Beaulieu v. L.O.M. Western Securities Ltd.

Between
Guy Armand Beaulieu, Carol Lynn Kowk, Richard Case Millson,
Olusegun Oduwole, Dudley Stewart Smith and George Ampeff
Peychoff, Plaintiffs, and
L.O.M. Western Securities Ltd., Tom Cox and Denis W. Hayes,
Defendants

[1993] B.C.J. No. 1088
50 C.P.R. (3d) 113
40 A.C.W.S. (3d) 384
Vancouver Registry No. C911126

British Columbia Supreme Court
Vancouver, British Columbia
Cohen J.

Heard: February 9 - 12, 15 - 19 and 22, 1993.
Judgment: filed May 18, 1993.
(59 pp.)

Torts — Fiduciary duty — Brokers and agents — Duty of stockbrokers — Plaintiffs ordering shares in company through brokers underwriting offering — No allotment made to plaintiffs — Brokers not disclosing own allotments.

This was an action for damages for breach of fiduciary duty. The defendants were employed as stockbrokers at the defendant firm and were appointed as the exclusive agents of an offering of shares in W. Believing that the offering would be a good investment, the plaintiffs contacted the defendants. The plaintiffs claimed that they ordered shares in W from the defendants who agreed to fill the orders. The plaintiffs later discovered that they had received no allotment even though funds had been deposited. The defendants claimed to have considered each of the plaintiffs' orders but decided that they would not be allotted stock as it was not a suitable investment or not they were not considered to be good future client prospects. On inquiring the plaintiffs were told that the stock had been oversubscribed but they were not told that the defendants allotted units to themselves. The plaintiffs argued the defendants breached the fiduciary duty owed to them or alternatively breached the contract. The defendants argued that there was no guarantee or confirmation of allotment. At issue was whether there was an agreement to sell and buy the units, whether a fiduciary duty was owed by the defendants and if so what damages were to be awarded.

HELD: The action was allowed. The defendants were liable for breach of a fiduciary duty. The defendant firm was vicariously liable to the plaintiffs. No agreement existed between the parties whereby the defendants agreed to deliver stock to the plaintiffs. The plaintiffs made

offers to purchase by placing the orders which were never accepted. However, a fiduciary duty arose once the relationship of broker and client was formed. The defendants were more than order-takers given the risks involved. The legal relationship of broker and client was fiduciary, namely one of agent and principal. The broker was not entitled, without full knowledge and assent of client, to place himself in a position where personal interest conflicted with client's. Defendants' fiduciary obligations extended to the allotment process. They failed in their duty by opening accounts, accepting funds and receiving confidential information in circumstances where plaintiffs placed funds in trust and trusted defendants to use best efforts to carry out instructions. As broker in a fiduciary relationship, the defendants were obliged to ensure best interests of clients and not allow personal interests to conflict unless made fair disclosure. Damages were measured by an assessment of losses flowing from breach as of time of breach. Damages flowing from breach were the difference between market price of stock at time of discovery of breach and original unit price. Damages limited to compensatory damages only, not punitive, as fair and appropriate remedy.

Counsel for the Plaintiffs: D.A. Hobbs.
Counsel for the Defendants: J.B. MacLean.

COHEN J.:—

I. BACKGROUND

The plaintiffs claim damages against the defendants for breach of fiduciary duty, alternatively for breach of contract and, further alternatively, for negligence. The plaintiffs' claim arises out of dealings between the plaintiffs and defendants in connection with the primary distribution of stock in a company called Waterford Resources Inc. ("Waterford").

Prior to contacting the defendants about purchasing stock in Waterford, the plaintiffs had either heard about Waterford from Jeff Trafford ("Trafford"), a stockbroker, or from each other. They each thought that purchasing stock in Waterford would be a good investment. When Trafford's firm withdrew from the underwriting, he referred several of the plaintiffs to the defendant, L.O.M. Western Securities Ltd. ("L.O.M.") (now Canaccord Capital Corporation) who had taken over the underwriting.

The defendants, Tom Cox and Denis Hayes ("Cox" and "Hayes"), stockbrokers employed at L.O.M., were the lead brokers on the Waterford underwriting. The underwriting was made through an Agency Offering Units Agreement (the "Agreement") dated February 21, 1990. According to the Agreement, Waterford was the "Issuer" and L.O.M. the "Agent". By the Agreement, Waterford appointed L.O.M. as its exclusive agent to offer 800,000 units comprised of one share and two warrants for sale pursuant to the Prospectus. The offering was to be made through the facilities of, and in accordance with, the rules and policies of the Vancouver Stock Exchange ("V.S.E.").

The final Prospectus provides, inter alia, that L.O.M. conditionally offers the securities subject to prior sale, if, as and when issued by Waterford, and accepted by L.O.M., in accordance with the conditions contained in the Agreement, and that the offering was made in accordance with the rules and policies of the V.S.E. on a day determined by L.O.M. and Waterford.

The Waterford issue was a V.S.E. listed initial public offering ("I.P.O."). According to defence counsel's brief of argument, the allotment process by which a primary distribution of shares is made to the public through the V.S.E. by way of an I.P.O. is as follows:

(a) a preliminary Prospectus is filed with the Superintendent of Brokers ("Superintendent");

(b) consequent to the filing of the preliminary Prospectus, deficiencies are noted and required to be cured by the Superintendent and further disclosure, if necessary, is made by way of amendment to the preliminary Prospectus;

(c) a final Prospectus is "receipted" by the Superintendent;

(d) an offering day is arranged with the V.S.E. and certain V.S.E. requirements are satisfied;

(e) the issuer, through its underwriter, draws up a "book" of initial subscribers;

(f) the securities offered by way of I.P.O. are transferred from the issuer to the subscribers and the company's shares are listed on the V.S.E. and posted for trading; and

(g) subsequent auction trading on the V.S.E. is referred to as the "after-market" or "secondary trading". The period between the receipting of the preliminary Prospectus and the receipting of the final Prospectus by the Superintendent is referred to as the "waiting period". During the waiting period, no trades in the security are permitted. A trade includes the receipt by a broker of an offer to purchase the securities.

The V.S.E. requires that the subscribers list contain at least 200 names each holding at least 1,000 shares. The total number of stock required to be held by that group is 300,000 shares.

Initially, the Waterford I.P.O. was an offering of 600,000 shares at $0.40 per share. The final amended Prospectus, under which the offering was 800,000 units each consisting of one share and two warrants at a price of $0.45 per unit, was receipted by the Superintendent on May 15, 1990. The units offering day on which the units were transferred to the initial subscribers and the securities of Waterford were posted and listed for trading on the V.S.E. was May 25, 1990.

The plaintiffs each contend that they ordered shares in Waterford from Cox and Hayes and that there was an agreement by Cox and Hayes to fill their orders. The plaintiffs did not receive an allotment of any stock in Waterford. They later learned that Cox took down 50,000 units and 50,000 units were allotted to Hayes' wife. The plaintiffs claim that the defendants' failure to fill

their orders for Waterford stock was a breach of fiduciary duty or, alternatively, a breach of agreement.

Each of the plaintiffs had initial telephone contact with Cox and Hayes (mainly Cox) in the months of February and March 1990. These initial conversations all took place prior to the receipt of the amended Prospectus, by which the Waterford offering became a units offering. Prior to opening an account at L.O.M. for each of the plaintiffs, with the exception of the plaintiff, Dr. Olusegun Oduwole ("Dr. Oduwole"), Cox filled out a New Client Application form which included information about the plaintiffs' ages, net worth, investment objectives, etc. Cox testified that this form was filled out in order to know his clients and that it was standard procedure to get as much information as possible about an individual to determine if the person was a suitable candidate for the investment. Hayes filled out this form for Dr. Oduwole. As well, each of the plaintiffs received a Client Account Agreement form and all but the plaintiffs, Guy Armand Beaulieu ("Beaulieu") and Carol Lynn Kowk ("Kowk"), signed and returned the forms to L.O.M. The form states, in the preamble and paragraph 1:

> "In consideration of your acting as brokers and at my request and at the request of the undersigned, opening an account for the purchase and sale of shares, bonds, debentures, notes or rights with respect thereto or the purchase or sale of any contract for or in relation to commodities (all hereinafter called "securities"), the undersigned hereby agrees:
>
> 1. That all transactions with respect to securities made by you for the undersigned shall be subject to the constitution, by-laws, rules, rulings, regulations, customs and usages of the exchange or market, and its clearing house, if any, where made, and regulatory authority that may be applicable (collectively the "Regulatory Requirements") and the undersigned acknowledges that none of your registered representatives or other employees are authorized or will be authorized by you to conduct any transaction contrary to any of the Regulatory Requirements so that you will not bear any responsibility or incur any liability with respect to any unauthorized transaction conducted by your registered representatives or other employees."

