canadian courts have explained that on certain facts it is possible for a plaintiff in a negligent misstatement case to proceed against the defendant on the basis of a simple negligence claim. For example, in *Yorkshire Trust Co.*,[3] Justice McLachlin, as she then was, cited with approval the following passage from a leading text on the law of misrepresentation.[4] The authors are discussing "misrepresentation giving rise to actions at the suit of persons other than the representee" and they note that "a very modern cause of action" is emerging – "the cause of action in negligence which arises from making a negligent misrepresentation in a situation in which a duty of care exists":

> In some of these situations there will be found to be a duty of care owed by the representor not only to the representee, but also to third parties; and where this is the case such a third party may have a cause of action notwithstanding that he is not the representee, and even in a case where he never had notice of the representation at all. But this cause of action, as will be seen, is not really an action for misrepresentation at all, but one *in negligence* in circumstances in which the negligence consists in making a representation without due care.[5]

[14] In *Lipson v. Cassels Brock*,[6] class members participated in an income tax reduction program which resulted in reassessments. The class members sued the law firm that provided the negligent tax opinion. The law firm argued that the plaintiff's negligence claim was a disguised negligent misrepresentation action that attempted to circumvent the reliance and causation requirements. The Court of Appeal explained why a free-standing claim for negligence could proceed:

> [T]he claim in simple negligence is distinct from [the plaintiff's] claim in negligent misrepresentation, which required proof of reliance on the opinion by individual class members in deciding to participate in the program. Framed in this way, the cause of action in simple negligence does not require a showing of reliance on the Cassels Brock opinion by individual class members. The allegation is that class members suffered damage because they participated in the program, which, but for Cassels

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[3] *Yorkshire Trust Co v. Empire Acceptance Corp.* [1986] B.C.J. No. 3254 (B.C.S.C.).

[4] Spencer Bower and Turner, *The Law of Actionable Misrepresentation*, (3rd ed.), at 395-6.

[5] *Ibid.*, at para. 12.

[6] *Lipson v. Cassels Brock*, 2013 ONCA 165.

> Brock's negligent opinion, would not have been marketed by the promoters and thus not available to class members.[7]

[15] Here as well, the plaintiff's negligence claim is based on the allegation that class members sustained losses which, but for the defendant's false audit of the Form 9s, would not have been sustained. If the defendant had filed accurate Form 9s documenting the regulatory breaches (or had not filed at all) the OSC, on the evidence, would in all likelihood have intervened before all the assets and monies were lost. In short, I am satisfied that on these facts and in principle that the negligence claim is appropriate.

[16] The more pressing issue is whether on the facts herein the plaintiff can establish a duty of care. This is a case about an auditor's misstatement that was filed with the OSC, was never seen by the class members, and arguably caused pure economic loss to the auditor's client's clients. This is obviously not a conventional negligence case. Nor is it sufficient for the plaintiff to say that the case fits within the "negligence performance of a service" category in which courts have recognized duties of care in certain third-party-benefit situations.[8] The underlying facts in the cases that have been grouped by academic commentators under the "negligent performance of a service" category are varied and the applicable law has not yet been uniformly articulated or accepted.[9]

[17] In any event, as the Supreme Court noted in *Martel*,[10] the categories of recovery in tort for pure economic loss, such as the 'negligence performance of a service' category, are "merely analytical tools" that may provide structure to the varied factual situations that can arise.[11] If the case (such as the case here) does not fall within a relationship that has been previously recognized as giving rise to a duty of care, the two-stage *Anns-Cooper*[12] analysis must be undertaken.[13]

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[7] *Ibid.*, at paras. 96 to 98.

[8] See generally Feldthusen, *Economic Negligence: The Recovery of Pure Economic Loss*, (6th ed., 2012) at 129 *et seq.* and the case law discussed therein.

[9] *Ibid.*

[10] *Martel Building Ltd. v. Canada*, [2000] 2 S.C.R. 860.

[11] *Ibid.*, at para. 45.

[12] *Anns v. Merton London Borough Council*, [1978] A.C. 728; *Cooper v. Hobart*, 2001 SCC 79.

[13] *Childs v Desormeaux*, [2006] 1 S.C.R. 643 at para. 15; *R v Imperial Tobacco*, [2011] 3 S.C.R. 45 at para. 38.

