Court File No. CV-15-530726

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

THE CATALYST CAPITAL GROUP INC. and
CALLIDUS CAPITAL CORPORATION

Plaintiffs

and

VERITAS INVESTMENT RESEARCH CORPORATION and
WEST FACE CAPITAL INC.

Defendants

BOOK OF AUTHORITIES OF THE RESPONDING PARTY THE CATALYST CAPITAL GROUP INC. and CALLIDUS CAPITAL CORPORATION

May 25, 2017

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LIST OF AUTHORITIES

TAB 1

2009 CarswellOnt 224
Ontario Superior Court of Justice

Fuda v. Conn

2009 CarswellOnt 224, [2009] O.J. No. 188, 174 A.C.W.S. (3d) 564

Salvatore Fuda (Plaintiff) and Gary Conn, Michael Hunter, Robert Moore, David Johnstone, and Salvatore Pacifico (Defendants)

Himel J.

Judgment: January 19, 2009
Docket: 08-CV-351943PD3

Counsel: Evert Van Woudenberg, James Cook for Plaintiff
No one for Defendants

Subject: Torts; Civil Practice and Procedure

***Himel J.*:**

1 Salvatore Fuda brought an action on April 2, 2008 alleging defamation and claiming general, special, aggravated and punitive damages and costs against the defendants. Each of the defendants was served personally with the claim. The defendants failed to deliver a statement of defence and were noted in default. The plaintiff moved for judgment and the matter was set down under Rule 19.01(4) for an undefended trial before me. The plaintiff led evidence in support of his claim and I reserved judgment. The following are my reasons for judgment.

Factual Background

2 Salvatore Fuda is a businessperson who is a director of a number of corporations including: Echo Energy Canada Inc. ("Echo Energy"), Ontex Resources Limited ("Ontex"), Leader Capital Corp. and Micromem Technologies Inc. ("Micromem"). The defendants are all members of the Board of Directors of Echo Energy. Gary Conn is the President and Chief Executive Officer of Echo Energy and President and Chief Executive Officer of Ontex. Echo Energy is a publicly traded company which is involved in the development of an Ontario natural gas reserve located on the shores of Lake Erie.

3 Mr. Fuda and others requisitioned Echo Energy to call a special meeting of its shareholders under section 105 of the *Business Corporations Act*, R.S.O. 1990, c. B.16 to remove Mr. Moore and Mr. Pacifico as directors and replace them on the Board. The special meeting and an annual meeting of shareholders were set for April 22, 2008. The requisition for the special meeting of shareholders was issued one day after a meeting of the Board of Directors of Echo Energy where it approved a private placement of $2,000,000 of common shares and flow through shares to the exclusion of any insiders. The effect of the proposed private placement would be to preclude the Fuda Group from participating and would dilute the control of the Fuda Group in Echo Energy. Mr. Fuda and others commenced an oppression action naming the defendants. Mr. Fuda also brought a motion for an injunction to prevent Echo Energy from proceeding. The motion for injunctive relief was heard on December 18, 2007 by Justice Morawetz. The defendants then brought a proceeding asking the court to prohibit the voting of certain shares in which Mr. Fuda had a substantial interest at the special meeting. That application was heard on April 14, 2008. The decision was released on November 28, 2008 holding that for the purposes of the shareholders' meeting held on April 22, 2008, the shares held by Challenge Gas Holdings AB are to be counted towards the election of the Board of Directors of Echo Energy Canada Inc. The decision on costs has not yet been made.

4 In preparation for the special meeting set for April 22, 2008 and in the context of a proxy battle, the defendants caused Echo Energy to produce a Management Information Circular (the "Circular") dated March 25, 2008 which was circulated to each of the shareholders. Its purpose was to support the management slate. It stated on pages 16 through 20 the defendants' rationale for the shareholders not supporting the position taken by Mr. Fuda. The Circular suggested that Mr. Fuda had violated corporate and securities laws and that there are "serious issues about the legitimacy of the financing for the acquisition" of the disputed shares by Mr. Fuda and his associates. Page 16 makes reference to the following:

> The Corporation understands that Salvatore Fuda's conduct has previously been the subject of interest by various law enforcement and regulatory authorities in Canada. In the Federal court of Canada Trial Division's decision in *Fuda v. Canada* (Royal Canadian Mounted Police), [2003] F.C.J. No. 314 (Fed. Ct. Trial Div.) the Court referred to Ontex's 1999 application for listing on the Toronto Stock Exchange (the "TSX") and the TSX's original denial of such application and stated that one of the reasons that such application was denied was that the TSX had received rumours that Salvatore Fuda, Ontex's Chairman at the time, was involved in organized crime. The TSX refused to provide any information to Salvatore Fuda related to such rumours. The application to list was eventually allowed.

5 The Circular goes on to mention various unsuccessful legal proceedings taken by Mr. Fuda to gain access to records concerning such alleged criminal activities following rumours that surfaced in 2001 and 2002. Mr. Fuda alleges that the statements made by the defendants are defamatory and that they were intended to undermine his reputation. He says they are false and scandalous and are based on old unfounded rumours.

6 Mr. Fuda also says that he and the defendants have been on the Board of Directors of Echo Energy for a number of years and the defendants have never raised concerns about unfounded rumours regarding a link to organized crime. When Mr. Fuda saw a draft of the publication of the Circular before it was released, he wrote an e-mail advising each of the defendants that he objected to the "misleading inflammatory and irrelevant statements" concerning him and which he considered to be defamatory. The defendants elected to distribute and publish the statements nonetheless.

7 Mr. Fuda claims that as a result of the defamatory statements which were published and distributed to shareholders of Echo Energy, his reputation was damaged among the shareholders and in other corporations, particularly Micromem. In the statement of claim, Mr. Fuda claimed general damages of $50,000,000 and special damages for lost income and opportunities because of the defamatory statements as well as aggravated and punitive damages in the amount of $1,000,000 arising from the intentional and "contumelious" conduct of the defendants. He also claimed costs on a substantial indemnity basis.

Analysis and the Law

8 Rule 19 of the *Rules of Civil Procedure* sets out the procedure in default proceedings where the defendant has been noted in default for failing to deliver a statement of defence or the defence has been struck out. Rule 19.01 provides that where the defendant has failed to deliver a statement of defence, the plaintiff on filing proof of service of the statement of claim may require the registrar to note the defendant in default. There are serious consequences that flow from the noting in default. Rule 19.02(1) provides as follows:

> 19.02(1) A defendant who has been noted in default,
>
> (a) is deemed to admit the truth of all allegations of fact made in the statement of claim; and
>
> (b) shall not deliver a statement of defence or take any other step in the action, other than a motion to set aside the noting of default or any judgment obtained by reason of the default, except with leave of the court or the consent of the plaintiff.

9 A defendant who has been noted in default is not entitled to notice of any step in the action and need not be served with any document in the action except where the court orders otherwise: see Rule 19.02(3). Where a defendant has been noted in default, the plaintiff may require the registrar to sign judgment against the defendant for a debt or liquidated demand in money, the recovery of possession of land or personal property or for the foreclosure, sale or redemption of a mortgage: see Rule 19.04(1). The court has power under Rule 19.03 to set aside the noting of default on such terms as are just.

10 Where a plaintiff moves for judgment under Rule 19.05, liability is deemed admitted but the plaintiff is required to prove and quantify the damages. If the claim is for unliquidated damages the matter must be proven at trial.

11 In the case of *Umlauf v. Umlauf* (2001), 53 O.R. (3d) 355 (Ont. C.A.) at para. 9, the court held that in an assessment of damages hearing after the defendant has been noted in default, it is not proper to inquire into the facts or liability that the defendant is deemed to have admitted. However, facts concerning damages must be proven. The trial judge has discretion to not award damages in excess of those claimed in the statement of claim.

12 Although a defendant by his default is deemed to admit the truth of the factual allegations of the statement of claim, Rule 19.06 provides as follows:

> 19.06 A plaintiff is not entitled to judgment on a motion for judgment or at trial merely because the facts alleged in the statement of claim are deemed to be admitted, unless the facts entitle the plaintiff to judgment.

13 In other words, the plaintiff is entitled to judgment only if the admitted facts entitle the plaintiff to judgment in law: see *Society of Architects v. Kendrick* (1910), 102 L.T. 526 (Eng. C.A.). In *Plouffe v. Roy* (2007), 50 C.C.L.T. (3d) 137, 160 A.C.W.S. (3d) 570 (Ont. S.C.J.), J.W. Quinn J. heard an undefended action where the plaintiff brought an action for damages for sexual assault by the defendant and the defendant did not file a defence and was noted in default. The court considered the implications of noting in default as provided in Rule 19.02(1) and said at paras. 51-53:

> This clause cannot possibly be literally correct in all situations where a defendant is noted in default. I will illustrate with two extreme examples. (1) If a plaintiff pleaded that he suffered the growth of a second head because of the wrongdoing of a defendant, does this mean that, in the absence of a statement of defence, the court is obliged to accept the allegation as a fact? (2) If a statement of claim stated that a plaintiff was unemployed for a period of three years because of the conduct of a defendant, but the "three years" was a typographical error and the pleading should have read "three months," is the court required to accept the truth of the former? Surely the answer to both questions is "No."
>
> Whatever application clause 19.02(1) has, it does not, in my view, inflexibly pertain where a trial is ordered under subrule 19.05(3) or where, as here, the matter is being tried as if it were so ordered. In the course of such a trial, the court is not relegated to the role of a rubber stamp. The court is entitled to make findings of credibility, weigh the evidence of the plaintiff and then make findings of fact. The situation may be different in respect of a motion for judgment pursuant to subrule 19.05(1), but that is not what I have here. Certainly, the absence of a statement of defence assists a plaintiff in the sense that there is no one to attack or challenge the evidence, but it does not eliminate the need for a plaintiff to prove his or her case. Perhaps I could put it this way: there is more scope for inquiry on the part of the judge who presides over a trial under subrule 19.05(3) than of a judge hearing a motion for judgment pursuant to subrule 19.05(1).
>
> Because this matter comes before me as it does, the trial is not merely an exercise in the assessment of damages. The deemed truthfulness of allegations of fact, mandated in clause 19.01(1)(a), is subject to the evidence that is actually adduced at the trial and to the duty of the trial judge to scrutinize that evidence to ensure that it is credible and that a *prima facie* case exists. And, importantly, as stated in rule 19.06, the facts must still entitle a plaintiff to the judgment he or she seeks.

14 Justice Quinn went on to say at para. 54: "The lack of a defence to an action should not lead a plaintiff to assume that the ultimate burden of proof is somehow lowered or that the law does not matter."

15 There are other examples where courts have commented on default proceedings. In *Poznekoff v. Binning* (1998), 19 C.P.C. (4th) 347 (B.C. S.C.), rev'd on other grounds (2000), 95 A.C.W.S. (3d) 933 (B.C. C.A.) [2000 CarswellBC 648 (B.C. C.A.)] the court held that not everything asserted in a statement of claim is legally enforceable by virtue of the default; in this case, where the court doubted that the pleadings on their face rose above mere abuse, it concluded the judgment could not stand on "such gibberish". In *Fritz v. Knorr* (1993), 108 Sask. R. 175 (Sask. Q.B.), the court refused to allow the plaintiff to proceed *ex parte* to assess damages against the defendant noted in default where there was a possibility that the claim may have been statute-barred. If the plaintiff was to pursue the matter further he had to give notice to the defendant.

16 The principle highlighted in all these cases is that although the Rules provide the consequences for noting in default, the court has the jurisdiction and the duty to be satisfied on the civil standard of proof that the plaintiff is able to prove the claim and the damages. If the court finds the evidence to be lacking in credibility or lacking "an air of reality", the court can refuse to grant judgment or grant partial judgment regardless of the default.

The Evidence at Trial

17 While the action was undefended and Rule 19.02(1) provides that the defendants are deemed to have admitted the allegations of fact in the statement of claim, I asked counsel for the plaintiff to lead evidence in accordance with Rule 19 to support the claim. The evidence filed included the Management Information Circular of March 25, 2008, various documents relating to the special and annual meeting scheduled for April 22, 2008, financial statements and brochures concerning Echo Energy, a document outlining the nature of the work done by Micromem Technologies Inc., and Ontex Resources Limited. Counsel also filed a copy of the decision of the Federal Court (Trial Division) of *Fuda v. Royal Canadian Mounted Police*, 228 F.T.R. 274, [2003] F.C.J. No. 314 (Fed. T.D.) which upheld the decision of the RCMP to refuse to provide Mr. Fuda with access to his personal information held in the RCMP's personal information banks, an article in the Lawyer's Weekly dated March 5, 2003 concerning Mr. Fuda's court application entitled "Mine chief fights mob rumours" and a decision of Justice Lang, then of the Divisional Court, in *Fuda v. Ontario (Information & Privacy Commissioner)* (2003), 65 O.R. (3d) 701 (Ont. Div. Ct.) granting leave to appeal two applications for judicial review concerning records in the possession of the Ministry of Finance and the Toronto Police Services regarding Mr. Fuda.

18 Counsel filed a brief in support of the claim for special damages and called *viva voce* evidence to support the damages claim. Andrew Brant testified that he was the Chair and Chief Executive Officer of the Liquor Control Board of Ontario from 1991 until 2006 and prior to that had been the Mayor of the City of Sarnia, a Member of Provincial Parliament, the Minister of the Environment, the Minister of Industry and Trade and the leader of the Ontario Progressive Conservative party. He has known Salvatore Fuda for many years in both a social and business relationship. Mr. Brandt described Mr. Fuda's reputation in business as exemplary and that he was a businessman involved in raising capital for corporations and leading in the development and focus of corporations. He said that he was "astonished" by the comments he had read in the Circular in that it resurrected rumours and innuendo from years ago. He said that in the twenty years he has known Mr. Fuda, he has seen no evidence remotely close to what was said in the Circular and that what was mentioned had no connection to the issues that were to be considered at the meeting of shareholders.

19 Mr. Brant outlined how Mr. Fuda's reputation was damaged within the Micromem Corporation as a result of the comments in the Circular. Micromem is involved in cutting edge technology in developing magnetic memory in the defence, military, security and health fields. It has a contract with British Aerospace and another contract is with the Defence Department in the United States. Mr. Brant testified that, as a result of the concerns raised about Mr. Fuda arising from the statements in the Circular, a contract between Mr. Fuda and Micromem was extended only three or four months instead of two years.

20 Salvatore Fuda testified that he is seventy-two years old, has three children and five grandchildren. He is a director and has significant shareholdings in the four publicly traded companies. He has been Chairman of Micromem since its inception and, since 1999, has raised equity funds of approximately $45 million. He was the Chair of Ontex from 1986 until June 2008 when he was removed through the efforts of Mr. Conn who is now President and Chairman. He had been the President and Chairman of the Board of Directors of Echo Energy until he was removed just before the shareholder meeting in April. Mr. Fuda had consulting contracts for five year terms with renewals of five years with the companies.