All of the plaintiffs testified that they understood themselves to be bound by the terms of the Client Account Agreement. Although requested of all the plaintiffs, only the plaintiffs, Dudley Stewart Smith ("Smith"), George Ampeff Peychoff ("Peychoff"), Dr. Oduwole and Dr. Richard Case Millson ("Dr. Millson"), deposited funds into their accounts at L.O.M. to be applied to the purchase of the Waterford stock ordered by them from Cox and Hayes. Cox said the reason for requesting the funds was to have a showing of good faith on the part of the plaintiffs.

During the waiting period, the plaintiffs frequently telephoned Cox and Hayes inquiring about when the Waterford issue would be trading. They did not make any inquiries about the process for allotment of the stock nor did Cox or Hayes tell the plaintiffs that they, their relatives, friends or fellow employees would compete with the plaintiffs for the stock, or that the offering was oversubscribed or that there were any criteria the plaintiffs had to meet to receive

their orders or that, according to the customs and usages of the V.S.E., Cox and Hayes could take stock in priority to the plaintiffs or fill their "best" clients' orders in priority to the plaintiffs' orders.

According to Cox and Hayes, on May 24th they considered each of the plaintiffs' orders and decided that none of them would be allotted stock in Waterford. They did not think it was a suitable investment for Dr. Oduwole because, in their view, he was too naive. As for the other plaintiffs, they did not consider them to be good prospects as future clients and, therefore, did not want to do business with them on the Waterford offering.

Each of the plaintiffs learned within a few days of May 25th, the day Waterford started trading, that no stock had been allotted to them. When they contacted Cox and Hayes about their orders, they were told that they had not been allotted any stock because the issue was oversubscribed and there was not enough stock to go around. They were not told who received stock, most particularly, that Cox and Hayes had taken down 100,000 units (50,000 to Cox and 50,000 to Hayes' wife).

The plaintiffs wrote to Cox complaining about the fact that their orders were not filled and giving notice that failure to deliver on their orders would result in legal action. They heard back, by letter, from L.O.M.'s Compliance Department. L.O.M. took the position that Cox did not guarantee their orders nor confirm an allotment to them nor was he under any obligation to do so. The letter stated that the issue was "heavily oversubscribed" and, as Cox had previously advised them, "L.O.M. was unable to accommodate all of the orders received". The letter said that L.O.M. had been unable to substantiate any violation and, accordingly, no adjustment could be made to their accounts.

The plaintiffs also complained to the V.S.E. In September 1990, the plaintiffs heard by letter from the Investigative Services Manager that the V.S.E. was unable to substantiate any violations of V.S.E. requirements. The plaintiffs did not appeal this finding.

Plaintiffs' counsel submitted that the V.S.E. brokerage community should be concerned about the facts of this case and should receive a message from this Court not to engage in the kind of conduct displayed by Cox and Hayes towards the plaintiffs. He was highly critical of the V.S.E. for its investigation of the plaintiffs' complaint, submitting that the investigation was little more than a sham focusing narrowly on whether V.S.E. Rule C.1.16 (Client Priority Rule) (the "Rule") applied to I.P.O.'s and not considering fully whether Cox and Hayes had offended other rules or regulations of the V.S.E. or the Investment Dealers Association relating to conflicts of interest.

Those plaintiffs who had sent in cheques to cover their orders had their funds returned by L.O.M. The plaintiffs now seek an accounting of the profits earned by the defendants in the course of the Waterford offering and from their purchase and sale of the units and claim compensation for their loss of profits foregone, general and special damages, punitive, exemplary and aggravated damages, interest and costs.

II. ISSUES

In my opinion, the only issues for me to decide are:

1. Was there an agreement between the plaintiffs and the defendants whereby the defendants agreed to sell and the plaintiffs agreed to buy units in the capital stock of Waterford?
2. Did the defendants owe a fiduciary duty to the plaintiffs and, if so, were the defendants in breach of that duty?
3. If the defendants were in breach of agreement or breach of fiduciary duty, what are the plaintiffs' damages?

III. DECISION

The defendants, Cox and Hayes, are liable to the plaintiffs for breach of fiduciary duty. The defendant, L.O.M., is vicariously liable to the plaintiffs.

IV. LIABILITY

1. The plaintiffs allege that the defendants were in breach of agreement for failure to deliver Waterford stock to them. In my opinion, no agreement existed between the parties whereby the defendants agreed to deliver Waterford stock to the plaintiffs.

At best, on the evidence, the plaintiffs placed orders with Cox and Hayes for the purchase of Waterford stock. The plaintiffs' offers to purchase Waterford stock was never accepted by L.O.M., as agent for Waterford.

Beaulieu testified that in March 1990 he understood that L.O.M. was selling shares on behalf of Waterford; that this was the first time the shares would be sold to the public; that when he ordered the shares from Cox he had not purchased the shares; that the issue had to receive regulatory approval; and, that the terms of the offering were as set out in the Prospectus. He said he understood that the offering was units comprised of one share and two warrants. When asked by defence counsel whether Cox guaranteed delivery of the units, Beaulieu said that Cox did not use the word "guarantee" or give him an assurance of delivery.

Peychoff testified that he understood he had placed an order for 10,000 shares. He believed that prior to May 1990 someone mentioned warrants to him. He said that he assumed he was putting in an order and that the defendants would fill it, not try to fill it. He was not aware at the time that L.O.M. was an agent for someone else or that conditions had to be met before L.O.M. could fill his order. He agreed that Cox and Hayes never told him definitely that he would be getting the shares he ordered, except, he said, by the positive tone of their conversations. He said they may have mentioned partial delivery, but they did not indicate he would be shut out.

Smith testified that he told the defendants that he was interested in purchasing 1,000 shares. He said, in cross-examination, that there was a possibility that Cox had told him that any orders for shares in big numbers may have to be allotted arbitrarily.

Kowk testified that Cox gave her the impression that she was going to get the shares she had ordered but said that she knew, after her conversation with Cox, that she had not completed a purchase of the shares.

Dr. Millson said, in chief, that there was no suggestion from Cox of uncertainty as to how many shares he might receive. He conceded that he had bought stock in an I.P.O. in 1983 so he knew of the possibility of a shortage. He said he asked Cox about it and Cox said "no problem". He claimed that he was not aware of the change in the offering from shares to units. In cross-examination, he denied defence counsel's suggestion that he would have said to Cox, when he called him after the trading date, "I would like to sell my stock, how many shares did I get?", insisting that this was something Cox invented. However, he was asked on discovery "Are you able to deny saying 'I would like to sell my stock. How many shares did I get?'" and answered that it was possible he said those words. He also agreed on discovery that when he phoned Cox, after he learned that the shares were trading, he may have wondered how many shares he had received. He testified that he knew the shares in Waterford were to be the first shares sold by Waterford to the public through L.O.M.; that in speaking to Cox he was trying to purchase shares in Waterford through L.O.M.

Dr. Oduwole testified that he told Hayes he was interested in purchasing some Waterford stock. He said that the defendants did not say anything about whether his order would be filled or whether he would get the number of shares he had ordered. He said that it was his impression that he was going to get his subscription filled. He was never told at any time that there would be a problem filling his order. At no time before the trading date did he know that the offering had changed from shares to units.