[18] The first stage of the *Anns-Cooper* analysis asks whether the facts disclose a sufficient level of foreseeability and proximity to establish a *prima facie* duty of care. The second stage of the analysis asks whether there are residual policy considerations that would justify denying liability in tort even though a *prima facie* duty of care has been established.[14] The onus at the first stage is on the plaintiff; at the second stage, on the defendant.[15]

Stage one – prima facie duty of care

[19] The first stage of the analysis, reasonable foreseeability and proximity (or neighborhood), requires the court to "evaluate the closeness of the relationship between the plaintiff and the defendant and to determine whether it is just and fair having regard to that relationship to impose a duty of care in law upon the defendant."[16] As the Supreme Court noted in *Hercules Management*,[17] the question of proximity, in essence, is "whether, as a matter of simple justice, the defendant may be said to have had an obligation to be mindful of the plaintiff's interests in going about his or her business."[18]

[20] Here on the evidence, I find that the foreseeability and proximity requirements are satisfied. Even though the class members never saw or even knew, at the time, about the Form 9s, the defendant auditor as a matter of simple justice had an obligation to be mindful of the plaintiff's interests when auditing and filing the Form 9 reports with the OSC.

[21] My analysis is based on the auditing standards applicable at the time and the evidence and admissions of the parties and their experts. The defendant understood that the Form 9s were used by the OSC to police the securities dealers and protect their investors. If the Form 9s indicated a breach of the segregation or minimum capital requirements, the OSC would intervene. If the defendant was negligent in its audit and filed false Form 9s, causing the OSC to believe that the securities dealer was in compliance with the regulatory requirements when the truth was otherwise, monies invested by clients of the securities dealer could well be lost. In short, the defendant (and in particular Mr. Kornblum) well understood the consequences to "its client's clients" if

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[14] *Imperial Tobacco, supra,* note 13, at para. 39.

[15] *J.(J.) (Litigation guardian of) v. C.(C.),* 2016 ONCA 718 at para. 34.

[16] *Cooper, supra,* note 12, at para. 34.

[17] *Hercules Management Ltd. v Ernst & Young,* [1997] 2 S.C.R. 165.

[18] *Ibid.,* at para. 28.

the segregation or capital deficiency information was misstated in the Form 9s - that a negligent audit of these Form 9s could expose the class members to the very loss that they incurred.

[22] The Supreme Court explained the relationship between foreseeability and proximity in *Imperial Tobacco*:[19]

> Proximity and foreseeability are two aspects of one inquiry - the inquiry into whether the facts disclose a relationship that gives rise to a *prima facie* duty of care at common law. Foreseeability is the touchstone of negligence law. However, not every foreseeable outcome will attract a commensurate duty of care. Foreseeability must be grounded in a relationship of sufficient closeness, or proximity, to make it just and reasonable to impose an obligation on one party to take reasonable care not to injure the other.[20]

[23] In my view, on the particular facts herein, a relationship of sufficient closeness has been established. The defendant was retained by Buckingham to audit and file the Form 9s. In doing this "assurance audit" for its client, the defendant had access to the individual names and investor accounts of every class member. The defendant knew the exact amounts involved, and even corresponded with some of the class members to verify that Buckingham's internal client account records were complete and accurate. Some of the class members responded to the auditor's letter and alerted the defendant to serious discrepancies between Buckingham's internal account records and the actual holdings and activity within their accounts. The defendant also knew, without being told, that even if the class members knew nothing about the Form 9s, they would reasonably expect Buckingham and its auditor to provide any information required under provincial law accurately and honestly, particularly if that information could affect their financial interests.

[24] I therefore have no difficulty concluding on the particular facts of this case, that it is just and reasonable to impose a *prima facie* duty of care on the defendant auditor. Tracking the language used by the Supreme Court in *Hercules Management,* I am satisfied that "as a matter of simple justice, the defendant [had] an obligation to be mindful of the plaintiff's interests in going about his or her business."[21]

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[19] *Imperial Tobacco, supra,* note 13.

[20] *Ibid.,* at para. 41.

[21] *Hercules Management, supra,* note 17, at para. 28.

[25] The plaintiff has established a *prima facie* duty of care under the first stage of the *Anns-Cooper* analysis.