21 He described how the dispute between Mr. Conn and him and their respective supporters caused him to requisition the special meeting. He also described the effect of the Circular on the proxy solicitations and the vote at the April 22, 2008 meeting. He produced financial statements for Echo Energy which show losses over the last two years. The market value of the corporation's shares has been reduced significantly during 2008. Mr. Fuda says he was paid $72,000 for his contracts with the corporations but that they expire in September 2008 and will not be renewed. pWhile he is now a consultant to Echo Energy, he has not been paid because the corporation does not have the money. Mr. Fuda says that his business acquaintances have asked him about what is contained in the Circular and he says that the statements are not true. He has been affected personally by the comments in that he has trouble sleeping and he is embarrassed with his friends and grandchildren.

22 Further, because the Circular was posted on a web-site for all public corporations, there have been consequences with others corporations. He had an employment agreement with Micromem through which he receives $150,000 subject to a 3% increase under the contract. He is to receive a cash payout in September 2009. He described how he requested an extension of the contract for five years but they extended it only three months. As for Ontex, he was told that they will not renew his contract as Chairman of the Board.

23 Mr. Fuda testified about the costs involved in hiring Wesley Hall to provide advice about shareholder communications. Mr. Hall advised the Fuda Group about the information circular sent to shareholders and about other communications involved in the proxy solicitation battle. For these services, he charged $22,423.16. Mr. Fuda also retained legal counsel to address the proxy fight and paid Joseph Groia $87,000 for his services from May to October, 2008. The matter is still pending before Justice Morawetz. Mr. Fuda may be able to recover his legal costs through a costs award in that proceeding.

24 Charles Edey is the Chief Operating Officer for Leader Resources Corporation and was with Ontario Power Generation and its predecessor Ontario Hydro for twenty-four years. He was retained by Echo Energy in 2004 to be involved in a joint venture to develop renewable energy projects on lands by Lake Erie. His role was to negotiate leases with the landowners. He described how at the last moment, he was unable to finalize a secure land package because several landowners decided they did not want to do business with his team. This brought the wind project to a standstill because the relevant parties refused to negotiate with him on behalf of the Fuda Group. He said that one of the owners had the Circular in his hand and made reference to the Fuda family as "crooks and gangsters".

25 Joseph Fuda gave evidence that he is the son of Salvatore Fuda and is a director and Vice President of Echo Energy. He says that his reaction to the Circular was "humiliation, anger and frustration" and that the consequences of it were devastating as "we did not get one vote that we did not already have." Mr. Fuda also described how his family as shareholders of Echo Energy received the documents which were humiliating. At a meeting between the two different companies concerning the proposed projects, he was asked a question about his father and his connection with organized crime. He testified that the information is available on the Internet and that the Ontario Securities Commission and the U.S. Securities and Exchange Commission check information from these sites in determining whether to allow certain businesses to be involved with share trading. He outlined the nature of the initiatives that Micromem had been working on with British Aerospace and the U.S. Department of Defence.

26 Peter Macaulay testified that he is a Chartered Accountant specializing in investigative and forensic accounting. He submitted a report dated October 20, 2008 on "Special Damages". He was retained by Mr. Fuda to consider various losses

alleged as a result of the publication of the defamatory statements. He reviewed documents concerning Echo Energy and the other corporations. He provided the assumptions underlying his opinion and an outline of his opinion of the costs to Mr. Fuda arising from the defamation.

27 Included in his calculation of damages were the following: a portion of the legal fees arising from the proxy battle and the litigation concerning whether the "Challenge Gas" shares can be included in the count at the Annual and Special meeting of shareholders and legal fees incurred by Mr. Fuda in connection with the "Challenge Gas" litigation for a total of $202,605.35, the cost of retaining Wesley Hill of Kingsdale Shareholder Services for communications advice and strategy concerning the proxy battle and other miscellaneous costs for a total of $109,415.34, loss of compensation for Mr. Fuda because his consultant agreements with Echo Energy, Micromem, Ontex and Echo Power may not be renewed ($2.9 million), loss of potential payouts from Micromem at selected common share prices which could be as much as $115,200,000.00, potential loss of stock options for Echo Energy, Ontex, and Micromem, losses caused by Echo Power's Projects not proceeding which resulted in it not earning fees of $2.6 million and that Mr. Fuda is owed $78,000 by Echo Energy which has been unable to pay him because of the financial position of the company. Finally, Mr. Macaulay has submitted his statement of account of $25,813.75 for services rendered in preparing the report and testifying in court.

Decision

28 The effect of Rule 19.02 is that the defendants are deemed to have admitted all allegations of fact made in the statement of claim. In reviewing the claim and the evidence tendered at trial, I am satisfied on a balance of probabilities that the plain and obvious meaning of the statements made by the defendants in the Circular were defamatory, that there were false innuendoes in the various comments found in the document and they have damaged the reputation of the plaintiff. While the Circular was published only one time (before the meeting scheduled for April 22, 2008), the information was distributed broadly by being repeated on various sites on the Internet. As there was no defence filed and only the plaintiff's evidence at trial, there is no issue of the defence of fair comment, qualified privilege or justification. Furthermore, an accusation of criminal behaviour is actionable without proof of special damages: see *Law of Defamation in Canada*, 2nd ed., (Looseleaf) (Scarborough: Carswell, 1994) at 4 — 52.

29 As for the question of damages, in the leading decision of *Hill v. Church of Scientology of Toronto*, [1995] 2 S.C.R. 1130 (S.C.C.) at para. 182, the Supreme Court outlined various factors to consider in assessing damages arising from defamatory comments. These factors which were highlighted in *Gatley on Libel and Slander*, 11th ed. (United Kingdom: Thomson Reuters (Legal) Ltd. 2008) at 269-70 include: the conduct of the claimant, his position and standing, the nature of the libel, the mode and extent of publication, the absence or refusal of any retraction or apology and the conduct of the defendant from the time when the libel was published down to the verdict.

30 General damages serve three functions: to act as a consolation to the claimant for the distress he suffers from the publication of the statement; to repair the harm to his reputation (including, where relevant, his business reputation); and as a vindication of his reputation: see *Gatley*, *supra*, at 265-266. At this trial, the plaintiff led evidence of damage to Mr. Fuda's business reputation and business losses arising from the defamatory remarks. He also alleged malice on the part of the defendants. In the case of *Hodgson v. Canadian Newspapers Co.* (2000), 49 O.R. (3d) 161 (Ont. C.A.), Sharpe J.A. wrote at para. 35: "Malice, then, relates to the state of mind of the defendant. As it is usually difficult to prove spite or ill-will, malice is ordinarily established through proof that the defendant knew that the statement complained of was untrue, was reckless with respect to its truth or that the defendant had some improper motive or purpose...." In my view, malice is demonstrated in this case because the statements contained in the Circular were published with an improper motive or purpose, that is, to malign the plaintiff in order to take support away from him in the proxy battle. In that the action was undefended, there was no explanation given concerning the state of mind of the defendants although evidence of the author's state of mind would have been admissible and relevant to the issue of malice.

31 I begin with the premise that each libel case is unique and that the damages flow from "a particular confluence of the following elements: the nature and circumstances of the publication of the libel, the nature and position of the victim

of the libel, the possible effects of the libel statement upon the life of the plaintiff, and the actions and motivations of the defendants..." see *Hill, supra* at para. 187. Applying that approach, I award general damages in the amount of $50,000.

32 Special damages may be awarded to compensate a person for loss of income and other expenses arising from the defamatory conduct. However, significant awards for special damages in defamation cases are the exception rather than the rule: see *Hodgson v. Canadian Newspapers Co., supra*, at para. 67. In that case, the Court of Appeal upheld the trial judge's finding that there was sufficient evidence to find a causal link between the defamatory articles and the respondent's termination to justify an award of damages but held that because of the age and circumstances of the respondent, the trial judge was in an unusual position of being able to measure actual damages arising from the defamation. A more typical case is one where the full measure of compensation is made through an award of general damages.

33 In the case before me, there is evidence led of potential losses arising from the defamatory statements. Frankly, I find the opinion preferred by the expert to be inflated. A number of losses alleged have not yet occurred. The proxy battle that took place was occurring regardless of the defamation. The litigation was directly related to the conflict between those supporting Gary Conn and the other directors and those supporting Salvatore Fuda. The strategic communications advice arose because of the proxy battle. The potential losses of possible payouts of shares and losses of compensation for directorships are speculative as are losses related to stock options. The loss claimed for $78,000 related to Echo Energy not having paid Mr. Fuda relates to the financial position of the company and potential loss of profits because projects have not proceeded. There may be a number of reasons for these projects not having come to fruition. Some of the costs claimed and described above may be recovered on a costs award on the litigation concerning the oppression action. The cost of Mr. Macaulay's services can be addressed on costs related to these proceedings rather than as special damages and are considered below.

34 Aggravated damages may be awarded "in circumstances where the defendants' conduct has been particularly high-handed or oppressive, thereby increasing the plaintiff's humiliation and anxiety arising from the libellous statement.": see *Hill, supra* at para. 188. Aggravated damages are designed to take into account the conduct of the defendants before and through the conduct of the case and their state of mind, including motive and individual acts of malice.

35 As Justice Cory wrote on the question of whether to award aggravated damages: "If aggravated damages are to be awarded, there must be a finding that the defendant was motivated by actual malice, which increased the injury to the plaintiff, either by spreading further afield the damage to the reputation of the plaintiff, or by increasing the mental distress and humiliation of the plaintiff": see *Hill, supra*, at para. 190.

36 In the case before me, Mr. Fuda alleges that the defamatory statements were published in the Circular expressly to undermine his reputation and had no connection to the issues at the time. Mr. Fuda warned the defendants in his e-mail of his objections but they published the remarks nonetheless. There has been no retraction or apology given. He says that in his business dealings his reputation is critical and his credibility has been impaired by the statements that were circulated. In my view, there is some evidence of malicious intention by the defendants in publishing the statements in the Circular. That is evident from the actions preceding the publication of the libel, the circumstances of the publication and the events since the publication. The fact that the statements were made in the context of a proxy battle is not a mitigating factor.

37 Aggravated damages are compensatory in character. In this case, Mr. Fuda says he has been unable to sleep and has experienced embarrassment with business associates and family members. I accept that the statements have had an effect on his business relationships since the publication was made. However, I find that because similar statements were published in 2001 and 2002 and were investigated at that time, they would no longer have as great an effect on Mr. Fuda's personal relationships. Aggravated damages to address the impact on business and personal relationships are awarded in the amount of $20,000 against the defendants. This amount takes into account that the defamatory statements were published in a document that is available on the Internet and the possible extent, frequency and repetition of the publication of the defamatory statements is an aggravating factor: see *Griffin v. Sullivan*, 2008 BCSC 827, [2008] B.C.J. No. 1333 (B.C. S.C.) at para. 97.

38 Turning to punitive damages, the purpose of punitive damages is two-fold: punishment and deterrence. Such damages are awarded where the defendant's conduct "is so malicious, oppressive and highhanded that it offends the court's sense of decency....It is important to emphasize that punitive damages should only be awarded in those circumstances where the combined award of general and aggravated damages would be insufficient to achieve the goal of punishment and deterrence.": see *Hill, supra*, at para. 196. Applying that approach to the case at bar, I find that the award of $20,000 for aggravated damages is reflective of strong disapproval of the defendants' wrongful conduct and has a deterrent effect. I do not see any need for a further award to achieve the purposes of punishment and deterrence: see *Hodgson v. Canadian Newspapers Co.*, *supra*, at para. 64; *Walker v. CFTO Ltd.* (1987), 59 O.R. (2d) 104 (Ont. C.A.) at 121 -2.

39 In *Hill, supra*, at para. 176, Cory J. noted that it is a well-established principle that all persons who are involved in the commission of a joint tort are jointly and severally liable for the damages caused by that tort. Regardless of who originally made the defamatory statement, it is not necessary to apportion liability for general or for special damages between joint tortfeasors and the damages award applies to all defendants. Judgment is, therefore, granted in the amount of $70,000.

40 As for the claim for costs, the plaintiff claims costs of $30,158.74 inclusive of disbursements and GST awarded on a substantial indemnity basis. In support of that position, counsel relies on the case of *Leenen v. Canadian Broadcasting Corp.* (2000), 48 O.R. (3d) 656 (Ont. S.C.J.); upheld on appeal at 2001 CanLII 4997 [2001 CarswellOnt 2011 (Ont. C.A.)] where Justice Cunningham awarded costs of $836,178.94 on a substantial indemnity basis after awarding general, special, aggravated and punitive damages. The court held that the intention of the trial judge to ensure that the plaintiff was fully indemnified with respect to his legal costs was properly founded in the circumstances and because of an offer to settle made in accordance with Rule 49.10.

41 Substantial indemnity costs are justified where there is "reprehensible, scandalous or outrageous conduct": see *Young v. Young*, [1993] 4 S.C.R. 3 (S.C.C.) at 134. It is only the "rare and exceptional case" where costs are awarded on the higher scale: see *Mortimer v. Cameron* (1994), 17 O.R. (3d) 1 (Ont. C.A.). Accordingly, costs are awarded in the amount of $18,824.10 for fees, disbursements of $4,458.08 which includes $3,000 for the report of P. Macaulay & Associates Inc. and relevant GST, an amount I deem fair and reasonable in the circumstances of this case taking into account the factors in Rule 57.01 of the *Rules of Civil Procedure*. These costs are payable by the defendants to the plaintiff.

End of Document

TAB 2

2012 ONSC 5184
Ontario Superior Court of Justice

Gould v. Western Coal Corp.

2012 CarswellOnt 11306, 2012 ONSC 5184, 221 A.C.W.S. (3d) 789, 7 B.L.R. (5th) 19

Wayne B. Gould, Plaintiff/Moving Party and Western Coal Corporation, Audley European Opportunities Master Fund Limited, Audley Capital Management Limited, Audley Advisors LLP, Cambrian Mining PLC, John W. Hogg, Robert Chase, John B. Byrne, John J. Conlon, Charles G. Pitcher and John Robert Brodie, Defendants/Respondents

G.R. Strathy J.