Cox testified that when Smith called him about purchasing 1,000 shares he told Smith he would see what he could do for him. He did not guarantee or promise Smith an allotment of shares. He did not guarantee to Peychoff that he would fill his order or confirm an allotment of shares to him. When Dr. Millson called him and said he was interested in purchasing shares, he told Dr. Millson that he would put him on the list and see what he could do for him. He did not guarantee Dr. Millson that he would get his order filled, or confirm an allotment of shares to him. Cox said that he told Dr. Millson that the offering had changed from shares to units and that when he told him this he reiterated that he could not guarantee him any stock and that he would see what he could do for him. He did not guarantee or confirm to Dr. Oduwole that he would receive shares or confirm an allotment of shares to him. In the case of Beaulieu, Cox denied that Beaulieu ordered 10,000 shares. When Beaulieu called, Cox said that he would see what he could do for him and told him that the best he could do was "maybe get 1,000 shares". He told Beaulieu that the offering had changed from shares to units.

In cross-examination, Cox acknowledged, as true, his discovery answer that he told the plaintiffs that he and Hayes would make final allotments. Cox agreed that he told the plaintiffs that "basically what it amounted to was that we make the final allotments, if you receive shares, it would be based on the final allotment after taking everything into consideration."

While based on their conversations with the defendants, the plaintiffs may have been optimistic that each would have their order filled, I am satisfied, on the evidence, that each knew they had not purchased Waterford stock but, rather, had merely placed an order for the purchase of stock in Waterford through L.O.M. It is clear that the defendants never guaranteed or

promised delivery of Waterford stock to the plaintiffs. In my opinion, there was no evidence of an acceptance by the defendants to the plaintiffs' offer to purchase Waterford stock and hence no agreement as alleged by the plaintiffs.

2. Having found that the plaintiffs did not have an agreement with the defendants for the purchase of Waterford stock, I turn then to consider whether, in failing to allot any stock to the plaintiffs, the defendants were in breach of fiduciary duty to the plaintiffs.

Plaintiffs' counsel argued that this is not a case about advice, but rather about clients placing their trust and confidence in a broker, forming a fiduciary relationship with that broker and then finding out that the broker had taken an opportunity to himself, the very opportunity that the broker understood he was asked to take up on behalf of the clients. He argued that the plaintiffs had no opportunity to control what happened on the allocation of the units and that the plaintiffs were singularly vulnerable to that situation. According to him, the defendants breached their duty to the plaintiffs by themselves taking an opportunity which they promised to pursue on behalf of the plaintiffs. He said that the conflicts in this case were many and were not disclosed to the plaintiffs.

Defence counsel argued that it may be there were some agent-principal aspects to the parties' relationship, but those aspects were narrowly constrained, if they existed at all. He contended that perhaps the opening of the accounts and the receipt of the plaintiffs' funds created some duties on the defendants but argued that those duties would be limited to not stealing the plaintiffs' funds and not using their funds for a purpose other than applying those funds to the purchase of Waterford stock, if such a purchase ever took place. He said that, in essence, the defendants were a mere conduit for those funds, if they were to be utilized, and in order to be a conduit, the opening of the accounts and receipt of funds had to be arranged in advance against the possibility of an allotment of stock to the plaintiffs. He contended that the opening of the accounts set up a mechanism whereby the plaintiffs might engage Cox and Hayes to undertake transactions on their behalf, but in fact no transactions took place for them. Defence counsel said that the defendants' duty was to see that Waterford considered the plaintiffs' offers and, in fact, this is what happened. He argued that the interests of the plaintiffs and the limited duties of the defendants did not conflict.

Notwithstanding that each of the plaintiffs had made up their minds to invest in Waterford before they contacted Cox and Hayes; that they did not seek or rely upon investment advice from the defendants; that they knew that L.O.M. was the exclusive agent for the primary distribution of Waterford stock; and, that their only motive in dealing with the defendants was to purchase stock in the Waterford I.P.O., the plaintiffs' claim that the defendants were in breach of fiduciary duty to them. They base their claim on the fact that they thought Cox and Hayes were dealing fairly with them and would make best efforts to fill their orders. They allege that Cox and Hayes were involved in a conflict of interest by competing with them in the Waterford offering and by their failure to disclose this conflict.

The defence to the plaintiffs' allegation of a breach of fiduciary duty rests on three main branches of argument. The first position of the defendants is that there was no transaction between the parties in which the defendants acted as brokers and the plaintiffs acted as clients which gave rise to the duty alleged by the plaintiffs. Defence counsel likened the relationship between the parties as analogous to a prospective purchaser dealing with a vendor's agent at an

open house. He contended that there would be nothing in that relationship to preclude the vendor's agent from seeking out other offers to purchase and assisting the vendor to weigh the offers nor, for that matter, anything to prevent the agent from making an offer to the vendor without disclosing the offer to the prospective purchaser. According to defence counsel, in the circumstances of this case, the only duty resting on the defendants to the plaintiffs was limited to not stealing the plaintiffs' funds held in trust by the defendants and to return those funds or properly apply those funds to the purchase of the stock, and deliver the stock, in the event that the plaintiffs' orders were filled. The problem with this position is that it does not accord with the facts.

In his discovery, and at trial, Cox took the position that he did not view the plaintiffs as clients. He said that the plaintiffs were only interested in acquiring stock in Waterford and that despite his aggressive efforts to solicit more business from them, he never established a working relationship with any of the plaintiffs. In his opinion, opening up accounts for them and receiving their funds did not make them L.O.M.'s clients. Similarly, Hayes, who did not testify at trial, said on discovery that he did not consider the plaintiffs to be L.O.M.'s clients, although he did say that to the extent accounts were opened for them they were clients. However, Ward McMahon, L.O.M.'s Vice-President Compliance, said on discovery that L.O.M. considered the plaintiffs to be clients of L.O.M. and at trial, he testified, in cross-examination, that the plaintiffs had opened accounts with L.O.M. and were "technically" clients.

In my opinion, there was nothing "technical" about the relationship between the plaintiffs and defendants. The plaintiffs were clearly clients of the defendants and the defendants were the plaintiffs' brokers. This is confirmed by the opening of an account for each plaintiff, filling out a New Client Application form for each plaintiff during which process Cox and Hayes requested, and received, confidential information about each plaintiff and, finally, the Client Account Agreements which, except for Beaulieu and Kowk, were signed by each plaintiff and returned to the defendants. The preamble to the Agreement is clear, it says, inter alia:

> "In consideration of your acting as brokers..."

There is no doubt in my mind that the relationship between the plaintiffs and defendants was that of broker and client. This brings me then to the next branch of the defendants' argument.

I think it is now trite law that the legal relationship of broker and client is a fiduciary one, that of agent and principal, and therefore, a broker is not entitled, without the full knowledge and assent of the client, to place himself in a position where his interest conflicts with that of his client.

The application of the fundamental principle of agency law, that an agent shall not place his interest in a position of conflict with the interest of his principal without making full disclosure, to the relationship of broker and client is set out at pp. 269-270 of Reed v. McDermid St. Lawrence Ltd. and Hope (1990), 52 B.C.L.R. (2d) 265 (B.C.C.A.):

> "The relationship of stockbroker to client is that of agent and principal. Evans J.A., as he then was, put it in R.H. Deacon & Co. v. Varga [1973] 1 O.R. 233, 30 D.L.R. (3d) 653 at 659-60, 1 N.R. at 80, appeal dismissed [1975] 1 S.C.R. 39, 41 D.L.R. (3d) 767, 1 N.R. 79:

'The duties owed by a stockbroker towards his client were stated by Riddell, J., in Johnson v. Birkett (1910), 21 O.L.R. 319, and adopted by McRuer, C.J.H.C., in Scherer v. Zacks, [1952] O.W.N. 341 at p. 344, [1952] 4 D.L.R. 503 at pp.
506-7, as follows:

(a) He is the same as any other agent acting for a principal.

(b) He has a duty to act in the interest of the principal.

(c) He is not permitted to allow his personal interests to conflict with the interest of the principal unless he has made full and fair disclosure of all material facts relative to the transaction and his interest in the transaction.'