Stage two – indeterminate liability

[26] The reason for stage two is especially important in cases such as this where the plaintiff's claim is for pure economic loss. The court's primary concern when imposing a duty of care in cases of pure economic loss is the spectre of indeterminate or unlimited liability.[22] Unlike physical injury or property loss claims that are almost always circumscribed, pure financial loss can materialize and spread quickly involving a wide range of direct and indirect claimants and exposing the defendant to unbounded liability. At stage two of the *Anns-Cooper* analysis, as the Court of Appeal noted in *CIBC v Deloitte*,[23] "[t]he overriding question is whether indeterminate liability can be shown not to be a concern on the facts of a particular case."[24]

[27] If the defendant can show that indeterminate liability is a genuine concern, the *prima facie* duty of care will be negated. However, if indeterminate liability cannot be established *on the facts of the particular case*, then a duty of care will be found to exist.[25]

[28] The case law has made clear that indeterminate liability will not be a concern under the second stage of the *Anns-Cooper* analysis in cases where the auditor knows the identity of the plaintiff (or a class of plaintiffs) *and* where the defendant's statements are used for the specific purpose for which they were made. Indeterminate liability will not be a concern if these facts are present because the defendant's scope of liability can be circumscribed. If the plaintiff-identity and specific-purpose conditions are satisfied the *prima facie* duty of care established at the first stage of the *Anns-Cooper* analysis will not be negated and a duty of care may properly be found to exist.[26]

[29] Here, on the uncontroverted evidence before me, both the plaintiff-identity and specific purpose conditions are satisfied. First, the defendant knew the names and addresses of each of Buckingham's clients at the time of its audits. It was also required, between audits, to stay informed of any major changes to Buckingham's business, such

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[22] *Mandeville v. Manufacturers Life Insurance Company*, 2014 ONCA 417 at para 173; *Hercules Management supra*, note 17, at para 31.

[23] *Canadian Imperial Bank of Commerce v. Deloitte & Touche*, 2016 ONCA 922.

[24] *Ibid.*, at para. 66.

[25] *Hercules Management, supra*, note 17, at 41.

[26] *Ibid.*, at paras. 30 and 37; *Deloitte, supra*, note 23, at para. 55.

as a significant change in customers, or the value of their accounts. The defendant therefore knew of the narrowly circumscribed class of people to whom it could be liable for a negligent audit. Second, the Form 9s on the facts herein were used for the very purpose for which they were prepared - to be relied on by the OSC in protecting investor (class member) assets.

[30] Further, the evidence shows that the defendant's potential monetary liability was also narrowly circumscribed. It knew its precise potential liability (the sum of all customer accounts) at the time of each audit, and it was required to stay informed of any major changes. Indeed, the plaintiff notes that the defendant's liability is actually much less today than it would have been at the time of the 2000 audit. The Form 9 for March 31, 2000 indicated that the aggregate value of customer securities at that time was approximately $47.7 million – more than four times the $10.6 million that was lost.

[31] One final point. The defendant's submission that it has statutory immunity under s. 141(2) of the OSA because it "intended" to comply with securities laws does not succeed. Section 141(2) provides as follows:

> No person or company has any rights or remedies and no proceedings lie or shall be brought against any person or company for any act or omission of the last-mentioned person or company done or omitted in compliance with Ontario securities law.

[32] This court made clear in *Sells v. Manulife*[27] that the immunity under s. 141(2) is only available to a defendant for acts or omissions that are "in compliance with Ontario securities law."[28] The defendant's filing of false Form 9s was obviously not in compliance with the OSA or the regulations thereunder, and thus s. 141(2) does not apply.

[33] In sum, I find that a *prima facie* duty of care has been established and has not been negated by any policy concerns of indeterminate liability. I find on the facts of this particular case that the defendant owed a duty of care to the class members.

[34] I will now answer each of the five common issues.

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[27] *Sells v Manulife*, 2014 ONSC 715.

[28] *Ibid.*, at para. 38.

The common issues answered

(a) Did the Securities Act, R.S.O. 1990, c. S.5 and the regulations thereunder require Buckingham to segregate the cash and securities of its clients from its own cash and securities?

[35] The answer to (a) is yes.

[36] The evidence is undisputed and the parties agree. As a registered securities dealer, Buckingham was required under the OSA and the regulations thereunder to segregate and hold in trust the cash and securities of the class on a client by client basis at all times.

(b) Did Buckingham fail to segregate its clients' cash and securities in violation of the OSA and, if so, when did Buckingham fail to do so?

[37] The answer to (b) is yes. Buckingham failed to segregate its clients' cash and securities at all times during its operation.

[38] The evidence shows that Buckingham never segregated its clients' cash and securities. In their settlement agreements with the OSC, Buckingham and its principals admitted that during the entire period of its registration as a securities dealer "Buckingham failed to segregate fully paid or excess margin securities owned by its clients and held in Buckingham's omnibus accounts with other brokerage firms." Mr. Kornblum also admitted that Buckingham failed to segregate at the time of the 1999 and 2000 Form 9s and he testified that Buckingham was "consistent" in the way it handled segregation prior to March 2000 (in other words, it did not segregate).

(c) Did the defendant owe a duty of care to the class and/or one or more of the sub-classes and what is the nature and extent of that duty?