Heard: June 11-13, 18, 2012
Judgment: September 14, 2012
Docket: CV-09-391701-00CP

Counsel: James C. Orr, Michael C. Spencer, Megan B. McPhee, Ahmad Erfan, for Plaintiff
Benjamin Zarnett, David D. Conklin, for Defendants, Western Coal Corporation and Cambrian Mining PLC
Matthew Milne-Smith, for Defendants, Audley
David F. O'Connor, Sean M. Grayson, for Defendants, Robert Chase, John Robert Brodie and John Hogg
David Di Paolo, A. Nicole Westlake, for Defendant, Charles G. Pitcher
Joseph Groia, Kellie Seaman, for Defendants, John B. Byrne and John J. Conlon

Subject: Corporate and Commercial; Securities; Torts; Civil Practice and Procedure; Evidence

MOTION by plaintiff for, inter alia, certification of action as class proceeding and for leave to commence action for secondary market misrepresentation.

G.R. Strathy J.:

1 The plaintiff moves to certify this action as a class proceeding under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 (the *C.P.A.*). He also seeks leave to commence an action for secondary market misrepresentation under Part XXIII.1 of the *Securities Act*, R.S.O. 1990, c. S.5. [1]

2 The plaintiff alleges that the defendants "fabricated" a financial crisis in the defendant Western Coal Corporation (the Company or WCC) in November, 2007, in order to artificially depress its stock price, so that they could enhance their shareholdings in the Company at a fraction of what the shares were worth. He claims that, as part of this scheme, some of the defendants created false cash flow projections and made inappropriate write-downs, causing the Company's auditors to insist that the November 14, 2007 quarterly financial statements be qualified by a note that there was "substantial doubt about the ability of the Company to meet its obligations as they come due". [2]

3 The plaintiff says that this contrived and unduly pessimistic news caused a loss of confidence in the Company, sending investors like him "stampeding to the exits", selling their securities and causing a dramatic drop in the share price. He claims that this allowed the defendants to acquire or increase their interests in the Company at a discounted price, thereby diluting the shareholdings of other stockholders.

4 The plaintiff asserts three claims, which he seeks to certify under the *C.P.A.*:

(a) an action for misrepresentation in the secondary securities market under Part XXIII.1 of the *Securities Act*, which requires leave of the court;

(b) a claim against some of the defendants for conspiracy; and

(c) a claim for oppression under the British Columbia *Business Corporations Act*, S.B.C. 2002, c. 57.

5 I will begin with the factual background. I will then summarize the plaintiff's claim as pleaded and provide some comments on the evidence. I will then address the three claims in the above order.

I. The Facts

6 In this section, I will introduce the parties, describe the events and transactions that are the basis of the plaintiff's complaints, and provide some context for the issues. Further detail will be added later, as necessary.

A. The Parties

The Plaintiff

7 The putative representative plaintiff, Wayne Gould (Gould), is a retired engineer and lives in Alberta. In 2007 Gould became interested in WCC and decided to purchase WCC debentures, which paid 7.5% annual interest and were convertible to common shares at $4.00. At various times between January and early November 2007, he purchased WCC debentures with a total value of $100,000.

8 Gould says that on November 15, 2007 he read an article in the *Globe and Mail*, based on a news release issued by WCC the previous day, announcing its results for the second quarter of 2008, which ended on September 30, 2007 (Q2 2008). The article stated that "... Western Canadian Coal said the soaring loonie, low coal prices and operational issues had pushed it to the brink of collapse." Gould immediately liquidated all his holdings in WCC, leaving him with a capital loss of about $30,000.

9 One week later, on November 22, 2007, Gould saw a news release announcing that WCC had entered into an agreement to issue a private placement of senior convertible debentures of between $30 million and $40 million to a group of investors led by the Audley defendants (the Audley Financing). He also learned that some of the individual defendants, who were officers and directors of WCC, had purchased "significant amounts of shares" in the Company shortly before the announcement of the Audley Financing. This made him suspect that the Audley Financing had been arranged well in advance of the November 22, 2007 news release. He speculated that the Q2 2008 financial statements were part of a conspiracy to temporarily deflate WCC's share price so that insiders and related parties could benefit from the enhanced stock price after the announcement of the Audley Financing.

10 Gould brings this action on behalf of all persons who held or disposed of WCC's securities during what he refers to as the "Misrepresentation Class Period" — that is, between the release of the Q2 2008 financial statements and the filing on SEDAR [3] of a Material Change Report confirming the completion of the Audley Financing (November 14, 2007 to December 10, 2007). He also seeks to represent those who acquired, held or disposed of securities of WCC between April 16, 2007 and July 13, 2009 — a period he describes as the "Oppression Class Period".

WCC

11 WCC is a British Columbia company, incorporated under the *Business Corporations Act* of that province. It is involved in the exploration, acquisition and development of coal mining properties in British Columbia. WCC is listed on the Toronto Stock Exchange (TSX) and on the Alternative Investment Market (AIM) of the London Stock Exchange. WCC was a reporting issuer under the *Securities Act* and was subject to the continuous disclosure obligations under Part XVIII of that Act and the civil liability provisions for secondary market misrepresentation under Part XXIII.1.

12 WCC's major shareholder was the defendant Cambrian Mining PLC (Cambrian), which held approximately 42% of WCC's issued and outstanding shares.

13 WCC had two primary coal-producing assets, both located in northeastern British Columbia. One was a group of open pit deposits, known as the Wolverine Mine or Wolverine Project. This project had a quarter billion dollar construction and start-up budget, which was to be financed through a combination of equity, debt and operations. Some of the debt financing, a $75 million facility, was provided by a syndicate led by BNP Paribas (BNP) and was secured by the assets of the Wolverine Mine. The other major coal asset was an open pit mine referred to as the Brule Mine.

14 In June 2007, Cambrian had acquired a company called Falls Mountain Coals Inc. (FMC), which owned the Willow Creek Coal Mine, situated near WCC's Brule Mine. Cambrian had given WCC a 180 day option to purchase FMC. The acquisition of FMC by WCC, if it could be accomplished, would enable WCC to use FMC's coal handling, processing and loading facilities in conjunction with its Brule Mine, giving rise to significant synergies and costs savings.

15 In the fall of 2007, there were some reasons to be optimistic about WCC's future. It held substantial coal reserves, the quality of its coal had received positive reviews from international steel companies, coal prices were on the rise and it had access to an efficient rail and port infrastructure to get its product to market.

16 There were, however, some real and significant immediate financial challenges facing WCC. Front and centre was its violation, as of September 30, 2007, of a current ratio [4] covenant in its long term lending facility with the BNP lending syndicate. It had received a short term waiver of that default until November 30, 2007, but it was required to produce new debt or equity financing of at least $15 million as a condition of that waiver. It was anticipated by WCC that the covenant would be violated again within twelve months of September 30, 2007. In the event of a future default, BNP would be entitled to exercise its security over WCC's assets, including its major income-producing asset, the Wolverine Mine. WCC's relationship with BNP was rocky. BNP had imposed substantial penalties as conditions of its waivers and had amended the credit agreement to accelerate the reduction of principal and to require increased equity contributions.

17 As well, WCC had not been generating operating profits. It had experienced losses since Q4 2007 (the three months ended March 31, 2007) and it was unlikely to turn a profit in the near term. The strengthening Canadian dollar impacted its revenues, because its sales were in U.S. dollars, but its costs were incurred in Canadian dollars. Revenues were insufficient to cover operating and overhead costs. WCC incurred a loss at the end of Q2 2008 of about $43 million, including a number of one-time or unusual items, some of which are discussed below. Operational difficulties had impacted revenues, adding to the company's cash flow problems. On top of all this, the asset-backed commercial crisis was unfolding, impacting WCC's ability to liquidate a $5 million investment and also causing a contraction of credit.

Cambrian Mining PLC

18 Cambrian is a UK-incorporated mining investment company that held a wide range of resource-based investments in Europe, North America and Australia.

Audley

19 Audley Capital Advisors LLP (incorrectly named in the Statement of Claim as Audley Advisors LLP) is an English investment advisor and the manager for Audley Capital Management Limited, a financial services firm located in Guernsey. Audley Capital Management managed and operated a number of private investment funds, including Audley European Opportunities Master Fund Limited. I will refer to all of these three entities as "Audley", unless otherwise noted. Audley held a 29% share of Cambrian at the material time.

The Individual Defendants

20 The individual defendants were officers or directors of WCC at the material times, as follows:

(a) John W. Hogg (Hogg) was President and CEO of WCC and a director of WCC;

(b) Robert Chase (Chase) and John Robert Brodie (Brodie) were directors of WCC;

(c) John Byrne (Byrne) was a director and Chairman of the Board of WCC. He was also a director and Chairman of the Board of Cambrian;

(d) John J. Conlon (Conlon) was a director of both WCC and Cambrian; and

(e) Charles G. Pitcher (Pitcher) had been President and CEO and a director of WCC between 2003 and 2004. He resigned from these positions in May 2004 and served as an independent director of WCC from 2007 until 2010.

B. The Events at Issue

21 To provide context for the discussion that follows, I will give an overview of the events that give rise to the plaintiff's claims of misrepresentation, conspiracy and oppression. Some of these events will be described in more detail later in these reasons, as the need arises.

The Q2 2008 Disclosures

22 On November 14, 2007, WCC released its results for Q2 2008. The relevant disclosures were contained in its financial statements, its Management Discussion and Analysis (MD&A) and a news release. The alleged misrepresentation, which is at the root of all the plaintiff's claims, was contained in Note 1 to the financial statements and in the MD&A, and was repeated in the news release. Note 1 stated, in part:

> The Company was in violation of a financial covenant in respect of its long term debt at September 30, 2007 and a waiver has been received from the Company's lenders. It is expected, however, that this financial covenant will be violated in the 12 months following September 30, 2007, accordingly, this debt has been classified as current in these interim financial statements, with the result that the Company has a working capital deficiency of $24,264,000 at September 30, 2007.
>
> At current coal prices and Canadian/US dollar exchange rates, <u>the Company does not expect to have sufficient funds to meet its long term debt obligations as they come due</u> and to continue the planned expansion of the Perry Creek Mine, and accordingly the Company will require equity or debt financing from its major shareholder and/or external sources. <u>These circumstances lend substantial doubt as to the ability of the Company to meet its obligations as they come due and, accordingly, the appropriateness of the use of accounting principles applicable to a going concern.</u> The Company has been successful in raising additional equity and debt financing in the past to fund its capital expenditures and operations, and management believes that these funds will be available in the future, however there is no assurance that any required funding would be available to the Company on acceptable terms.
>
> [Emphasis added.] [5]

23 The focus of the alleged misrepresentation is the underlined portions, particularly the sentence in the second paragraph expressing "substantial doubt" about the ability of the Company to meet its obligations as they come due, and therefore the appropriateness of going concern accounting. This will sometimes be referred to as the "going concern note".

24 When I discuss the leave test, I will describe the background to the preparation of the financial statements and, more specifically, the reasons for the decision to insert the going concern note in the financial statements.

25 Immediately after the release of the Q2 2008 results, there was a significant decline in the value of WCC's common shares, which fell from about $1.68 to 50 cents on November 15, 2007, rising slightly in the days following.

26 The plaintiff asserts that the alleged misrepresentation concerning WCC's financial condition was deliberately engineered as part of the defendants' master plan to enrich themselves and to seize control of WCC. The plaintiff also asserts that these alleged misrepresentations were made in violation of generally accepted accounting principles (GAAP) and depressed WCC's share price. This, allegedly, enabled the defendants to carry out certain transactions, described below, at vastly reduced costs.

The Accounting Adjustments

27 The plaintiff pleads that the going concern note was only one of the means used by the defendants to effectuate their conspiracy to misrepresent WCC's financial condition. He claims that the defendants also made "selective write-downs" in Q2 to inflate WCC's losses and "concocted" false cash flow projections in order to make the Company's financial condition appear worse that it was. He says that these actions, along with the going concern note, gave the "false impression that [WCC] was on the verge of bankruptcy."

28 These accounting adjustments are discussed later in these reasons.

Non-Disclosure of the Audley Financing

29 Another feature of the alleged conspiracy is Gould's claim that the Audley Financing, which provided an injection of capital to forestall a default in WCC's obligations to BNP on November 30, 2007, had been secretly pre-arranged by WCC and Cambrian, with the knowledge of the individual defendants. The intentional short-term deflation of the share price was, he claims, intended to allow Audley, Cambrian and the individual defendants to acquire WCC's shares at bargain-basement prices through the Audley Financing and the other transactions described immediately below.

The Impugned Transactions

30 The transactions at issue are:

(a) the acquisition of shares in WCC by three directors, Chase, Brodie and Hogg;

(b) the Audley Financing, whereby Audley made any investment of $30 million in WCC by way of debentures convertible at 75 cents per share;

(c) the sale of FMC by Cambrian to WCC in exchange for shares of WCC; and

(d) the amendment of a loan agreement between Cambrian and WCC.

31 The plaintiff contends that the defendants benefitted from these transactions because the price of WCC's shares had been artificially reduced as a result of the conspiracy to misstate the Company's financial condition. He pleads that the impact of the last three transactions was to enable Cambrian and Audley to increase their holdings in WCC on favourable terms and diluted class members' holdings in the Company. These three transactions are at the core of the plaintiff's claim of oppression.

(a) Acquisition of WCC Shares by Chase, Brodie and Hogg

32 Gould's suspicion of a conspiracy and insider trading was excited by his discovery that three WCC directors had purchased shares of WCC shortly after the disclosure of the Q2 2008 results. I will discuss the evidence surrounding these transactions, which were openly made and relatively modest, in due course. The directors have given uncontradicted evidence that they did not take advantage of any undisclosed material information concerning the affairs of WCC.

(b) The Audley Financing

33 At the end of June 2007, WCC had closed a private placement of approximately $45 million, to meet its commitments due June 30, 2007 and to provide additional working capital.

34 Around the same time, WCC became aware that it had violated certain reporting and financial covenants in its loan agreement with BNP. BNP granted a waiver of this default, but only on condition that WCC increase its principal payment due on September 15, 2007 from $10 million to $15 million.

35 It soon became apparent that WCC would not be able to make the September 15, 2007 payment. Not only was it continuing to sustain operating losses, but its illiquid $5 million investment in asset-backed commercial paper was not available to help pay down the BNP loan.

36 On September 15, 2007, BNP granted another waiver, but once again imposed tough terms. WCC was obliged to immediately pay $10 million of the outstanding loan, to raise $5 million to replace the illiquid commercial paper, and to raise an additional $10 million in capital by November 30, 2007.

37 To satisfy BNP's immediate demands, Cambrian made a $5 million loan to WCC in September 2007. The terms were negotiated between Cambrian's CEO and WCC's independent directors. The loan included an agreement that Cambrian would be issued 520,000 warrants to purchase common shares of WCC, exercisable up to September 30, 2008, at $2.35, the price that had been used for the $45 million equity issue in June, 2007.