The primary duty of an agent is to carry out the instructions of his principal and the finding in this case is that it did so. The duty of disclosure arises when there is a conflict of interest between the principal and agent or where the principal has imposed such a term in the agency agreement. If the principal authorizes his agent to act imprudently or if he acts upon his own decision without relying on his agent's advice then he cannot complain about any resulting loss: Commerce Realty Ltd. v. Olenyk and Olenyk (1957), 8 D.L.R. (2d) 60. Mr. Starr also argued that there was a legal duty on the broker to investigate the financial status of the customer and to protect him against improvident stock transactions. I know of no authority for such a startling proposition Mr. Starr did not cite any and his arguments did not convince me. [emphasis added].'

The respondent's counsel says that the passage emphasized does not

> correctly state the law of British Columbia. He referred to what is known in the trade as the "know your client" rule. In our opinion, the passage emphasized is as much the law of British Columbia as it is of Ontario."

The concept of "fiduciary" was thoroughly examined by La Forest and Sopinka JJ. in LAC Minerals Ltd. v. International Corona Resources Ltd. (1989), 61 D.L.R. (4th) 14 (S.C.C.). Sopinka J., concluding that a fiduciary relationship did not arise between LAC and Corona, said as follows at pp. 61-63 about the creation of fiduciary relationships:

> "While equity has refused to tie its hands by defining with precision when a fiduciary relationship will arise, certain basic principles must be taken into account. There are some relationships which are generally recognized to give rise to fiduciary obligations: director-corporation, trustee-beneficiary, solicitor-client, partners, principal-agent, and the like. The categories of relationships giving rise to fiduciary duties are not closed nor do the traditional relationships invariably give rise to fiduciary obligation. As pointed out by Dickson J. in Guerin v. The Queen, supra, p. 341:
>
> > 'It is sometimes said that the nature of fiduciary relationships is both established and exhausted by the standard categories of agent, trustee, partner, director, and the like. I do not agree. It is the nature of the relationship, not the specific category of actor involved that gives rise to the fiduciary duty. The categories of fiduciary, like those of negligence, should not be considered closed...'.
> >
> > The nature of the relationship may be such that, notwithstanding that it is usually a fiduciary relationship, in exceptional circumstances it is not. See J.C. Shepherd, The Law of Fiduciaries (1986), at pp. 21-2. Furthermore, not all obligations existing between the parties to a well-recognized fiduciary relationship will be fiduciary in nature. Southin J. in Girardet v. Crease & Co. (1987), 11 B.C.L.R. (2d) 361 (S.C.), observed that the obligation of a solicitor to use care and skill is the same obligation as that of any person who undertakes to carry out a task for reward. Failure to do so does not necessarily result in a breach of fiduciary duty but simply a breach of contract or negligence. She issued this strong caveat against the overuse of claim for breach of fiduciary duty (at p. 362):
> >
> > 'Counsel for the plaintiff spoke of this case in his opening as one of breach of fiduciary duty and negligence. It became clear during his opening that no breach of fiduciary duty is in issue. What is in issue is

whether the defendant was negligent in advising on the settlement of a claim for injuries suffered in an accident. The word "fiduciary" is flung around now as if it applied to all breaches of duty by solicitors, directors of companies and so forth. But "fiduciary" comes from the Latin "fiducia" meaning "trust". Thus, the adjective, "fiduciary" means of or pertaining to a trustee or trusteeship. That a lawyer can commit a breach of the special duty of a trustee, e.g., by stealing his client's money, by entering into a contract with the client without full disclosure, by sending a client a bill claiming disbursements never made and so forth is clear. But to say that simple carelessness in giving advice is such a breach is a perversion of words. The obligation of a solicitor of care and skill is the same obligation of any person who undertakes for reward to carry out a task. One would not assert of an engineer or physician who had given bad advice and from whom common law damages were sought that he was guilty of a breach of fiduciary duty. Why should it be said of a solicitor? I make this point because an allegation of breach of fiduciary duty carries with it the stench of dishonesty if not of deceit, then of constructive fraud. See Nocton v. Lord Ashburton, [1914] A.C. 932 (H.L.). Those who draft pleadings should be careful of

words that carry such a connotation.'
When the court is dealing with one of the traditional relationships, the characteristics or criteria for a fiduciary relationship are assumed to exist. In special circumstances, if they are shown to be absent, the relationship itself will not suffice. Conversely, when confronted with a relationship that does not fall within one of the traditional categories, it is essential that the court consider: what are the essential ingredients of a fiduciary relationship and are they present? While no ironclad formula supplies the answer to this question, certain common characteristics are so frequently present in relationships that have been held to be fiduciary that they serve as a rough and ready guide. I agree with the enumeration of these features made by Wilson J. in dissent in Frame v. Smith (1987), 42 D.L.R. (4th) 81, [1987] 2 S.C.R. 99, 9 R.F.L. (3d) 225. The majority, although disagreeing in the result, did not disapprove of the following statement, at pp. 98-9:

'A few commentators have attempted to discern an underlying fiduciary principle but, given the widely divergent contexts emerging from the caselaw, it is understandable that they have differed in their analyses: see, for example, E. Vinter, A Treatise on the History and Law of Fiduciary Relationships and Resulting Trusts, (3rd ed. 1955); Ernest J. Weinrib, "The Fiduciary Obligation" (1975), 25 U.T.L.J. 1; Gareth Jones, "Unjust Enrichment and the Fiduciary's Duty of Loyalty" (1968), 84 L.Q.R. 472; George W. Keeton and L.A. Sheridan, Equity (1969), at pp. 336-52; Shepherd,

supra, at p. 94. Yet there are common features discernible in the contexts in which fiduciary duties have been found to exist and these common features do provide a rough and ready guide to whether or not the imposition of a fiduciary obligation on a new relationship would be appropriate and consistent.

Relationships in which a fiduciary obligation have been imposed seem to possess three general characteristics:

(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.

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

It is possible for a fiduciary relationship to 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.

The one feature, however, which is considered to be indispensable to the existence of the relationship, and which is most relevant in this case, is that of dependency or vulnerability. In this regard, I agree with the statement of Dawson J. in Hospital Products Ltd. v. U.S. Surgical Corp., supra, at p. 488, that:

'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.'

The necessity for this basic ingredient in a fiduciary relationship is underscored in Professor Weinrib's statement, quoted in Guerin, supra, at p. 340 that:

'[T]he hallmark of a fiduciary relationship is that the relative legal positions are such that one party is at the mercy of the other's discretion.'"

[Emphasis Mine]

In Sopinka J.'s opinion, the vital ingredient in the creation of a fiduciary relationship is that of vulnerability.

The point about vulnerability was also made in Hodgkinson v. Simms (1992), 65 B.C.L.R. (2d) 264 where, at p. 272, McEachern C.J.B.C., after referring to the decision in LAC, supra, said:

> "What first emerges out of the judgment of Sopinka J. is that a fiduciary duty must arise out of the relationship of the parties prior to the breach and not out of the conduct of the alleged fiduciary in the breach."

After noting Sopinka J.'s reference to Wilson J. in Frame v. Smith, the Chief Justice said at p. 273:

> "I conclude from the foregoing that, at bottom, as the English judges often say, the most significant characteristic of a fiduciary relationship is the vulnerability of the beneficiary arising most often out of the authority which the fiduciary actually has or acquires over the property or opportunities of the former."

On the other hand, in LAC, supra, La Forest J., concluding that Corona was vulnerable to LAC, disagreed with his brother Sopinka that vulnerability, or its absence, will conclude the question of fiduciary obligation, saying that the issue should be "whether, having regard to all the facts and circumstances, one party stands in relation to another such that it could reasonably be expected that other would act or refrain from acting in a way contrary to the interests of that other." He identified three ways the term fiduciary is used. First, where there is the class of relationship which gives rise to fiduciary obligations (i.e. the case at Bar, agent-principal). Second, where the duty can arise as a matter of fact out of the specific circumstances of a relationship and third, where the Courts have resorted to fiduciary language because of the view that certain remedies, deemed appropriate in the circumstances, would not be available unless a fiduciary relationship was present.