[39] The answer to (c) is yes. Under the *Anns-Cooper* analysis, as set out above, the defendant owed a duty of care to the class to conduct an audit of Buckingham's Form 9 reports with the skill and care of a competent practitioner.

(d) If the answer to (c) is yes, did the defendant breach that duty of care to the class and/or one or more of the sub-classes, either negligently or recklessly?

[40] The answer to (d) is yes.

[41] The defendant signed audit reports addressed to the OSC for fiscal years 1998, 1999 and 2000, falsely stating that its examinations of the Form 9s "were made in accordance with generally accepted auditing standards and accordingly included such tests and other procedures as we considered necessary in the circumstances, including the audit procedures prescribed by the Ontario Securities Commission." The defendant has admitted that it breached its duty of care in the 1999 and 2000 Form 9 audits. The

uncontested opinion of the plaintiff's expert is that the defendant also breached its duty of care in the 1998 Form 9 audit. The defendant has not filed any expert evidence to rebut that opinion.

(e) If the answer to (d) is yes, was the defendant's breach of that duty a cause of damages to all of the class and/or all of one or more of the sub-classes?

[42] The answer to (e) is yes.

[43] The uncontested evidence is that shortly after the 1998 Form 9 was submitted, Buckingham was failing to segregate but had adequate net free capital. This means that if the OSC had intervened at that point to correct the segregation deficiency there would have been enough money to pay out all of Buckingham's clients in full. In other words, says the plaintiff, if the defendant had conducted a proper audit in 1998 there would have been no losses, based upon his admission that there were sufficient funds in 1998 and on the likelihood that the OSC would have (at a minimum) imposed segregation, protecting client assets on a go-forward basis.

[44] In any event, common issue (e) only asks whether the defendant's breach of the duty of care was *a* cause of the damages sustained by the class. It cannot be disputed that the defendant's filing of the false Form 9s was at least *a* cause of the losses sustained by the class members.

(e)(1) If the answer to (e) is yes, can such damages be determined on a class wide basis in respect of the class and/or one or more of the sub-classes?

[45] The answer to (e)(1) is no.

[46] The plaintiff has a "corrected spreadsheet" prepared by the Receiver that shows each individual class member's loss as of July 6, 2001. However, this corrected spreadsheet is not in the evidence that is before the court. There is therefore no evidence of the class members' actual losses, whether on an individualized or class-wide basis, and no proposed methodology for making this determination. The expert reports purporting to estimate aggregate losses do not assist because actual loss is needed to establish liability in a tort claim and aggregate damages cannot be used to establish actual loss/liability.[29] The answer to common issue (e)(1) must therefore be no.

[47] The plaintiff has indicated that it may bring a follow up motion for summary judgment based on this corrected spreadsheet. The defendant has cautioned the plaintiff

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[29] *Pro-Sys Consulting Ltd. v. Microsoft Corp.*, 2013 SCC 57 at paras. 128 and 135. Also see the discussion in *Kalra v. Mercedes Benz*, 2017 ONSC 3795 at paras. 48-50.

that if such a motion is brought, it will question both the contents of the corrected spreadsheet and the assessment of each class member's alleged loss. Needless to say, this motion is not before me today.

(e)(2) If the answer to (e)(1) is yes, how should the damages to be payable by the defendant be calculated?

[48] Given the answer to (e)(1), there is no need to answer (e)(2).

Conclusion

[49] The common issues, with the exception of damages, are answered in favour of the plaintiff. Buckingham Securities was required to segregate the class members' cash and securities and failed to do. The defendant owed a duty of care to the class members when it audited and filed the Form 9s and breached this duty of care. This breach of duty was a cause of the losses that were sustained herein. However, the class members' losses cannot be determined on the record before the court, whether on an individual or class-wide basis.

[50] The plaintiff has indicated that he may bring a follow-up motion based on the "corrected spreadsheet" so that these losses may be determined - but this remains to be seen.

Disposition

[51] The motion for summary judgment on the five common issues is granted. Common issues (a), (b), (c), (d) and (e) are answered "yes". Common issue (e)(1) is answered "no" and common issue (e)(2) is not answered.

[52] If the parties cannot agree on costs on a partial indemnity basis, I would be pleased to receive brief written submissions – from the plaintiff within 14 days and from the defendant within 14 days thereafter. The defendant is reminded that if it intends to challenge the reasonableness of the plaintiff's dockets, it should provide a certified copy of its own dockets showing the time expended on this motion.

[53] My thanks to counsel on both sides for their assistance.

Justice Edward P. Belobaba

Date: July 12, 2017