38 From June 30, 2007, up to the completion of the Audley Financing, WCC and its officers and directors were engaged in extensive efforts, personally and through outside expert consultants and with the assistance of Cambrian, to obtain more stable and secure long-term financing to replace the BNP facility. The evidence concerning these efforts is described in detail, in the affidavit of Jeff Redmond (Redmond), the acting CFO of WCC at the material time, the affidavit of Greg Jones, the former in-house counsel and corporate secretary of WCC and the affidavit of Chase.

39 Notwithstanding these efforts, financing had not been arranged by November 14, 2007, when the Board of WCC met to approve the Q2 financial statements and regulatory filings. In spite of this, management was confident, as stated in Note 1 to the financial statements and in the MD&A and news release, that financing would be arranged, as it had been in the past.

40 In the period immediately following the release of the Q2 2008 results on November 14, 2007, WCC continued to aggressively search for financing on a number of fronts, in order to meet its November 30, 2007 obligations to BNP and to finance the Company's operations through to the spring of 2008, when cash flows were expected to improve.

41 Financing proposals were ultimately received from three sources, including Audley. A term sheet was ultimately signed with Audley for up to $40 million in convertible debentures, with Audley committing to purchase $30 million and WCC being able to place $10 million with other investors. The debentures paid interest at 8.5% per annum and were convertible at 75 cents per share. In addition, Audley Management received warrants to purchase 4.24 million common shares of WCC at 75 cents per share as an underwriting and arrangement fee.

42 WCC was able to rely on an exemption permitted under s. 604(e) of the TSX Company Manual that permitted issuers in "serious financial difficulty" to conclude a financing without shareholder approval. WCC sought and obtained the exemption for the Audley Financing.

(c) The Sale of FMC by Cambrian to WCC

43 As a condition of the Audley Financing, WCC was required to exercise its option to acquire FMC from Cambrian. Audley believed that FMC would strengthen WCC's asset base, provide operational efficiencies and synergies, and increase WCC's long term value.

44 The details of the negotiations leading up to the agreement of WCC to acquire FMC from Cambrian, and the amendment to the Cambrian loan, are set out, at great length, in the affidavits of both Burridge and Chase. They resulted in a memorandum of understanding dated November 30, 2007. The total price was set at approximately $28 million dollars, with an initial payment of 18,740,898 common shares at seventy five cents per share, representing approximately $14 million and a deferred payment of approximately $14 million to be made September 30, 2008, in either cash or shares, at the option of Cambrian. If Cambrian exercised that option, or if WCC was not able to fund the payment in cash, Cambrian was to receive 9 million shares of WCC valued at $1.56 per share.

45 The memorandum of understanding was subsequently amended in February 2008, to provide that if Cambrian elected to receive the deferred payment of $14 million by June 30, 2008, it would receive 4,534,088 shares of WCC at a price of $3.10 per share.

46 The evidence is clear that the negotiations were arm's length and involved genuine bargaining. The transaction was recommended by an independent committee of WCC's directors and was the subject of a fairness opinion from Capital West. It was ultimately approved by 99.94% of the votes cast by shareholders in favour of the acquisition of FMC. In the course of negotiations, the special committee of WCC obtained an opinion that FMC had a value of between $100-115 million, far in excess of the price of approximately $28 million.

(d) The Amendment of the Cambrian Loan

47 It was also a condition of the Audley Financing that there be an amendment to the terms of the of the $5 million loan made by Cambrian to WCC in September 2007, to ensure that Cambrian would not exercise its right to demand repayment of the loan, a right that would be triggered by the financing.

48 The amendment was negotiated between the independent directors of Cambrian and WCC and provided that:

(a) Cambrian agreed to waive its right to demand repayment of the loan;

(b) Cambrian agreed to release the asset-backed commercial paper that it held as security for the loan;

(c) Cambrian agreed to waive the $125,000 fee that was due to it; and

(d) Cambrian was entitled to convert the loan to shares on the same basis that Audley and the other investors had been offered — namely, $0.75, as opposed to the original price of $2.35 per share.

49 The amendment to the Cambrian loan was made in November 2007 and was disclosed in a February 28, 2008 Information Circular. It was overwhelming approved by the shareholders of WCC on March 31, 2008.

50 As events transpired, Cambrian did not exercise its conversion rights under the loan and, instead, the amounts owing to Cambrian were set off against amounts owed by Cambrian to WCC.

51 The plaintiff claims that the Audley Financing, the sale of FMC to WCC and the amendment of the Cambrian loan were the end game of the conspiracy and were oppressive because they diluted class members' holdings.

52 The Audley Financing allowed WCC to survive the "perfect storm" of November 2007. It also made it possible for WCC to exercise its option to purchase FMC from Cambrian. As events transpired, coal prices rose significantly in April 2008 and had a dramatic effect on the Company's profitability and, correspondingly, on its share price. Ultimately, in 2011, the Company was bought by Walter Equity at $11.50 per share, a handsome appreciation for those shareholders who accepted management's opinion that WCC would find acceptable financing in November 2007 and who decided to hang on to WCC's shares, having decided that the risk was an acceptable one.

II. The Pleading and the Evolution of the Plaintiff's Case

53 In this section, I will summarize the allegations in the Fresh as Amended Statement of Claim and will contrast those allegations with the position the plaintiff takes on this motion. I will give more details of the pleadings of misrepresentation, conspiracy and oppression in the sections dealing with those specific claims.

54 The Fresh as Amended Statement of Claim pleads that WCC, the Audley defendants and Cambrian "misrepresented the true state of Western Coal's finances to enable Audley, together with Cambrian, to acquire a controlling interest in Western Coal on highly favourable terms." The plaintiff alleges that the misrepresentation included the statement that WCC did not have sufficient funds to meet its obligations as they came due, the improper accounting adjustments and the deliberate failure to disclose the allegedly pre-arranged Audley Financing.

55 The plaintiff pleads that the alleged misrepresentation had a strategic purpose and was part of the conspiracy between WCC, Cambrian and Audley to profit financially. He says that the defendants knew, or ought to have known, that this misrepresentation would result in a precipitous drop in WCC's share price, enabling them to acquire control of WCC on favourable terms through the Audley Financing, the sale of FMC by Cambrian to WCC and the amendment of the Cambrian loan.

56 He pleads that these transactions were oppressive and unfairly prejudiced the rights of class members, because their shareholdings were diluted.

57 Gould also alleges that Hogg, Brodie and Chase "purchased shares in Western Coal with the benefit of inside knowledge that had not been publicly disclosed, in violation of securities laws."

58 Relying on the evidence of his expert accounting witness, the plaintiff argues in his factum that the Q2 2008 disclosures painted an unnecessarily "bleak" picture of a company on the verge of bankruptcy. He alleges that the defendants deliberately enhanced WCC's losses in the second quarter in order to "spread alarm" among investors and "concocted" false cash flow projections in order to induce WCC's auditor, PricewaterhouseCoopers (PwC) to make the going concern note in the financial statements.

59 The plaintiff's case has morphed over time. As presented in the original motion record, it was alleged that the Audley Financing was part of the entire "scheme". Gould deposed in his affidavit that when he learned that the individual defendants had purchased shares shortly before the announcement of the Audley Financing, he became "suspicious" that the financing had been pre-arranged. Having sold his debentures at a loss, in the belief that the Company was about to fail, he was shocked and probably angry to discover that some of the directors had bought the Company's shares during the crisis and that the stock price had rebounded on the announcement, a week after the release of the Q2 2008 results, that a source of funding had been obtained.

60 In the face of the extensive and largely unchallenged evidence of the defendants, the plaintiff's case has changed significantly. By the time the motion was heard, the plaintiff substantially downplayed, to the point of abandonment, his assertion that the alleged misrepresentation was part of a pre-planned scheme to enable Audley to seize an interest in WCC. Instead of contending that the Audley Financing had been pre-arranged, it was suggested that WCC deliberately delayed its efforts to obtain financing, apparently, to leave itself with no saviour other than Audley and that Audley was only too happy to jump into the vacuum, knowing that the going concern note in the financial statements was wrong. The plaintiff also suggested that the defendants deliberately painted a bleak financial picture for WCC by focusing on its short term problems rather than its long term prospects.

61 It remained the plaintiff's position, at least in counsel's factum, delivered less than a month before the hearing, that the individual defendants (other than Pitcher), with the collaboration of Redmond, *deliberately* misrepresented to the public that "[WCC's] financial condition was dire and the Company might not even survive".

III. The Evidence

62 As the leave motion requires an evidence-based analysis of whether the plaintiff's claim has a reasonable possibility of success at trial, it is appropriate to make some preliminary comments on the evidence that has been tendered by the parties.

A. The Plaintiff's Evidence

63 The plaintiff provided evidence from two fact witnesses and two expert witnesses.

64 Gould swore a short affidavit, describing his acquisition of the WCC debentures and the circumstances, described above, that led to the commencement of this action. He also deposed to his good faith in commencing this action and explained why, in his view, the action was appropriate for certification as a class action.

65 The other fact witness was an associate in the office of the plaintiff's counsel, who set out the background of the various transactions that are the subject of this action, based on public documents and corporate disclosures.

66 Quite obviously, neither Gould nor his lawyers had any personal first-hand knowledge of the transactions at issue or of the underlying facts behind the claims of oppression, conspiracy, intentional misrepresentation and insider trading that are made in the statement of claim.

67 The plaintiff filed two expert reports of Rosen & Associates Limited, an accounting firm specializing in forensic and investigative accounting. The first report took the form of an affidavit of Lawrence S. Rosen, one of the principals of the firm. The other was a report jointly signed by Mr. Rosen and A.T. Mak, who is also a principal in the firm. It was filed following the delivery of the defendants' reply evidence. For the sake of convenience, I will refer to the authors of both reports as "Rosen". Rosen's evidence will be discussed in this part and also in my analysis of the issues in Part IV.

68 The other expert was Derek Sigel, a securities lawyer, who deposed that the Audley Financing must have been known to WCC and its senior management "a number of days" in advance of its announcement on November 22, 2007. The purpose of this evidence appears to have been to attempt to show that the Audley Financing must have been arranged for some time, and inferentially that it was probably know at the time the Q2 2008 disclosures were made on November 14, 2007.

69 As I have noted, by the time of the hearing, the allegation that the Audley Financing had been pre-arranged was effectively demolished by the defendants' evidence and had been abandoned by the plaintiff.

70 In the result, the plaintiff's case is exclusively based on the public record, the evidentiary foundation produced by the defendants and the expert evidence of Rosen.

B. The Defendants' Evidence

71 The defendants have delivered a substantial body of evidence. WCC, Audley and Cambrian have provided evidence through one or more former officers or directors. Every one of the individual defendants, other than Conlon, has provided an affidavit. Affidavits have been provided by the audit partner of PwC responsible for WCC, and by the consultants involved in searching for financing for WCC. The deponents, fifteen in all, were personally involved in the events that are the subject of this litigation and they have provided detailed and thoroughly documented evidence concerning their actions during the material time.

72 In addition, expert accounting evidence has been provided by several affiants on behalf of Deloitte & Touche LLP and by Navigant Consulting Inc.

73 Only four of the defendants' witnesses were cross-examined: Julian Treger (Audley) Mark Burridge (Cambrian's former CEO), Lenard Boggio (Boggio), the audit partner of PwC responsible for WCC, and Redmond (Western's former Director of Finance and acting CFO).

C. Comments on the Evidence

74 The plaintiff objects that the mountain of evidence adduced by the defendants is a strategic attempt to turn the leave motion into an assessment of the merits based on the balance of probabilities and with an incomplete evidentiary record. He says that if the court condones this practice it will enable well-resourced and powerful defendants to overwhelm would-be class actions with an impenetrable wall of evidence.

75 The plaintiff notes that there have been no affidavits of documents and says that the defendants have made selective disclosure, putting their best foot forward and concealing evidence that could harm their case. He notes that large volumes of material, and some affidavit evidence, was produced by the defendants only after cross-examinations had been completed.

76 I do not accept the plaintiff's position on this issue. The plaintiff claims damages of $200 million. He makes very serious allegations against the defendants and other professionals. The consequences of granting leave and certification are significant. The defendants are entitled to put a record before the court to establish that the plaintiff's misrepresentation claim has no reasonable possibility of success. They are also entitled to rely on that record to show that there is no basis in fact for the existence of common issues of conspiracy and oppression.

77 The plaintiff was at liberty to cross-examine any of the defendants' witnesses. Only a few were cross-examined. No document has been identified that the plaintiff has requested and that the defendants have failed to produce. No motion was brought by the plaintiff for the production of any additional document or for leave to cross-examine any additional witness.

78 In *Silver v. Imax Corp.*, [2009] O.J. No. 5573, 66 B.L.R. (4th) 222 (Ont. S.C.J.), leave to appeal ref'd, 2011 ONSC 1035, [2011] O.J. No. 656 (Ont. S.C.J.) *(*Silver v. Imax (Leave)*)*, van Rensburg J. noted that the "reasonable possibility of success" requirement in the statutory leave test captures two meanings — the possibility must be more than a "mere" possibility and it "must be based on a reasoned consideration of the evidence" (at para. 324). In this latter regard, van Rensburg J. noted that the evaluation of the merits at the leave stage is necessarily constrained by the motion procedure — at paras. 326-327:

> In undertaking this evaluation the court must keep in mind that there are limitations on the ability of the parties to fully address the merits because of the motion procedure. There is no exchange of affidavits of documents, no discovery (although affiants may be cross-examined) and witnesses cannot be summoned. The credibility of a witness' evidence given by affidavit in a motion, irrespective of how searching an out-of-court cross-examination may be, can only be fully determined when it is tested in open court. As Master McLeod noted in *Caputo v. Imperial Tobacco Ltd.*, [2002] O.J. No. 3767 (S.C.) at para. 19:
>
>> A judge weighing affidavit evidence does not have the same opportunity as a trial judge to look the witness in the eye and assess whether he or she is forthright and believable. There is, of course, opportunity to reject affidavit evidence because it is internally inconsistent, illogical, wanting in detail, contrary to documentary evidence, or otherwise contradicted.
>
> As a result, the court must evaluate and weigh the evidence at hand, keeping in mind the restrictions of the motions process and what may be available to the parties in a trial. This does not mean that the court should speculate about what better evidence a party may advance when the matter reaches trial, or fill obvious gaps in a party's case; it does however require the court to assess the evidence realistically, having regard to which party has the burden of proof and access to evidence that may be brought forward at the preliminary stage, and paying attention to conflicts in the evidence that may not be capable of being determined in a motion, without a full assessment of a witness' testimonial credibility

79 Van Rensburg J. concluded, at paras. 331-334:

> The leave provision, working with the definition of the statutory cause of action and defences, requires plaintiffs to put forward the evidence they rely on as to the misrepresentation, and the extent of knowledge or participation required for non-core documents and liability for officers, and permits each proposed defendant to offer an account that may contradict the plaintiffs' allegations, or would fall within the terms of one or more of the defences afforded by the statute.
>
> The evidence must be considered at the leave stage to determine whether the plaintiffs' action, after the respondents have had the opportunity to put forward evidence to support their defences and the positions of the parties have been explored in cross-examination, has a reasonable possibility of success.
>
> In this regard it is not sufficient (as the respondents contend) to put forward defences which the plaintiffs must "overcome". Nor is the court required (as the plaintiffs assert) to leave any assessment of the defences to a trial. The court must consider all of the evidence put forward in the leave motion, including evidence supportive of any statutory defence. Because the onus of proof of a statutory defence is on the respondents, the court must be satisfied that the evidence in support of such a defence at the preliminary merits stage will foreclose the plaintiffs' reasonable possibility of success at trial.
>
> Considering all of the factors noted above, I have approached part two of the leave test by asking myself whether, on the evidence that is before the court on this motion — that is the affidavits and transcripts of examinations, as well as the various documents that have been tendered as exhibits, and produced in response to undertakings and ordered to be produced during the cross-examination process — as well as reasonable inferences to be drawn from such evidence, and considering the onus of proof for each of the cause of action and the defences, as well as the limitations of evaluating credibility in a motion, is there a reasonable possibility that the plaintiffs will succeed at trial in proving [the various elements of the statutory cause of action] ...