As, in my opinion, the relationship between the plaintiffs and defendants was that of broker and client, I must now explore whether the fiduciary obligations of the defendants arising out of that relationship extended to the allotment of the Waterford stock by Cox and Hayes. On the point of fiduciary obligations, at pp. 28-29 of LAC, supra, La Forest J. said:

> "Much of the confusion surrounding the term "fiduciary" stems, in my view, from its undifferentiated use in at least three distinct ways. The first is as used by Wilson J. in Frame v. Smith. There the issue was whether a certain class of relationship, custodial and non-custodial parents, were a category, analogous to directors and corporations, solicitors and clients, trustees and beneficiaries, and agents and principals, the existence of which relationship would give rise to fiduciary obligations. The focus is on the identification of relationships in which, because of their inherent purpose or their presumed factual or legal incidents, the courts will impose a fiduciary obligation on one party to act or refrain from acting in a certain way. The obligation imposed may vary in its specific substance

> depending on the relationship, though compendiously it can be described as the fiduciary duty of loyalty and will most often include the avoidance of a conflict of duty and interest and a duty not to profit at the expense of the beneficiary."

[Emphasis Mine]

The defence position is that if a fiduciary relationship is found to exist in the case at Bar, that relationship did not suffuse the entire dealings between the parties. Defence counsel argued that the fiduciary nature of the relationship did not extend to the allotment of the Waterford stock, contending that the element of vulnerability was missing in this case. He claimed that, insofar as the allotment process was concerned, the relationship between the parties was that of offeror-offeree, that L.O.M., as agent for Waterford, could accept or reject the plaintiffs' offers to purchase stock in Waterford. He submitted that the vulnerability of the plaintiffs to the defendants, such as it was, was the same vulnerability of any offeror to an offeree, that the offer may be rejected, not the kind of vulnerability discussed in LAC or Simms.

In Reed v. McDermid St. Lawrence, supra, the Court, at pp. 270-271, said:

> "But the client's relationship with the broker may give rise to higher obligations on the part of the broker if the client, by words or deeds, make such obligations part of the relationship and the broker accepts those obligations. As an example, a stockbroker can stand in a fiduciary relationship to a client but not all stockbrokers do: see Elderkin v. Merrill Lynch, Royal Securities Ltd. (1977), 80 D.L.R. (3d) 313, 22 N.S.R. (2d) 218, 31 A.P.R. 218 (C.A.). However, if the client says to the broker: "I am minded to buy X,Y,Z, is there any reason why I should not?" And if the broker says "no" when he knows the company is about to make an assignment in bankruptcy, he would be liable for breach of his contractual duty quite apart from any question of fiduciary duty. McFarlane J.A. in Central B.C. Planers Ltd. v. Hocker, 72 W.W.R. 561, 10 D.L.R. (3d) 689, affirmed [1971] 5 W.W.R. 89, 16 D.L.R. (3d) 368n (S.C.C.), said very simply each case depended on its own particular circumstances.
>
> The extent of the duty of broker to client beyond the bare duty of executing instructions and being honest is thus a question of fact in each case of what passes between broker and client."

Throughout the trial, and in his final argument, defence counsel attempted to characterize Cox and Hayes as being merely order takers. However, the evidence establishes that not only were they not mere order takers but that they were caught up in a number of conflicting interests.

Mr. W.H. Funt, Vice-President Compliance for the V.S.E., testified that a broker takes a tremendous risk in a circumstance such as this to be just an order taker. He said:

> "These are high risk securities we have been talking about that are in the language of the industry not seasoned. Meaning they haven't traded so you don't have any ideas as to what the appropriate price may be. It is very

> dangerous in a circumstance like that for a broker to just accept an order without questioning it."

Cox said that with a new issue the broker must weigh the interest of the client, the issuer and the agent as well as the position of the brokers. He testified:

> "It's almost like a giant juggling act because you have to try and keep everybody happy and also try to provide a good shareholder base, a good, you know, you have to make a deal so it will at least have a chance. You don't want to bring on an issue that's going to fall through the floor on the first day, and that'll destroy any possibility of the company being financed ever down the road. It's definitely a very delicate situation."

Plaintiffs' counsel read in Cox's discovery answer where, in discussing the impact of the distribution of shares on the after market, he said:

> "Well, as I mentioned previously, I tried to do the best for everybody, the shareholders, the company, to make everything work out perfectly. It's a very delicate thing to get everything to work properly."

Cox insisted that he and Hayes were not competing with the plaintiffs because they had agreed with Waterford to take down 100,000 shares and, therefore, the units available for allotment were 700,000, not 800,000. However, I am satisfied that they were competing with the plaintiffs for units in Waterford. In fact, in cross-examination, Cox conceded this point:

> "Q: I suggest to you it's obvious that there is an element of competition because there is only so many units available for allocation, and in the case of over subscription there's more people wanting more units than there are available to satisfy all those needs. Do you appreciate that there is an element of competition in that environment?
>
> A: Yes."

As well, Cox made some important concessions with respect to the extent of the fiduciary nature of the relationship between himself, Hayes and the plaintiffs:

> "Q: And all those people who are competing for units to be allocated to them they are in your hands and Denis's hands, because you are the ones who are going to exercise the discretion and decide who gets them. Do you agree with that?
>
> A: Yes.
>
> Q: And they are all vulnerable, they are vulnerable to you. And by that I mean they don't have any control over what you and Denis do. They don't have any say in it. You're off with Denis and you and Denis make that decision, and whatever you decide that is what happens; do you agree?

A: Yes.

Q: And the clients that contact you as a broker they are merely instructing you to do your best for them, as a broker, to try to assist them in obtaining some shares in that IPO. That is what you are agreeing to do for them, right?

A: Yes."

And:

"Q: Did you understand that the plaintiffs, in letting you hold their money or have their instructions to buy shares on the Waterford IPO, that they were placing some trust and some confidence in you?

A: I guess to some degree, yes.

Q: It's a significant thing to give someone else money and instructions and ask them to go and do something for you, that is a very trusting relationship, isn't it?

A: Yes.

Q: The person might take off with your money and you may never see them again?

A: Well I couldn't touch their money. I mean the money was deposited into their account. It's just like a bank account.

Q: It's also significant, sir, to have someone's instructions, such as a broker, a person gives you instructions to buy something for them. They don't have any control over what you do with those instructions. They leave it to you to do it and whatever you do that's what they're left with. Do you agree with that?

A: Yes."

As to Cox's agreement with Waterford to take down 50,000 shares, in cross-examination he said that he never saw the agreement as placing him in a position of conflict with the plaintiffs:

"Q: Mr. Cox, if I could just return to some words that you used in your direct examination and I have asked you some questions about in cross-examination yesterday, and those were the words, "best I can do maybe is get you one thousand", and I'll suggest to you that it wasn't true to say that that was the best you could do?

A: Under the circumstances it probably was the best I could do at the time.

Q: I suggest to you that it wasn't true that it was the best you could do because you or Denis could have filled the orders of the plaintiffs from the fifty thousand units you received and from the units that Denis's wife Jill received. You had a hundred thousand there. There was plenty either from yours or Denis's or both to satisfy the plaintiffs?

A: Yes, but that would have broken the agreement that I had made previously.

Q: You were caught in a clear conflict between your obligations to the plaintiff and your agreement with somebody else?

A: Not exactly no.
Q: Not exactly, no?
A: No, I don't agree.
Q: How not exactly no?

A: Well I had an agreement arranged previously with the company, and I didn't have conflict of interest with the company -- I mean with the individuals.

Q: You would have either had to satisfy your agreement with the company or you had to satisfy your duty to the plaintiffs as their stockbroker. You were caught in that conflict?

A: I never saw it as a conflict.

Q: And most certainly it wasn't something that was disclosed to the plaintiffs at any time that you had an obligation or an agreement with the company that might have put you in some conflict to your duty to the plaintiffs as their stockbroker?

A: I never had a conflict there.

Q: I put to you that you never disclosed the fact to the plaintiffs that you were obligated to the Company?