80 I respectfully adopt these comments. In this case, the defendants have — as they are entitled to do — put forward evidence to contradict the plaintiff's allegations. In assessing the weight to be accorded this evidence, I am required to consider the limitations of the motions process, including the fact that the evidence is not given *viva voce*. I am also entitled to consider whether the evidence has been challenged on cross-examination, and whether it is consistent with other evidence and contemporaneous documentation, viewed as a whole.

D. Comments on the Plaintiff's Expert Evidence

81 The defendants have raised issues about Rosen's evidence. They accuse him of breaching the duties of an expert by giving opinions on matters outside his expertise, by weighing evidence and making findings of fact and by engaging in argument and legal analysis. The plaintiff has failed to answer these objections and in my view they are well-founded. They call Rosen's independence into question and justify substantially discounting his evidence to the point that I have no confidence in its reliability. I have come to this conclusion for the following reasons.

82 *First*, Rosen and Mak are chartered accountants. They describe themselves as forensic accountants. They have experience and qualifications in matters of financial reporting and disclosure, GAAP (generally accepted accounting principles) and accountants' negligence. In the course of their reports, however, they repeatedly purport to give opinions on matters outside their proven expertise, including matters of corporate governance and securities law. For example, in commenting on the use of "going concern" language in the Q2 2008 financial statements, Rosen stated: "Unwarranted gloom and biased descriptions do not constitute fair financial presentation, nor were they permitted under the Canadian accounting standards that existed at the time. Unjustifiable management-based impacts on share prices are contrary to good governance principles and basic securities law." Leaving aside the accusation of bias, which is utterly unfounded, Rosen has no proven qualifications to opine on governance principles or securities law, even if evidence of the latter was admissible, which it is not.

83 Other examples abound. Rosen made comments about WCC's attempts to obtain financing, suggesting that management's efforts were "slow and half-hearted and fell short of expected measures for a business that was supposed to be in financial distress." This statement is not only impermissible fact-finding, but it also expresses an opinion on a subject matter — corporate financing practices — for which Rosen has no proven expertise, education or training.

84 Rosen also purports to give evidence on matters having to do with corporate governance and oppression — frequently based on suspicion and innuendo — for example, "Far too many events and activities by the management of WCC raised very serious concerns about the governance of WCC in 2007. Minority shareholder oppression has to be thoroughly investigated as one possibility."

85 The willingness of an expert to step outside his or her area of proven expertise raises real questions about his or her independence and impartiality. It suggests that the witness may not be fully aware of, or faithful to, his or her responsibilities and necessarily causes the court to question the reliability of the evidence that is within the expert's knowledge.

86 *Second*, Rosen purports to weigh evidence, evaluate the credibility of witnesses and make findings of fact. Some of the previous examples are indicative of this propensity, but there are others. Simply by way of example, in one of his reports, Rosen stated: "Further investigation of the disclosures is necessary. Many indications exist that WCC was *not* insolvent and that its management chose not to explore viable options prior to, and during, the purported 'financial distress period'. Such behaviour would be consistent with an intention to create false panic about the financial health of the Company, so as to suppress its stock price." This statement is objectionable on a number of grounds: it is unvarnished fact-finding, it attributes motive and it contains pure speculation.

87 I have already referred to Rosen's evidence to the effect that the efforts of management to obtain financing lacked a "sense of urgency". This is pure fact-finding in the form of generalized conclusory statements, without any attempt to provide a factual basis for his conclusions, couched in pejorative and argumentative language.

88 By the time Rosen delivered this report, he had the affidavits of all members of senior management of WCC, including Redmond, and the affidavit of Boggio of PwC explaining the process leading up to the inclusion of the going concern note in the financial statements. He also had the evidence of the defendants concerning their efforts to explore financing options before, during and after the release of the financial statements. In making the foregoing statements he was purporting to weigh and evaluate this evidence and was drawing adverse and unsupported conclusions about what the evidence established.

89 *Third*, Rosen engaged in blatant advocacy, making exaggerated, inflammatory and pejorative comments and innuendos, which were argument rather than evidence. For example, in commenting on the Q2 2008 disclosures, Rosen stated: "In our opinion, WCC's public announcement significantly overstated the financial risks facing the company in November 2007. A major concern for shareholders has to be that the Company's disclosures could very well have deliberately been made to create false panic with investors and depress the Company's share price." This is also another example of Rosen attributing motive, and engaging in speculation, rather than confining himself to opinions that are within his area of expertise.

90 Again, there are numerous examples of this kind of language set out in the factum of counsel for Chase, Hogg and Brodie. Rosen seldom missed an opportunity to take a pejorative swipe at the defendants, often in a speculative way. The following will suffice simply as examples:

- "Minority shareholder oppression is highly <u>suspected</u>, based on publically available evidence."
- "[t]he entire transaction <u>appeared to be</u> unusual, carrying possible impacts on WCC's share price and therefore <u>could be oppressive</u> to some shareholders."

• "...the second quarter (ended September 30, 2007) financial statements represented the only opportunity to disseminate adverse news under the guise of "regular" financial reporting."

• "A major concern for shareholders has to be that the Company's disclosures could very well have deliberately been made to create false panic with investors, and depress the Company share price."

• "We would expect that specific, extensive effort would have been made by WCC management to follow the seemingly simple solution to avoid adverse financial disclosures."

[emphasis added]

91 There are multiple other instances in which Rosen exceeds the bounds of his expertise, purports to make findings of fact and engages in argument, advocacy and hyperbole. They offend the rules applicable to expert evidence as set out and discussed in: *R. v. Mohan*, [1994] 2 S.C.R. 9 (S.C.C.); *Williams v. Canon Canada Inc.*, [2011] O.J. No. 5049 (Ont. S.C.J.); *Carmen Alfano Family Trust v. Piersanti*, 2012 ONCA 297, [2012] O.J. No. 2042 (Ont. C.A.); *R. c. J. (J.-L.)*, 2000 SCC 51, [2000] 2 S.C.R. 600 (S.C.C.), at para. 37.

92 In the *Carmen Alfano Family Trust* case, the Court of Appeal observed, at paras. 107-108:

> That said, courts remain concerned that expert witnesses render opinions that are the product of their expertise and experience and, importantly, their independent analysis and assessment. Courts rely on expert witnesses to approach their tasks with objectivity and integrity. As Farley J. said in *Bank of Montreal v. Citak*, [2001] O.J. No. 1096, "experts must be neutral and objective [and], to the extent they are not, they are not properly qualified to give expert opinions."
>
> When courts have discussed the need for the independence of expert witnesses, they often have said that experts should not become advocates for the party or the positions of the party by whom they have been retained. It is not helpful to a court to have an expert simply parrot the position of the retaining client. Courts require more. The critical distinction is that the expert opinion should always be the result of the expert's independent analysis and conclusion. While the opinion may support the client's position, it should not be influenced as to form or content by the exigencies of the litigation or by pressure from the client. An expert's report or evidence should not be a platform from which to argue the client's case. As the trial judge in this case pointed out, "the fundamental principle in cases involving qualifications of experts is that the expert, although retained by the clients, assists the court."

93 The Court of Appeal continued, at para. 110, by noting that where the court observes a lack of independence, it will generally discount the weight to be given to the expert's opinion:

> In most cases, the issue of whether an expert lacks independence or objectivity is addressed as a matter of weight to be attached to the expert's evidence rather than as a matter of the admissibility. Typically, when such an attack is mounted, the court will admit the evidence and weigh it in light of the independence concerns. Generally, admitting the evidence will not only be the path of least resistance, but also accord with common sense and efficiency.

94 Rosen's willingness to engage in this type of advocacy, exaggeration and over-statement, and his failure to make a balanced assessment of the evidence, drawing only the most unfavourable conclusions, casts serious doubt on his independence and objectivity and causes me to discount the weight which might be given to his evidence.

95 Rosen signed an acknowledgment of expert's duty in which he acknowledged a duty to provide fair, objective and non-partisan opinion that related only to matters that were within his area of expertise. He also acknowledged that this duty prevailed over any obligation he might owe to the party that retained him. Rosen did not confine himself to matters within his expertise. He engaged in impermissible fact-finding and speculation. The tone of his report was not fair, objective and non-partisan. These failings, together with shortcomings in his logic, discussed below, give me no confidence that his evidence can be relied upon, or could possibly be relied upon at trial.

IV. The Issues and Analysis

96 My examination of the issues departs from a conventional analysis of a certification motion, in which the court typically considers whether each of the requirements of s. 5(1) of the *C.P.A.* has been met. In these reasons, I first address the issue of whether leave should be granted to pursue the claim for secondary market misrepresentation under the *Securities Act*. I have concluded that leave should not be granted because the plaintiff's claim has no reasonable possibility of success at trial. This conclusion makes it unnecessary to consider whether that claim should be certified. As the alleged misrepresentation is also a central aspect of the conspiracy claim, I then consider whether the evidence establishes a sufficient basis, in fact, for the existence of common issues that would make it appropriate to certify the conspiracy claim, assuming the other requirements of s. 5(1) of the *C.P.A.* are met. I have answered this question in the negative. Finally, I have accepted the defendants' submission that this court has no jurisdiction over the oppression claim because the cause of action is within the exclusive jurisdiction of the Supreme Court of British Columbia. In these circumstances, it is not necessary to consider the many other issues raised by the parties, including the issues of whether the other requirements of s. 5(1) of the *C.P.A.* have been met in the case of each claim.

A. The Leave Motion and Certification of the s. 138.3 Claim

97 Section 138.3 of the *Securities Act* confers a cause of action for misrepresentation in the secondary securities market in favour of a person who acquires, or disposes of, the issuer's securities between the release of the document containing the misrepresentation and the time the misrepresentation was publicly corrected, regardless of whether or not the plaintiff actually relied on the misrepresentation. The section provides:

> 138.3(1) Where a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document that contains a misrepresentation, a person or company who acquires or disposes of the issuer's security during the period between the time when the document was released and the time when the misrepresentation contained in the document was publicly corrected has, without regard to whether the person or the company relied on the misrepresentation, a right of action for damages against,
>
> (a) the responsible issuer;
>
> (b) each director of the responsible issuer at the time the document was released;
>
> (c) each officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document.

98 A "misrepresentation" is defined in s. 1(1) as:

> (a) an untrue statement of material fact, or
>
> (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made.

99 A "material fact", when used in relation to issued securities, means:

> a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.

100 Where the misrepresentation is made in a "core document", which includes the issuer's annual and interim financial statements and MD&A, the issuer, its directors and each officer who authorized, permitted or acquiesced in the release of the document, are liable for the misrepresentation, subject to the availability of the "reasonable investigation" defence in s. 138.4(6). In the case of core documents, therefore, it is not necessary to show that the issuer or the officer or director knew that the document contained a misrepresentation.

101 In contrast, where the misrepresentation is made in a non-core document, or in a public oral statement, the burden is higher. Section 138.4(1) provides that to establish liability, the plaintiff must prove that the issuer, officer or director:

> (a) knew, at the time that the document was released or public oral statement was made, that the document or public oral statement contained the misrepresentation;
>
> (b) at or before the time that the document was released or public oral statement was made, deliberately avoided acquiring knowledge that the document or public oral statement contained the misrepresentation; or
>
> (c) was, through action or failure to act, guilty of gross misconduct in connection with the release of the document or the making of the public oral statement that contained the misrepresentation.

102 In this case, because the same alleged misrepresentations were made in both core documents (the financial statements and MD&A) and a non-core document (the news release), it is unnecessary to consider the requirements of s. 134.8(1).

103 No action may be commenced under s. 138.3 without leave of the court, and leave can only be granted where the court is satisfied that:

> (a) the action is brought in good faith; and
>
> (b) there is a <u>reasonable possibility</u> that the action will be resolved at trial in favour of the plaintiff (s. 138.8(1)).

[Emphasis added.]

104 The plaintiff pleads that:

(a) he purchased and sold WCC debentures during the class periods;

(b) WCC is a "responsible issuer" within the meaning of the *Securities Act*;

(c) Cambrian is an "influential person" within the meaning of the *Securities Act*;

(d) the Individual Defendants were directors of WCC during the Misrepresentation Class Period;

(e) WCC released one or more documents knowing that they contained a "misrepresentation";

(f) as a result of the misrepresentation, the share price of WCC on the TSX dropped from a high of $1.75 on November 14, 3007 to a low of $0.47 the next day, on heavy trading;

(g) the individual defendants made the misrepresentations by releasing, or authorizing, permitting and/or acquiescing in the release of the documents containing the misrepresentations;

(h) Cambrian made the misrepresentations by knowingly influencing the release or by authorizing, permitting and/or acquiescing to the release of the documents containing the misrepresentations; and

(i) WCC, the individual defendants and Cambrian are liable to the Plaintiff and the Misrepresentation Class Members who held or disposed of their shares during the Misrepresentation Class Period.

105 The history of the statutory remedy, and the principles applicable to the leave test, have been discussed at some length in *Silver v. Imax Corp.*; *Dobbie v. Arctic Glacier Income Fund*, 2011 ONSC 25, [2011] O.J. No. 932 (Ont. S.C.J.) and *Green v. Canadian Imperial Bank of Commerce*, 2012 ONSC 3637, [2012] O.J. No. 3072 (Ont. S.C.J.).

106 The test should be applied in such a way as to screen out strike suits while providing access to the courts for shareholders with legitimate claims. It is necessary, however, to examine all the evidence to determine whether the plaintiff's case is "so weak, or has been so successfully rebutted by the defendant, that it has no reasonable prospect of success": *Green v. Canadian Imperial Bank of Commerce*, above, at para. 374.

1. Good Faith

107 As noted, s. 138.8(1)(a) of the *Securities* Act requires that the action be brought in good faith. The defendants do not challenge the plaintiff's good faith in bringing the claim. That being said, I have noted on several occasions that the commencement of this action by Mr. Gould appears to have been inflamed by three particular assumptions, to which Rosen has added fuel, and which have now been demonstrated to be entirely unfounded — namely, that the alleged misrepresentation was a deliberate act, that the Audley Financing was pre-arranged and that the individual defendants took advantage of inside information to increase their stockholdings.

2. Reasonable Possibility of Success at Trial

108 I will now turn to the question of whether the plaintiff's misrepresentation claim meets the second part of the leave test — that is, the requirement of s. 138.8(1)(b) that there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.

109 I will begin by examining the alleged misrepresentation in the context in which it was made in the Q2 2008 disclosures. I will then identify the main accounting principles that are at issue and that informed the disclosures that were made by WCC. I will then examine the process leading up to the release of the disclosures. Next, I will examine the expert evidence on both sides of the issue. As the plaintiff's allegations of misrepresentation are tied to his claim that WCC made improper accounting adjustments to inflate its losses in Q2 2008, I will examine this contention as well as certain other allegations, including the allegation that some of the individual defendants enriched themselves by acquiring WCC shares to take advantage of their misrepresentation. Finally, I will explain why I have concluded that the plaintiff's misrepresentation claim has no reasonable possibility of success at trial and leave should not be granted.

(a) The Alleged Misrepresentation

110 It is important to put the alleged misrepresentation in context. It was contained in the first note to the unaudited consolidated financial statements of WCC for the three and six months ending September 30, 2007. The financial statements are twenty-one pages long and there were nineteen notes. Although I have quoted the note earlier, I repeat it here for context. Note 1 provided, in part, as follows:

> The Company was in violation of a financial covenant in respect of its long term debt at September 30, 2007 and a waiver has been received from the Company's lenders. It is expected, however, that this financial covenant will be violated in the 12 months following September 30, 2007, accordingly, this debt has been classified as current in these interim financial statements, with the result that the Company has a working capital deficiency of $24,264,000 at September 30, 2007.
>
> At current coal prices and Canadian/US dollar exchange rates, the Company does not expect to have sufficient funds to meet its long term debt obligations as they come due and to continue the planned expansion of the Perry Creek Mine, and accordingly the Company will require equity or debt financing from its major shareholder and/or external sources. These circumstances lend substantial doubt as to the ability of the Company to meet its obligations as they come due and, accordingly, the appropriateness of the use of accounting principles applicable to a going concern. The Company has been successful in raising additional equity and debt financing in the past to fund its capital expenditures and operations, and management believes that these funds will be available in the future, however there is no assurance that any required funding would be available to the Company on acceptable terms.

[Emphasis added.]

111 This language was repeated in the MD&A, at page eighteen of a twenty-four page document, which set out, in great detail, management's views on the financial circumstances of the Company. The MD&A also described the Company's violation of its financial covenant with BNP and the need to reclassify the long term debt as current. A somewhat more abbreviated statement was contained in the eight-page news release. The second bullet on the first page of the news release stated:

> At current coal prices and Canadian/US dollar exchange rates, the Company does not expect to have sufficient funds in the near term to meet its financial obligations as they come due. The Company will require additional capital from its major shareholder and external sources. In the past, the Company has been successful in raising additional capital and management believes that these funds will again be available in the future.

[Emphasis added.]

112 Like the MD&A, the news release contained substantial additional information about WCC's financial condition, concerning such matters as its summary of revenues and operations, the operating loss for the quarter, other expenses, the Company's long-term debt, and the market outlook. The latter section forecast strong demand for WCC's coal and rising coal prices. It concluded with the following comment:

> In the longer term, the Company believes that the market fundamentals for metallurgical coal will provide substantial opportunity to increase market diversity and market share. The Company's Wolverine hard coking coal has received positive reviews from some of the world's leading steel mills. The Company's Burnt River low volatile PCI coal is consistently ranked in the top three PCI coals worldwide and has experienced unparalleled demand. These coals, in conjunction with highly efficient rail and port infrastructure with excess capacity, provide to the Company a strategic advantage to grow and diversify.

113 A similar statement was made in the MD&A.

114 The statements in Note 1, some of which are identified above, must be read as a whole. The plaintiff focuses on the going concern note in the second paragraph, but gives no attention to the sentence immediately following, which I have highlighted, expressing management's belief that funds will be available. As well, the note cannot be read in isolation. It must be considered in the context of the financial statements as a whole and the MD&A as a whole and it must be considered from the perspective of a reasonably informed investor. Such an individual, on reading these documents, would be informed that while WCC was facing some major challenges, it also had some real opportunities.

115 Some of the major challenges identified in the disclosures included, but were by no means limited to:

- WCC had sustained a net loss for Q2 2008 of nearly $44 million and an operating loss of $13.5 million;
- WCC had a working capital deficiency of about $25 million;
- it was unable to meet its long term debt obligations without additional equity or debt financing;
- there had been violations of its debt covenants and future violations were anticipated;
- the strengthening Canadian dollar was impacting revenues and cash flow; and
- WCC's current coal sales agreements for its Wolverine hard coking coal covered shipments only for the coal year ended March 31, 2008, with the result that increases in coal prices would not hit the financial statements until some time after that date.

116 On the other hand, the financial statements and MD&A identified a number of positive features of WCC's circumstances, including:

• the Company had over $400 million in assets, including the Wolverine Project and the Brule Mine, both of which had demonstrated economic viability;

• the acquisition of FMC pursuant to the agreement with Cambrian would create considerable synergy with WCC's existing operations;

• there was an anticipated increased global demand for both metallurgical coal and pulverized coal, with corresponding anticipated price increases;

• there had been positive reviews of WCC's coal from some leading global steel companies;

• negotiations were under way to fix long term sales agreements with "top tier steel mills with excellent growth and stability prospects"; and

• management believed that the needed additional financing would be available, albeit without an assurance that the terms would be acceptable.

117 The MD&A noted that over the previous two years WCC had transitioned "from a junior coal exploration company into a coal producer." A reasonably informed investor reading the disclosure documents could see that there were risks attached to the investment, including the risk that WCC would not obtain additional funding on acceptable terms, even though it had managed to do so in the past. That same investor would also see that there were opportunities attached to the investment, including the potential FMC acquisition, rising international coal prices and long term sales contracts with top tier steel companies.

118 In order to understand the discussions that took place between WCC management, the Audit Committee and the auditors, PwC, concerning the appropriate level of disclosure in the financial statements, it will be helpful to give a general description of the applicable accounting principles. There will be further discussion of these principles when I examine the expert evidence on the issue.

(b) Applicable Accounting Principles

119 The Handbook of the Canadian Institute of Chartered Accountants (the Handbook and CICA) is considered to be an authoritative statement of Canadian GAAP. In this section, I will set out the applicable GAAP principles, as identified in the evidence.

120 The Q2 2008 financial statements of WCC were prepared on a going concern basis. This is consistent with Section 1000 — Financial Statement Concepts of the Handbook, which provides, at para. 58, that financial statements are prepared on a going concern basis, meaning that the entity will continue in operation for the foreseeable future and will be able to realize assets and discharge liabilities in the normal course of operations. [6]

121 The Handbook mandates that in preparing the financial statements, management must make an assessment of whether the company is able to continue as a going concern. [7] It provides that the statements *shall* be prepared on a going concern basis, unless management intends to liquidate the entity or stop business or has no realistic alternative but to do so. However, when management is aware of "material uncertainties" that may cast "significant doubt" on the ability of the entity to continue as a going concern, the Handbook provides that those uncertainties shall be disclosed. [8]

122 The Handbook provides further guidance on the going concern assumption, requiring management to take into account all available information about the future, looking forward at least twelve months from the balance sheet date. [9]

123 As well, assistance is given by the Ontario Securities Commission in OSC Staff Notice 52-7194, dated December 2010, entitled "Going Concern Disclosure Review":

> Overall, we found that issuers disclosed material uncertainties in the notes to their financial statements. However, 41% did not explicitly state that the disclosed uncertainties may cast significant doubt upon the entity's ability to continue as a going concern. <u>This omission is significant because, absent such linking disclosure, the going concern risk is not highlighted for readers to assess the likelihood and impact of the uncertainties disclosed on the issuers' financial condition.</u> During our review, we often found it difficult, based on the entity's public disclosures alone, to differentiate uncertainties that cast significant doubt on an entity's ability to continue as a going concern from uncertainties that do not cast such doubt, and had to request additional information from the issuer for clarification. Investors do not have the ability to request this additional information and rely on the public disclosure record to make investment decisions. <u>That is why clear robust disclosure is important. In order for the going concern disclosures to be useful to investors, the going concern disclosures should explicitly identify that the disclosed uncertainties may cast significant doubt upon the entity's ability to continue as a going concern.</u>
>
> <u>[Emphasis added.]</u>

124 This extract expresses the important requirement that disclosure of the going concern risk must be "clear" and "robust", must identify the uncertainties that cast doubt on the ability of the entity to continue as a going concern and must specifically link those uncertainties to the going concern risk.

125 GAAP also gives guidance concerning the accounting and reporting of situations in which debt covenants are expected to be violated within twelve months after a reporting period. This is set out in the abstracts of the Emerging Issues Committee (EIC) of the CICA. Issue 1 of EIC 59 provides that where the entity has violated one of more of its long-term debt covenants, giving the creditor a right to demand repayment of the debt, the debt must generally be re-classified as a current liability, unless the creditor has waived the right to demand payment and it is not likely that there will be a further violation of the covenant, giving a right to demand repayment, within one year of the balance sheet date. [10]

126 As we shall see, since WCC had violated its debt covenant with BNP, and did not fall within the exception because further default was anticipated, WCC classified the BNP debt as current, rather than long term, in its Q2 2008 financial statements. This had other impacts on WCC's financial statements, as discussed below.

127 I now turn to the preparation of the Q2 2008 disclosures and the circumstances that led to the inclusion of the alleged misrepresentation.

(c) The Preparation of the Q2 2008 Disclosures

128 As I have said, the root of the plaintiff's allegations of misrepresentation, conspiracy and oppression is the complaint that the going concern note to WCC's financial statements — flagging the issue of whether it was appropriate to use going concern accounting in light of substantial doubt about WCC's ability to meet its obligations as they came due — was a deliberate misrepresentation or was an unduly "bleak" forecast.

129 In order to examine this allegation, I will turn first to the evidence of those involved in the preparation of the disclosure documents. In the next section, I will examine the expert evidence on this issue.

130 It will be recalled that Redmond was the senior financial officer of WCC at the material time, with responsibilities as acting CFO. He was responsible for preparing the Q2 2008 interim financial statements. He worked closely during that time with Boggio, the PwC partner who was the audit engagement leader for WCC's audit.

131 Redmond's affidavit describes his involvement in seeking financing for WCC in the fall of 2007, his work in managing the Company's financial position in November, his preparation of the Q2 2008 interim financial statements and

the advice and direction he received from PwC about the disclosures required to be made in those financial statements. He also described his participation in the search for financing for WCC between November 15 and November 30, 2007, culminating in the Audley Financing. Redmond produced his entire working papers for the preparation of the financial statements.

132 Boggio had been a partner in PwC for twenty years and was a senior partner in the firm's Canadian Mining Industry Group. He had considerable experience in matters of accounting policy and had served, from 2006 to 2009, as a member of the Continuous Disclosure Advisory Committee of the Ontario Securities Commission.

133 Boggio was directly involved in the review of WCC's Q2 2008 interim financial statements. He swore a detailed affidavit setting out his work in the review engagement, which was carried out between the second week in October, 2007 and the filing of the statements on SEDAR on November 14, 2007. He deposed that the "going concern" language to which the plaintiff objects was composed by him and that he advised WCC that the wording was necessary and appropriate in the circumstances.

134 Redmond deposed that he prepared the first draft of Note 1, which was presented to WCC's Audit Committee on November 9, 2007. It did not contain the "going concern" language and instead simply referred to WCC's "capital obligations" in connection with the completion of the Perry Creek Mine and the acquisition of FMC. Note 1 as drafted by Redmond stated:

> The Company's ability to meet these planned obligations depends on its ability to generate positive cash flow and profits from operations, and on its ability to raise financing and/or debt financing from its major shareholder or other third parties. There is no assurance, however, that any required funding would be available to the Company on acceptable terms.

135 Boggio attended the meeting of the Audit Committee on November 9, 2007, having previously provided the committee with a report of PwC's review of the unaudited interim financial statements. At that meeting, Boggio expressed reservations about Redmond's draft of the proposed language of Note 1, in view of his opinion, which was shared by WCC management, that there would be insufficient funds available to meet the Company's debt obligations as they came due and to meet the conditions imposed by BNP, including the obligation to raise an additional $15 million in equity by November 30, 2007. He suggested to the committee that greater disclosure was required. It was left that both Boggio and management would give further consideration to the issue.

136 After the Audit Committee meeting, Boggio did additional research on the disclosure requirements. He sent Redmond an extract from the Handbook including EIC 59, discussed above. He concluded that, in the circumstances that existed at the time, WCC was not able to fall within the exception in EIC 59 and the BNP debt was required to be re-classified as a current liability.

137 The language of Note 1 was substantially revised by Boggio, who sent a "blacklined" revision of the note to Redmond on November 11, 2007. The language now proposed by Boggio included the wording of which the plaintiff complains, specifically the statement:

> These circumstances lend substantial doubt as to the ability of the company to meet its obligations as they come due and, accordingly, the appropriateness of the use of accounting principles applicable to a going concern.

138 Boggio discussed the issue with his risk management partner and his quality review partner to obtain their input. All agreed that the disclosure he proposed was consistent with disclosures by other companies with significant going concern contingencies.

139 On receipt of Boggio's blacklined revision, Redmond sent Boggio an email in which he argued that there were a number of factors that justified "a more favourable outlook than what is currently being presented in your marked up version of our financials". These included the projections of increased coal prices in the year commencing April 1,

2008, agreements in principle with customers for long term contracts and the existence of a long range plan projecting positive cash flows. He concluded with the observation that WCC's financial position was "not as bleak as this set of marked up financial present". Redmond expressed the concern that the statements could be misleading to shareholders, customers and employees.