A: No, the subject never arose."

And:

"Q: So you are sitting there with that circumstance and those instructions and the choice has to be made; you take some shares for yourself, or you satisfy your clients needs, and you are caught in a conflict there. You either satisfy yourself or you satisfy your client; do you agree?

A: Normally I might say yes, but under the circumstances as I mentioned I already had a prior agreement that I had committed to.

Q: That's right. And it would all be all right if you had just disclosed to your clients your prior agreement because then they would know that you had a prior agreement. Do you understand that?

A: I don't see the relevance of that, no, I don't."

On the other hand, Mr. Funt, who, in cross-examination, would not say that Cox and Hayes' conduct was good business practice but also would not say their conduct was in breach of the V.S.E. Rules, had no difficulty, in re-examination, calling a broker's failure to disclose a prior agreement unethical:

"Q: What if the broker had committed to buying the shares from the issuer before the issue became a hot issue?

A: The broker then has themself clearly in a conflict, and again to be consistent with some of my earlier comments, I think that if there's some understanding that that is a possibility, hot or cold issue, that then it may be ethical, if there's some understanding of that. If not I would have to say it is unethical."

On the whole of the evidence, I am satisfied, that the defendants' fiduciary obligations extended to the allotment process of the Waterford offering and that they failed in their fiduciary duty for the following reasons:

1. Cox and Hayes opened accounts for the plaintiffs. In the case of Peychoff, Smith, Dr. Oduwole and Dr. Millson, they accepted their money as an

> expression of good faith. They requested and received confidential information from the plaintiffs. Cox and Hayes, who had control over the allotment of the stock, encouraged the plaintiffs to leave their funds in trust with L.O.M. pending the trade in the stock and, further, the plaintiffs trusted Cox and Hayes to use their best efforts in carrying out the plaintiffs' instructions for the purchase of the stock.
>
> 2. As set out in the authorities, a broker standing in a fiduciary relationship to a client is expected to pursue the best interest of his client. He is not permitted to allow his personal interest to conflict with the interest of his client unless he has made a full and fair disclosure of his interest in the transaction. In this regard, Cox and Hayes failed in their duty to the plaintiffs. They agreed to use their best efforts to try and fill the plaintiffs' orders for Waterford stock, all the while competing with the plaintiffs for a share of the 800,000 unit allotment. In doing so, they acted in breach of their fiduciary obligations to the plaintiffs by placing their interests in conflict with the interests of the plaintiffs, first, by agreeing with the issuer to take down stock in Waterford and, second, by taking down stock in Waterford in priority to the plaintiffs, without making full disclosure of these facts to the plaintiffs.

Defence counsel submitted that in the event I found that Cox and Hayes' fiduciary obligations extended to the allotment process, then I must go on and consider the customs and usages of the V.S.E. relating to I.P.O.'s and their bearing on the defendants' liability to the plaintiffs.

After the plaintiffs learned from Cox and Hayes that they did not receive any stock, they complained to the V.S.E. Mr. David Zwarich, one of the V.S.E. investigators who looked into their complaint, wrote a memorandum dated September 14, 1990, in which he stated:

> "While it is commonly accepted and justifiable that Brokers allocate "hot" issues to their "best" clients (thus resulting in these new clients not receiving an allocation), it is disturbing to see that the two brokers involved purchased such a large portion (12.5%) of the Offering ahead of their clients."

Mr. Zwarich testified that the allotment practice described in his memorandum is an accurate description of the practice on the V.S.E. However, as to his point about Cox and Hayes purchasing stock ahead of their clients, on page two of his memorandum he said:

> "Apparently for years now it has been commonly understood that Rule C.1.16 does not apply to Vancouver listed IPO's even though the written Rule does not identify this exception."

The Rule provides that "Client's orders have priority over all other orders executed on the Floor except as provided for under rules C.2.24 and C.3.16". At the time of interviewing Cox and Hayes, Mr. Zwarich thought they had acted in violation of the Rule. He only found out about the V.S.E. practice of suspending the application of the Rule to I.P.O.'s during the course of his

investigation into the plaintiffs' complaint. Although, in his memorandum, he expressed strong disagreement with the practice, he testified that his memorandum accurately recorded the "understanding" that existed and that he had not seen anything since writing his memorandum to cause him to disagree that it was a practice of the V.S.E. He was instructed to close his file on the plaintiffs' complaint because of the practice that the Rule did not apply to I.P.O.'s, although he felt personally that either the Rule should apply to I.P.O.'s or the V.S.E. should amend the Rule and inform the public.

In support of their contention that the suspension of the application of the Rule to I.P.O.'s was a custom and usage of the V.S.E., the defendants relied upon the minutes of the V.S.E. Market Functions Committee meeting of September 19, 1985 and the evidence of Mr. Funt.

The majority viewpoint of the Committee on whether a client should have priority on all "ordinary market orders" in the case of an I.P.O. over all broker orders of the member acting as the agent or underwriter, as stated in the minutes, was that "the individual who was instrumental in arranging the financing should not be required to, in effect, 'share' the potential rewards when his efforts are successful because he is, by practice, made responsible for any losses that result from those efforts".

In chief, when Mr. Funt was asked "is there anything in your experience that causes you to disagree with the statement I just read from Mr. Zwarich's memorandum?" (that the Rule did not apply to I.P.O.'s), he replied:

> "A: No, with the exception of the application of C.1.16 there could also be a C.3.16.
>
> Q: Oh, are you saying that both C.1.16 and C.3.16 do not apply to initial public offerings?
>
> A: That's right.
>
> Q: Is there a policy of the Vancouver Stock Exchange to that effect?
>
> A: By the - - I'll take your word policy as being a small 'p' policy, a general practice perhaps. Because we do have listings policies and it is not a listings policy. But it has been a practice of the exchange not to apply those rules during an IPO. And that is outlined really, or at least considered, in the Market Functions Committee minutes which you gave to me.
>
> Q: Is that policy or practice set out anywhere else in writing?
>
> A: With the exception of the investigation file relating to this case I am

not aware of any other place."

And:

"Q: And in IPO distribution lists would you recognize broker participation by way of subscription?

A: Well as part of my role as manager of surveillance and being involved in the industry for quite a few years I naturally acquired a knowledge as to who some of the brokers were, not all of them but many of them, and certainly acquired a knowledge as to which ones were more active in financings. So, yes, I would see and know that a broker or somebody with the same surname was taking down part of a financing and know that it was a hot issue at that time I was looking at it.

Q: And can you give me any idea of the frequency of that?

A: I would say it was frequently that that would be the case and that recognize it is my understanding and belief that that was acceptable under the rules. There was no reason for me to kind of remember or open a case or anything like that to keep an exact count, but it just didn't raise any eyebrows or cause serious concern.

Q: All right. I am not sure what understanding and belief you are talking about when you replied here.

A: Understanding and belief that it was acceptable for R.R.'s to take a position in a financing, even in a hot issue, and a hot issue of course being a case where not all clients were filled in terms of their orders or perhaps some clients got absolutely no shares.

Q: In fact it was more than your understanding, it's a policy of the Vancouver Stock Exchange? A: Yes."

In cross-examination, Mr. Funt testified:

"Mr. Hobbs:

Mr. Funt, as I understand the position of the Vancouver Stock Exchange, rule C.1.16 which is commonly referred to as the client priority rule, and I think sometimes also the client first rule, maybe

> incorrectly, it doesn't apply in the circumstances of an initial public offering; that's the position of the Vancouver Stock Exchange?
>
> A: Yes.
>
> Q: All right. Now, and it's the position of the Vancouver Stock Exchange that that's custom and usage of the Vancouver Stock Exchange or it falls into that category?
>
> A: Yes."