140 Boggio responded by email later that day, making it clear that in his view it was necessary to include the going concern language. He made the point that the Company's need to obtain outside investment triggered the requirement to express doubt about the going concern assumption and that management's optimism about the ability to raise financing was a factor that could be addressed, but left to investors to evaluate. His response is instructive and I will quote it in full:

> Jeff — thanks for your notes.
>
> Your long range plans, the waiver request to the banks and your notes below all indicate that there is a shortfall of cash and that you will need to go outside for funds and that therefore you will be relying on others to agree to cut a cheque for new equity or new debt for the company.
>
> One of the key items to consider in whether you need to identify that there is substantial doubt about going concern explicitly in your financial statements revolves around whether or not you expect to earn the funds from your regular operations to continue in realizing assets and repaying obligations in the normal course, or whether you must go to the outside to bring in third party investors. The third party investor requirement is really what triggers the need by management to disclose that there is substantial doubt with respect to the going concern assumption, and to make sure that it is referenced on the balance sheet.
>
> I don't think that putting this information in to the statements is anything more than factual, and we recommended this disclosure knowing pretty much of all of the information you set out below, most of which we have already talked about and factored in to our review. The thing is, if you weren't optimistic about the outcome, you couldn't properly represent that you think you will be able to raise or earn the money to continue. This still doesn't change the uncertainty that you face with respect to getting outside investors to share your optimism, and the fact that it is their call on whether or not to invest, and not yours.
>
> I am going to be out this evening, but we can carry on our discussion in the morning. I have three meetings scheduled during the day, but we can find time to talk in between them.
>
> [Emphasis added.]

141 As there was, in fact, substantial doubt about WCC's ability to meet the commitment due on November 30, 2007, and in light of BNP's express refusal to waive the obligation, Redmond agreed to include the language that Boggio had proposed.

142 Boggio swore in his affidavit that, had the note to WCC's financial statements not incorporated the language he proposed, or similar language, he would have had to consider whether PwC should have withheld or qualified its review engagement report on the basis that the interim financial statements had not been prepared in accordance with GAAP, due to the failure to disclose the going concern contingency. This fact would have to have been noted in WCC's public filings, presumably with negative results in terms of its ability to raise capital.

143 The evidence of Brodie, who was an independent director of WCC and Chair of the Audit Committee at the material time, is particularly significant. Brodie is a chartered accountant and a former partner in KPMG holding a number of senior management and directorship positions with the firm, including chairing the firm's audit committee and serving as managing partner of its Ottawa office. He had extensive personal experience as a C.A. in the audit of public companies and had served on the board and as chair of the audit committees of several mining and resource companies. Brodie was a member of the independent committee that reviewed and approved the Audley Financing and the special committee that was formed to consider the acquisition by WCC of the shares of FMC.

144 Brodie gave extensive affidavit evidence concerning the events and discussions leading up to the release of WCC's Q2 2008 disclosures on November 14, 2008. As might be expected, he communicated regularly with Redmond in preparation for the Audit Committee meeting on November 9, 2007 and discussed the implications of the Company's breach of its working capital covenant under its loan from BNP as of September 30, 2007.

145 Brodie's evidence makes it clear that there was, at what he described as a "long and detailed" Audit Committee meeting on November 9, 2007, extensive, vigorous and sophisticated discussion of the proposed note to the financial statements, the disclosure recommended by PwC, the need for going concern language, the need for disclosure of the Company's financing requirements and the need to make fair disclosure that would comply with the rules expressed in the Handbook.

146 At the conclusion of the meeting, it was agreed that the Audit Committee would meet again on November 13, 2007 to review and finalize the financial statements and the wording proposed by PwC. Brodie participated in ongoing communications with Redmond and Boggio concerning the financial statements. Brodie swore that in light of his knowledge of the financial condition of the Company, and his knowledge of the CICA Handbook, he was in agreement with the recommendations of PwC in connection with the going concern note.

147 At the meeting of the Audit Committee on November 13, 2007, there was specific discussion of the need to classify the Company's long-term debt obligations as current and the changes to the going concern note as recommended by PwC. Brodie's evidence concerning the discussion of the language proposed by PwC was:

> The meeting was advised that the auditors were comfortable with the proposed disclosure language. Mr. Redmond was of the view that the disclosure as contemplated was required to be made to investors. I accept and agreed with the advice of the auditors and Mr. Redmond. I also stated, as I believed then and I still believe now, that the disclosure contained in the second quarter financial statements was factual and, even though it was unfortunate, going concern disclosure was required.

148 Brodie said that he agreed with the inclusion of the going concern language because the ability to obtain financing was not within the Company's control. He also agreed that it was appropriate to express management's believe that funds could be raised in the future, "but they also knew, as I did, that there was no guarantee that funds would be made available on acceptable terms to [WCC]".

149 The financial statements, including Note 1, were approved by the Audit Committee at its meeting on August 13, 2007.

150 The disclosures were approved by WCC's Board on November 14, 2007, prior to their public release.

151 Brodie's further comments are instructive:

> As a member of the Audit Committee and Board, I carefully considered all of the issues raised with respect to the Second Quarter 2000 Interim Financial filings. Based on the analysis and information provided by management (including Mr. Redmond) relating to the Company's finances, forecasts and cash flows, and based on the report, advice and strong recommendations of Mr. Boggio, I agreed as a member of the Audit Committee and of the Board with all of the content and wording of the second quarter financial filings. I also note, and relied upon the fact, that both Mr. Hogg and Mr. Redmond certified the accuracy of the financial statements.
>
> Contrary to the allegation of the plaintiff, there was no financing agreement reached between [WCC] and Audley on or before November 14, 2007. I was not aware of any consideration or discussion within [WCC] of the prospect of Audley providing any financing to or investment in [WCC]. I, like Mr. Chase explains, learned that Audley might be prepared to provide financing at the Board meeting on November 17, 2007 when Mr. Burridge advised the Board that there was a 50/50 chance that Audley might invest.

152 Chase's evidence accords substantially with the evidence of Brodie. Chase was a professional non-executive director. He was trained as a chartered accountant although most of his career had been spent in the business world. He had extensive experience in the mining and resource industries and extensive experience with the audit of public companies and auditing standards. He attended the meeting of the Audit Committee on November 9, 2007 and was satisfied that the going concern language was accurate and required by GAAP. While he was optimistic that financing could be arranged going forward, it was accurate, in his view, to state that there was no assurance that financing would be available in a timely manner or on acceptable terms. He flatly denied that the Audley Financing was pre-arranged. In a subsequent affidavit, he also denied that the financial disclosures made by WCC were designed to create a false panic about the financial health of the Company or to depress the value of its stock.

153 Byrne's evidence is also germane. He was Chairman of the boards of both WCC and Cambrian. He deposed that WCC's Board was concerned that the Q2 2008 statements would deliver a negative message to the market about the financial risks confronting the Company. The Board discussed whether less severe language could be used in the disclosure because they believed that the Company would obtain the financing it needed to meet its obligations. Byrne was persuaded, however, that the Board should follow the advice of WCC's auditors. Byrne's evidence continued:

> As a result, we [the WCC Board] felt that it was important that [WCC] issue the November 14, 2007 news release that accompanied the financial statements and emphasized our collective belief that [WCC] would obtain financing to allow the Company to meet its financial commitments due at the end of November to BNP.

154 The evidence of Redmond, Boggio, Brodie, Chase and Byrne, which is entirely consistent with the evidence of all other factual witnesses, makes it clear that the alleged "misrepresentation" was not the result of a conspiracy hatched by the defendants to misrepresent the Company's financial position. On the contrary, the language originated with the Company's auditors and was initially resisted by the Company because of management's expectation that the Company would weather the immediate financial crisis. The Company and its senior officers and directors only agreed to the inclusion of the going concern note after being persuaded by the auditor that the facts and the requirements of GAAP required the disclosure of uncertainty about the going concerning assumption, which could be balanced by the reference to management's expectations.

155 I turn now to the expert evidence on the central issue of whether the Q2 2008 disclosures contained a misrepresentation that will support the plaintiff's proposed class action under Part XXIII.1 of the *Securities Act*.

(d) Expert Accounting Evidence

The Plaintiff's Expert Evidence

156 Rosen's initial report indicated that he had been retained to provide an opinion on financial events affecting WCC in November and December 2007. The thrust of Rosen's evidence was that the events surrounding the dramatic decline in WCC's stock price following the November 15, 2007 disclosures "warrant considerable investigation." Rosen suggested that transactions carried out during the "liquidity crisis" (his quotation marks) [11] in the November to December 2007 period "have extensive ownership dilution effects and tend to favour a few insiders and related entities".

157 Rosen noted that it would be necessary for investors to have more knowledge about the events in question in order to understand the large trading volumes and sharp drop in the share price following the release of WCC's Q2 2008 results. He added, "[M]inority shareholder oppression is highly suspected, based on the publicly-available evidence". He noted that, around the time of the liquidity crisis, debt financing had been arranged and FMC had been acquired from a related company (Cambrian) using depressed stock prices. The use of convertible debt and share warrants to undertake these transactions had, he opined, serious dilution consequences for the other shareholders of WCC.

158 Rosen stated that several accounting write-downs had been made by WCC, and suggested that the financial statements painted a "gloomy picture of WCC's future":

> The fiscal 2008 second quarter financial results were released on November 14, 2007. Several accounting write-downs were made in the second quarter, which served to paint a gloomy picture of WCC's future. The pessimism underlying the negative accounting adjustments was not consistent with WCC management's positive assessment of operational prospects. In particular, the anticipation of future losses was contradicted by management's expectation of rising future coal prices and the intention to proceed with the FMC acquisition. The FMC acquisition was expected to generate significant synergies.

159 Rosen noted that the financial statements, MD&A and news release reported that the Company did not expect to have sufficient funds in the near term to meet its financial obligations as they came due and expected to violate financial covenants within the next twelve months and, on that basis, "chose to reclassify its long-term debt to current liabilities." He added, "[T]he effect was to create an impression that the company had significant impending repayment obligations, which would not be met. Such a disclosure by a company would reasonably be expected to alarm investors."

160 Rosen suggested that there were "numerous inconsistencies" in WCC's public statements. He pointed out that:

> • the company's concerns about its cash flow were predicated on "current coal prices and Canadian/US dollar exchange rates", yet he noted that the same statement referred to the fact that future coal prices were expected to be significantly higher;
>
> • management believed that additional capital would be available in the future, and expressed his opinion that "the expectation of available financing contradicts the belief that WCC would not be able to fulfill its repayment obligations. Additional financing, or refinancing, apparently was expected, yet had been downplayed in the wording that had been utilized in communications with shareholders";
>
> • WCC had an option to acquire FMC from Cambrian, with potential synergies for WCC's operations, adding "it would seem highly unusual for a company that purportedly is on the verge of bankruptcy to write about corporate acquisition and expansion."

161 I have commented on aspects of Rosen's evidence that lead to my conclusion that he failed to display the independence and objectivity required of an expert witness. His statement about future coal prices, however, reflects a lack of knowledge of the nature of WCC's business and the pricing of coal contracts which, as even Gould knew, was done in April of each year. Thus, the Company's cash flow until at least April 2008 would be based on its existing contracts at lower coal prices. His comments in the second two bullets reflect, in my view, not only a lack of balance in his own evidence but also a lack of appreciation for the need for balance and objectivity in the Company's disclosures.

162 Rosen then set out his comments about the going concern note, expressing the opinion that if WCC did not expect to satisfy its debt obligations as they came due, it was not appropriate to continue to apply going concern accounting. It is important to set out his evidence in full:

> An analysis of WCC's financial reporting and accounting choices yields similar concerns. The November 14, 2007 news release expressed management's belief that the company would not be able to meet its financial obligations as they came due. Yet, WCC continued to apply 'going concern' accounting, which implies that it would be able to discharge its liabilities as they came due.
>
> As set out in Section 1000.58 of the Handbook of the Canadian Institute of Chartered Accountants, 'going concern' accounting refers to the presumption that a business entity will be able to continue in its normal course of operations, realizing its assets and discharging its liabilities as they come due. If an entity is not considered to be a going concern, other bases of accounting would be appropriate or be compulsory. An example of an alternative accounting basis is liquidation accounting. Liquidation accounting would restate the assets to their expected net realizable values, and liabilities to their present values if settled immediately.

> If WCC did not expect to be able to satisfy its debt obligations as they came due, it would not have been appropriate to continue applying the 'going concern' assumption. In my view, WCC's decision to remain with going concern accounting is not consistent with its assessment of its liquidity position, and the reclassification of its debt to the current liability category, as is noted below.

163 Rosen then referred to EIC-59, requiring a debt to be classified as current if a covenant is likely to be violated within one year of the balance sheet date. He suggested that management's stated expectation that additional financing would be obtained from related parties to meet its cash requirements was inconsistent with the view that additional covenants would be violated in the coming year.

164 I will discuss Rosen's opinion below, and will compare it to the opinions expressed by the defendants' expert. After reviewing other accounting adjustments made by WCC, Rosen came to the rather dramatic conclusion that stock manipulation had taken place:

> The inconsistencies in WCC management's explanations and the accounting adjustments strongly suggest that the negative liquidity news and financial reports were intended to cause a suppression of the company's stock price.

165 He then suggested that further investigation was required to get to the bottom of the matter:

> Given the timing of the financial disclosures and reporting, and the apparent effect of the same on WCC's stock price, significant further investigation is required. The accounting choices by WCC's management must be probed, and factual support carefully evaluated.

166 Rosen's second report was prepared with the benefit of having had access to the substantial volume of affidavit evidence filed by the defendants, including the evidence of Redmond and WCC's expert accounting witness, Wayland of Deloitte. He concluded that WCC's going concern disclosures were not required by GAAP and surmised that they must have been made deliberately to cast a "dark cloud" over the company and to deliberately suppress its stock price:

> Overall, Western Coal's 'going concern' disclosures were not required by GAAP, particularly for an interim or quarterly report, given the magnitude of dollars involved. Admissions of financial difficulty therefore were voluntary and appear to have been elected to be made by management to cast a dark cloud over the Company. Given the adverse implications for the confidence of investors, employees, suppliers and customers in a company when admissions of imminent business failure are made, WCC's decision to volunteer incomplete, distressing news is puzzling. Announcing possible business failures carries a risk that the warning will be self-fulfilling. Hence, we would expect that such disclosures would not be made unless failure was unavoidable.

> Further investigation of the disclosures is necessary. Many indications exist that WCC was not [emphasis in original] insolvent and that its management chose not to explore viable options prior to, and during, the purported "financial distress period" [his quotation marks]. Such behaviour would be consistent with an intention to create false panic about the financial health of the Company, so as to suppress its stock price.