While I am satisfied that the evidence establishes customs and usages of the V.S.E. relating to I.P.O.'s, I find that these customs and usages do not save the defendants from being liable to the plaintiffs for breach of fiduciary duty. First, the basis of my finding that Cox and Hayes committed a breach of fiduciary duty is not that they agreed to and did purchase Waterford stock in priority to the plaintiffs, but rather that they did not disclose their agreement and purchase to the plaintiffs. Defence counsel, citing Greenshields Incorporated v. McDonough, [1968] 1 O.R. 297, contended that the plaintiffs are bound by the customs and usages of the V.S.E. relating to I.P.O.'s whether disclosed to them or not. However, that case, which says at p. 300, "Ignorance of the regulation is no excuse; in stock exchange transactions there is a tacit agreement that rules and regulations and the usual course of business will be followed.", does not deal with a broker's fiduciary duty to disclose a conflict of interest to his client.

Second, Mr. Funt said that it is the role of the broker to describe the I.P.O. process to a client. He testified:

> "Q: If it is a custom and usage of the Vancouver Stock Exchange that the client first rule doesn't apply to an IPO there is no way of the public knowing that? There is nothing they can go to that will say to them in writing this rule doesn't apply to initial public offerings?
>
> A: The in writing part is the key part of your question and so then I have to answer no, it doesn't. But the role of a broker and advisor is certainly one to be able to describe what goes on during an IPO or any other type of transaction that requires further education than what maybe clearly outlined in the rules."

He testified further:

> "...if a new client is coming into an IPO I would like to think there was some kind of conversation that occurred to make the client familiar as to what process they were about to enter into."

When plaintiffs' counsel asked him:

> "...But if there is no disclosure then he cannot find out these things, such as the rocket to the moon or the sinking ship or the client best custom and

usage or that stock brokers take stock on IPOs when they've got clients waiting with money in the account for a long time, there is just no disclosure of that?"

He answered:

"A: You're viewing this as a written word only and I am pointing out that, yes, the written word is important and perhaps key, but there is also the relationship that builds between a broker and a client.

Q: All right. So the only other source of disclosure beyond the written words is what information the broker is giving to you to educate you and inform you during the process?

A: Well I imagine you might talk to your friend or associates or colleagues down the hall if they had some experience. I don't know. But in terms of a formal relationship I would agree with you, its the broker in the role."

In my opinion, the fact that there exists a custom and usage of the V.S.E. that allows a broker to take down stock in an I.P.O. ahead of his client, and that the plaintiffs agreed to be bound by the customs and usages of the V.S.E., cannot override Cox and Hayes' fiduciary obligation of obtaining the plaintiffs' full knowledge and assent before placing themselves in a position of conflict of interest with them. As well, it is clear from Mr. Funt's evidence that although the V.S.E. suspended the application of the Rule to I.P.O.'s, it did not relax its policy or rules on the broker's obligation to educate his client on the I.P.O. process, including the customs and usages of the V.S.E., or to disclose a conflict of interest. On this latter point, Mr. Funt said:

"Q: All right. Let me try to come at it from this approach.
The customs and usages of the Vancouver Stock Exchange would never include a broker acting in conflict of interest to that of his client?

A: No. The rules of exchange do allow for a broker to act in conflict with his client under certain circumstances.

Q: All right. And in those circumstances where the broker is going to act in conflict of interest to that of his client, there would have to be a very clear disclosure of that to the client, wouldn't there?

A: That's generally what the rules are focused on, is disclosure of that conflict, not the elimination of it."

And, after Mr. Funt acknowledged that the V.S.E. is trying to maintain a high standard of ethics, plaintiffs' counsel put the following hypothetical to him:

> "Q: Of course. Well let me give you a hypothetical then. You have got a naive investor, a person who doesn't normally buy on the Vancouver Stock Exchange and they call the broker and they open an account, and they give the broker money right away, early on, because they are asked to. And nothing is disclosed to them during the course of the waiting period that they might not get any stock, that the best clients might come first; that the broker might take the stock himself, nothing. They are in the dark about all of those understandings. And it becomes a hot issue and there's not enough to go around and the broker is there near the end ready to do the allocation and there was one share left and it is either him or his client and he takes it. And he doesn't tell his client that he is going to do that, is that unethical?"

He answered:

> "A: I think the relevant part in your description or hypothetical case is the disclosure aspect of that. In that, as I think I alluded to in earlier testimony, that one of the key parts here is the relationship that has built between the broker and the client and so that if that understanding was there, as I presume it is in most cases, then I wouldn't find it offensive or unethical. Without it there it's much more difficult, because then it's all the facts of what did the client know, what can you reasonably expect the client to know, has the client bought many other issues as IPOs? How were they referred to the broker? I mean a myriad of questions come up that you would need to know I think before you answer that question as just simply this is ethical or not."

On the subject of the V.S.E. investigation of the plaintiffs' complaint, the fact that the V.S.E. closed its file and informed the plaintiffs that it could not find a violation of its requirements has no bearing on my findings. It is plain from Mr. Funt's testimony that the V.S.E. did not consider Cox and Hayes' fiduciary obligations to the plaintiffs or, whether their conduct was in violation of V.S.E. conflict of interest rules (for example, Rule F.2.10 which says, "No Member acting as agent for a client to buy or sell securities shall be the buyer or seller for his own account or otherwise act in such manner as to create a conflict between his own interests and those of his client."). On this point, Mr. Funt testified:

> "Q: I have been maybe criticized in the cross-examination because I have been taking you through the Securities Act and various rules and so on and we have been relating Waterford and hypotheticals to those rules, but having done that my question is why did the Vancouver Stock Exchange close the investigative file and rely solely on C.1.16, given the presence of all of these other factors that could have been pursued further?

A: Well, I don't agree with you in the sense all of [sic] other factors should have been pursued. There were aspects that I think we could have done better. There are aspects of what you have described were pursued and although it may look to you that there is a case here on certain other aspects, I don't think so. I don't think we would have a winnable case from where I sit that I have to take forward and prosecute occasionally on many of these aspects. Having said that the case seems to have been closed for because there was a very precise rule question asked. It wasn't asked about whether there was a market manipulation. That wasn't the question that was raised in closing this file. That is a surveillance question. The question raised in closing this file was only whether our rules allowed for an R.R. to take stock ahead of the client on a IPO. And my understanding and interpretation of the rules and the practices say that that was within the two brokers were acting in that aspect consistent with our rules. So we took a very narrow approach to the closing of this file. And quite frankly maybe we took too narrow an approach. I don't know. We are not perfect in investigating all our files either."

I also think that the custom and usage argument relating to the broker's discretion to favour "best" clients on the allotment process has little or nothing to do with why the plaintiffs were not allotted any stock. There is no evidence before me that the plaintiffs did not receive stock because Cox and Hayes decided to allot Waterford stock to their "best" clients. On the contrary, Cox conceded at his discovery that a large number of the units were allotted to insiders, L.O.M. employees or relatives and V.S.E. promoters. (In Mr. Funt's words "It was a tight deal, in a sense that the shares were held in friendly hands,...". The fact that it was a tight distribution may have had a bearing on the rise in the price of Waterford stock although Mr. Funt testified that the V.S.E. surveillance department did not find any evidence of market manipulation). Further, although at the time of the V.S.E. investigation, and in this lawsuit, Cox and Hayes took the position that they did not allot any stock to the plaintiffs because Dr. Oduwole was too naive for the investment and they could see that the plaintiffs were one transaction clients and, therefore, decided that they did not want to do business with them, the only reason given to the plaintiffs by the defendants was that there was not enough stock to go around.

There was a long delay between the plaintiffs' initial contact with Cox and Hayes and the offering finally coming to trade. The plaintiffs frequently called Cox and Hayes enquiring into the status of the offering and were told that the trading day was imminent. Cox testified that on the day before the trading day he was out-of-town and spoke long-distance with Hayes to discuss the allotment of the stock and they decided at that point not to allot the plaintiffs any stock.

It seems incredible to me that after stringing the plaintiffs along for several months encouraging them to wait for the stock to trade, that on the eve of trading Cox and Hayes would suddenly reach the conclusion that they did not wish to do business with the plaintiffs. Surely if this was the case they would have informed the plaintiffs much sooner that they would not be able to fill their orders. In fact, not only was this information not disclosed to the plaintiffs before Waterford started trading, even after it started trading neither Cox nor Hayes contacted the

plaintiffs to tell them that they were shut out of the offering. Cox claimed that he did not contact the plaintiffs because, being out-of-town, it was inconvenient for him to do so. However, even after Cox returned to his office, the plaintiffs had to chase him and Hayes by way of the telephone to find out if they had been allotted any stock. I gained the distinct impression from Cox's testimony that he did not contact the plaintiffs because he did not wish to face telling them that they had not received any stock. I think the only legitimate reason the plaintiffs were not allotted Waterford stock is the one given to them by the defendants at the end of May, viz. the offering was oversubscribed. Although Cox insisted that he would not have allotted stock to the plaintiffs even if there was enough to go around, I am satisfied that, in the circumstances of the Waterford offering turning out to be a "hot" issue, Cox and Hayes, who had unsupervised control over the allotment of the stock, decided to favour their own interests and that of their fellow employees and relatives over the plaintiffs' interests. As so aptly posed by plaintiffs' counsel to Mr. Funt, when questioning him about the broker's discretion in the allotment process, "...if it's a rocket going to the moon you'd have trouble to get a seat but if a ship is sinking there is plenty of space available?"

V. DAMAGES

The plaintiffs' damages must be measured by an assessment of the losses flowing from the defendants' breach of fiduciary duty, as of the time of the breach. See Huff and Donnelly v. Price et al (1990), 51 B.C.L.R. (2d) 282 (B.C.C.A.) at p. 293. The principles behind awarding equitable compensation for breach of fiduciary duty are summarized by McLachlin J. in Canson Enterprises Ltd. v. Boughton & Co. (1991), 61 B.C.L.R. (2d) 1 (S.C.C.), where at pp. 37-38 she said:

> "In summary, compensation is an equitable monetary remedy which is available when the equitable remedies of restitution and account are not appropriate. By analogy with restitution, it attempts to restore to the plaintiff what has been lost as a result of the breach, i.e., the plaintiff's lost opportunity. The plaintiff's actual loss as a consequence of the breach is to be assessed with the full benefit of hindsight. Foreseeability is not a concern in assessing compensation, but it is essential that the losses made good are only those which, on a common sense view of causation, were caused by the breach. The plaintiff will not be required to mitigate, as the term is used in law, but losses resulting from clearly unreasonable behaviour on the part of the plaintiff will be adjudged to flow from that behaviour, and not from the breach. Where the trustee's breach permits the wrongful or negligent acts of third parties, thus establishing a direct link between the breach and the loss, the resulting loss will be recoverable. Where there is no such link, the loss must be recovered from the third parties."

After learning that they had not been allotted units in Waterford, the plaintiffs wrote to the defendants in June and July 1990, taking the position that they were entitled to the shares they had ordered and instructing the defendants to liquidate an equivalent amount of units at the prices they were trading on the date of their written instructions. The dates of the notices were July 6 for Beaulieu, Kowk, Peychoff and Smith, June 13 and July 25 for Dr. Millson and July 5 and July 11 for Dr. Oduwole. Hence, Plaintiffs' counsel argued that there is no difficulty for the

Court in fixing the amount of the plaintiffs' damages because the plaintiffs took the hypothetical risk which is the same risk they would have taken if they had received the units and decided to sell on those dates.

While I accept the approach taken by plaintiffs' counsel to measure the plaintiffs' damages, I agree with defence counsel that the concept of mitigation applies to the facts of this case. The plaintiffs did not learn of the status of their orders on the day that Waterford started trading. However, by the end of May 1990 they were all made aware by Cox and Hayes that they did not receive an allotment of Waterford units in the primary distribution. Each of the plaintiffs had the financial means to purchase Waterford stock on the secondary market and, perhaps with the exception of Dr. Oduwole who relied heavily on Dr. Millson for advice, they understood that this option was open to them. Nevertheless, with the exception of Smith, they decided not to. Their decision was based mostly on the fact that by the time they each learned that Waterford was trading, the price of the stock had increased and they did not wish to incur added risk, although when Smith found out that he had not received any stock, he purchased 2,000 shares of Waterford on the secondary market.

In the circumstances, I find that the measure of the plaintiffs' damages, flowing from the defendants' breach of fiduciary duty, is the difference between the market price of the Waterford stock on June 1, 1990, being a reasonable period consequent to the plaintiffs' discovery of the defendants' breach (May 28 for Peychoff and Smith, May 29 for Beaulieu, Kowk and Dr. Oduwole and May 30 for Dr. Millson) less the unit price of $0.45 per unit.

As to the calculation of the plaintiffs' damages, there is a dispute between the plaintiffs Beaulieu, Kowk (Beaulieu's wife) and Cox over the number of shares ordered by them; Beaulieu and Kowk insisting that they ordered 10,000 shares each, and Cox certain that the number ordered by each was 1,000 shares. As to the other plaintiffs, Peychoff ordered 10,000 shares, Dr. Oduwole 1,500, Dr. Millson 10,000 and Smith 1,000.

It may be that when Beaulieu and Kowk contacted Cox they wanted to order a greater number of shares, but I am satisfied that the number of shares ordered by them was 1,000. Cox was convincingly adamant that he told Beaulieu that the best he could do was maybe get him 1,000 shares and this is the amount entered on Beaulieu and Kowk's New Client Application forms. Despite the fact that after Waterford started trading, Beaulieu and Kowk repeatedly took the position with the defendants that they had ordered 10,000 shares, I do not think that Cox ever acknowledged an order from them for 10,000 shares. Further, there is an independent piece of evidence on this point in the testimony of Mr. Bruce Clokie, who, as an investigator with the V.S.E., interviewed Beaulieu. In cross-examination, Beaulieu testified that it was not possible he told Mr. Clokie that Cox told him that he could only guarantee 1,000 shares for him and Kowk. However, in a note made of his interview with Beaulieu, Clokie wrote that he was told by Beaulieu, "Cox said he couldn't guarantee 10,000 but he said he would see what he could do but promised at best 1000 for Guy and his wife".

As to Peychoff's order for 10,000 shares, Peychoff, at his request, had his funds returned at the beginning of May 1990. Cox said that after Peychoff's funds were returned to him he instructed L.O.M.'s administration department to close the account, which he thought had been done, and he did not hear from Peychoff again. However, Peychoff's account was not closed at

that time and at his discovery Cox said that each of the plaintiffs was on the subscription list "until the very end", although at trial he claimed that Peychoff was not on the list.

I accept Peychoff's evidence that he asked for his funds to be returned because it was taking so long for Waterford to come to market and the defendants were content to return his funds and contact him when Waterford started trading at which time he would send L.O.M. another cheque. This is consistent with the fact that even though the defendants did not have Beaulieu or Kowk's funds in hand they nevertheless left their names on the subscription list. Further, when L.O.M. wrote to Peychoff in July 1990, the only reason given to him for not receiving any stock was that the subscription was oversold, not that his account had been closed or that his name had been removed from the subscription list prior to the trading day.

Plaintiffs' counsel submitted that the facts disclose an extreme case of breach of fiduciary duty and, relying on Huff and Donnelly v. Price et al, supra, Canson Enterprises Ltd. v. Boughton & Co., supra, and S.M. Waddams "The Law of Damages" 2nd.Ed., he contended that I should use the full gamut of the remedies available to me, including punitive damages and an order that the defendants disgorge their profits.

An I.P.O. on the V.S.E. is a high risk speculative venture for the issuer, broker and investor. No doubt, all of the participants in the Waterford offering, including the plaintiffs, were driven by the incentive of making an instant large profit on their investments. While the profit motive may have blinded Cox and Hayes to their fiduciary and professional obligations, I do not think that the conduct of the defendants should be punished over and above the requirement that they pay the plaintiffs compensatory damages. I think, in the circumstances of this case, that awarding only compensatory damages to the plaintiffs is the fair and appropriate remedy.

In the result, I find that the plaintiffs are entitled to damages against the defendants for breach of fiduciary duty calculated on the basis of the facts found above, plus interest and costs.

COHEN J.

DRS/DRS/DRS/DRS