167 This statement is yet another example of Rosen improperly engaging in fact-finding, speculation and the attribution of motive.

168 Rosen's conclusions on the disclosure issue can be summarized, using his own language in some cases, as follows:

• disclosure of doubts about WCC's ability to continue as a going concern was not required, recommended or appropriate according to GAAP, and was made by management without providing disclosure of all the relevant facts;

• the Company's cash pressures were limited to the need to refinance a relatively small proportion of its overall liabilities and the use of going concern language was either prohibited by GAAP or was highly unusual;

• "Unwarranted gloom and biased descriptions do not constitute fair financial presentation, nor were they permitted under Canadian accounting standards that existed at the time. Unjustifiable management-based impacts on share prices are contrary to good governance principles and basic securities law";

• "The Company's claims of impending insolvency were not consistent with its available financial resources or with management's actions leading up to the disclosures. In our opinion, WCC's public announcement significantly overstated the financial risks facing the company in November 2007. A major concern for shareholders has to be that the Company's disclosures could very well have deliberately been made to create false panic with investors, and depress the Company's share price."

169 Later in the report, Rosen suggested that where doubt exists about a corporation's ability to continue as a going concern "much softer wording is utilized in financial statements". He said that, "[T]he term 'going concern' is typically avoided because of its harshness and severity. Hence, inclusion of such words by WCC was likely to cause alarm and concerns. In our opinion, such effects should have been well known to the management of WCC." He said that, "[E]xcessive conservatism and gloom is not an acceptable GAAP concept", referring to the Handbook s. 1000.21(d). [12]

170 Rosen went further in the report, suggesting that admissions that the going concern assumption may be in doubt "are tantamount to a company declaring imminent business failure". He described the going concern qualification in WCC's financial statement as being "questionably consistent with the definition of insolvency" and "an unwarranted admission that the Company expected to become insolvent".

171 Rosen concluded that WCC "was not facing a legitimate risk of insolvency in November 2007" and that the disclosure of going concern doubts was "not warranted based on relevant Canadian financial reporting standards." He pointed, in particular, to the positive value of the Company's substantial net assets, its forecasted cash flows from future operations, the failure to renew or obtain a support letter from Cambrian and the alleged lack of urgency in obtaining alternative financing, which he said were all indicative of the absence of any real crisis. The cash pressures facing the Company, he said, were limited to a need to refinance a relatively small proportion of its overall liabilities, refinancing options existed, and the Company was far from insolvent on a day-to-day operational basis.

172 Rosen suggested that the overstatement of the financial risks facing WCC in November 2007 raised the concern that these could have been made deliberately, with the intention of creating "false panic with investors ... [to] depress the Company's share price." He suggested that the conduct of the Defendants, including the management of WCC, Cambrian and Audley, "requires close scrutiny and investigation", because it is not consistent with experience and observations over many years.

173 Rosen's reply report suggested that his work had only just begun. He said that further investigation of WCC's disclosures was necessary and that there were many indications that WCC was not insolvent and that its management deliberately chose not to explore viable options during the period of financial distress. He suggested that, "[S]uch behaviour would be consistent with an intention to create false panic about the financial health of the Company, so as to suppress its stock price."

174 I turn now to the expert evidence on behalf of the defendants.

The Defendants' Expert Evidence

175 As noted above, expert accounting evidence on behalf of the defendants was given by Wayland, a chartered accountant and partner with Deloitte, with extensive experience in GAAP compliant financial statements and disclosures. He prepared an initial report dated March 1, 2011 and a second report, dated November 28, 2011, specifically in response to Rosen's reply report.

176 In his first report, Wayland expressed the opinion that, in view of (a) WCC's breach of its debt covenant, which was waived for a period of two months after September 30, 2007 conditional on a requirement that WCC contribute equity of a total of $15 million (an increase from the previous requirement for $10 million) and (b) management's forecast that the covenant would be violated within the next twelve months, it was required under GAAP and specifically EIC 59, discussed above, to classify the long-term debt as a current liability. There is no dispute about this requirement. The classification of the long-term debt as current resulted in a $24 million working capital deficiency.

177 Moreover, as required by GAAP, in preparing its financial statements it was necessary for the Company to make an assessment of its ability to continue as a going concern. Wayland's opinion is that it was appropriate to prepare the financial statements on a going concern basis, in light of management's stated belief that the Company would have available sufficient funds to meet its obligations in the future and had no intention of liquidating or ceasing operations. It was also his opinion, however, that in accordance with s. 1400 of the Handbook, it was appropriate for the Company to disclose the material uncertainties that cast doubt on its ability to continue as a going concern. These uncertainties included:

- the absence of any firm commitment to renew or re-finance WCC's existing debt or to provide the additional $15 million in equity it would require, by November 30, 2007, to satisfy the condition attached to BNP's waiver;
- management's cash flow forecasts that demonstrated that if the $15 million equity injection could not be obtained, WCC's cash flow would not be sufficient to enable it to repay its now current debt; and
- the Company had incurred significant losses in Q2 2008 and in each of the previous four quarters.

178 Wayland agreed with Boggio's conclusion that if a client did not make disclosures that he believed were required by GAAP, he would have to consider withholding or qualifying his review engagement report.

179 Wayland's first report also addressed several accounting write-downs that were taken by WCC in Q2 2008, including a $14.7 million valuation allowance that had been taken against losses in previous years which had been recorded as an asset. These are discussed in the next section.

180 Wayland's second report was prepared in response to Rosen's second report. He opined that Rosen has misstated the purpose and import of the going concern note in WCC's financial statements. Rosen's report repeatedly characterized Note 1 as describing an "impending threat of insolvency" or "impending insolvency" or "an unavoidable threat" as if it was a statement that insolvency was about to happen. [13] This misstatement has been carried through by plaintiff's counsel in their submissions. Plaintiff's counsel claimed that it described WCC as being "on the verge of bankruptcy" or facing "pending insolvency".

181 As I will explain later in these reasons, I accept the evidence of Boggio and Redmond, who were actually involved in the disclosure decisions and of Wayland, whose evidence confirms the reasonableness of their approach. In my view, Rosen's evidence fails to consider the disclosure as a whole, distorts the standard to be applied and proposes a form of "disclosure light" that is not consistent with the law or with GAAP and would confuse and mislead readers of the financial statements. I find that there is no reasonable possibility that Rosen's evidence would be accepted at trial in preference to the defendants' evidence.

(e) Alleged Improper Accounting Adjustments

182 As I have noted, the plaintiff claims that the defendants intentionally made inappropriate discretionary accounting write-downs and adjustments and unjustifiable projections, deliberately inflating WCC's loss for Q2 2008, as part of their strategy to misrepresent WCC's financial condition in the Q2 2008 disclosures. In Rosen's initial report, it was noted that a large portion of WCC's net loss for the quarter, was tax related. He said, "[S]uch a percentage, based on discretionary choices, merits investigation."

183 In this section, I will review the main plaintiff's principal contentions. It is worth repeating, however, that as of September 30, 2007, the end of Q2 2008, and as of November 14, 2008, when the public disclosures were made, WCC was facing significant financial challenges and uncertainties. Not the least of these was its failure to obtain financing to stave off default on its obligations to BNP, which were coming due on November 30, 2007. This circumstance, and the need to classify the Company's long-term debt as current, had other accounting implications.

"Cleaning House" and Write-off of Costs

184 As evidence of the alleged conspiracy to misrepresent WCC's financial condition, the plaintiff relies on an email dated October 28, 2007 from Redmond to Brodie, Chase and Conlon in which he explained the rationale for writing off costs incurred in connection with WCC's option to purchase FMC. Redmond stated:

> John — another issue Western will need to consider at this point is the classification of its deferred transaction costs as at September 30, 2007.
>
> The Company has a total of approximately $1.2 million in deferred costs of which $650k related to the FMC transaction contemplated during Q1 and $550k incurred to date relating to Project Carbon [the potential merger of WCC and Cambrian]. I was comfortable arguing that the FMC costs could be rolled into an evolved transaction but given where we are we may wish to consider writing off as either abandoned transaction costs or consulting costs or a combination thereof <u>further enhancing our loss this quarter</u>.
>
> [Emphasis added.]

185 In response, Brodie, the Chair of WCC's Audit Committee, wrote:

> I am in agreement, let's <u>clean house</u> and put everything behind us.
>
> [Emphasis added.]

186 The plaintiff says that Redmond's words "further enhancing our loss this quarter" are evidence that he was deliberately seeking to "enhance" WCC's losses, to make its losses seem greater than they really were. In my view, the plaintiff is taking a perfectly innocuous "sound bite" out of context and is giving it an unwarranted sinister meaning.

187 To put the statement in context, WCC had just held a board meeting, at which it had been agreed that "Project Carbon", a proposed merger between WCC and Cambrian, would not be taking place in the foreseeable future. The Board also concluded that WCC was not in a position to exercise its option to purchase FMC in light of its financial condition. In these circumstances, the evidence establishes that it was perfectly appropriate accounting practice to write off the costs of those transactions, which had previously been recorded as assets.

188 On cross-examination, Redmond gave a complete explanation of his rationale for the adjustment and denied that it was part of a deliberate strategy to enhance losses. He stated:

> And I think that our position was that we needed to really put our numbers under scrutiny to make sure that they could stand up to the tests of a review and certainly, you know, the assertions that the financial statements were prepared within and this comment about let's clean house, I'm not sure if it reflected the entirety of those financials or just simply the transaction costs that were associated with the FMC and project carbon, in that it was sort of determined that that was a transaction given the state where we were at that wasn't going to go forward and I think we could look at the next three months and say with certainty that we were not going to pursue a transaction that related to merging with Cambrian.

189 Brodie, who was not cross-examined on this issue, gave similar evidence:

> With respect to the write-off of the transaction costs of approximately $950,000, I should set out my thoughts on the issue at the time. I did not believe at the time of the release of the financials (November 14 th) that it was appropriate to conclude that the Company would complete the two transactions (the acquisition of FMC and a potential merger with Cambrian) for which costs had been capitalized and recorded previously as assets. The Board had shelved discussions of any merger with Cambrian in late October and the Company simply did not have the money to exercise its option to acquire FMC before the contractual 180 day deadline expiring on December 31, 2007. In my view, it was conservative to write off the costs for September 30, 2007, rather than maybe taking the charge in a subsequent quarter.

190 The evidence of Wayland of Deloitte is that the expensing of previously capitalized corporate transaction costs is appropriate under EIC 94 where "the enterprise ceases to be engaged on a regular and ongoing basis with completion of the specifically identified transaction and it is not likely that activities with respect to the completion of the particular transaction will resume within the next three months." This was the situation at the time. The decision to write off these expenses, which were, in the overall scheme of things, relatively modest, was therefore in accordance with GAAP.

191 Rosen claimed that because the FMC transaction was ultimately completed, albeit well after November 15, 2007, the statements should have been corrected and the recording of the write-off was premature. In my view, the ultimate occurrence of the subsequent event did not make the write-off improper at the time it occurred.

192 In the overall context, in which WCC was contemplating going into the market to obtain financing, it made perfect sense that it would attempt to "clean house", write off unrealizable assets and put its losses behind it. The entire tone of the emails, and the evidence of Redmond and Boggio is to this effect, and is inconsistent with any ulterior and improper motive.

Cash Flow Forecasts

193 The plaintiff also alleges that WCC's officers "concocted" cash flow projections to show that it would not have sufficient funds to meet its long-term obligations as they came due, and then duped its auditors, PwC, into buying into this proposition.

194 This allegation is based on the portion of Note 1 to the financial statements, which was prepared by management, to the effect that:

> At current coal prices and Canadian/US dollar exchange rates, the Company does not expect to have sufficient funds to meet its long term debt obligations as they come due and to continue the planned expansion of the Perry Creek Mine, and accordingly the Company will require equity or debt financing from external sources.

195 There is no dispute about the impact of the strengthening Canadian dollar on WCC's cash flow, because coal sales were made in US dollars and the Canadian/US exchange rate had strengthened approximately 5% from Q1 to Q2, according to the MD&A.

196 Gould says, however, that the statement about coal prices was false because WCC knew that spot coal prices as of November 2007 were in the range of US$120 to $160 per tonne and forecasts for 2008 were in the range of $110-135 per tonne. The plaintiff says that the forecasts used in WCC's projections were based on contracts entered into on or before March 2007, when prices were much lower, at around US$86 per tonne.

197 The flaw in this analysis is that, although market prices had been increasing during 2007, a factor that was discussed in a positive and prominent way in the MD&A and news release, the practice in the coal market was to set coal contract prices on April 1 of each year. Thus, most of WCC's contracts as of November 2007, and up to March 31, 2008, were based on prices that were in effect in March 2007 and those prices were much lower than the "spot" prices

that were prevailing in November 2007. The fact that the market price was on the rise would not significantly impact WCC's cash flow until Q1 2009, at the earliest.

198 Redmond's evidence is completely consistent with the foregoing and completely inconsistent with any deliberate attempt to pull the wool over the eyes of the auditors. This is another example of Rosen's inclination to find a boogie man under every bed. When light is actually shone on the subject, it disappears.

199 Quite apart from this, as Boggio pointed out on his cross-examination, the immediate issue facing WCC at the time, and the primary reason for the going concern note, was the uncertainty about whether funding could be obtained to satisfy WCC's November 30, 2007 obligation to BNP.

Write Down of Future Income Tax Assets (FITA)

200 Income tax losses, which are capable of being carried forward, are referred to as a "future income tax asset" (FITA), because they can, in certain circumstances, be applied against future income for tax purposes. WCC substantially wrote down a FITA in Q2 2008 on the basis that it would not likely have sufficient income in the future to make use of the carry-over of these losses. This resulted in a decrease in assets and net income of $14.7 million. The rationale for this adjustment was specifically identified, and explained, in Note 13 to the financial statements.

201 In criticizing the write down of the FITA assets, Rosen observed that WCC was forecasting positive cash flows as early as January 2008, producing a taxable income against which previous years against which the previous years' losses could be applied. He concluded:

> The write-down of the future income tax asset resulted in a decrease to assets and a decrease in net income of $14.7 million. In short, in our opinion, management made a negative arbitrary decision to paint an unwarranted, alarming financial position. Financial statement fairness apparently was ignored.

202 This is another example of Rosen's assumption of a fact-finding role, his tendency to ascribe motive to conduct and his propensity to engage in argument and advocacy.

203 GAAP (Handbook s. 3465) requires that a tax loss be recorded as a FITA where it is "more likely than not", (i.e., more than a 50% probability), that sufficient future income will be generated to enable the company to use the loss carry forward.

204 The defendants' expert witness, Wayland of Deloitte, commented on this issue, and opined that, in light of management's conclusion that there was substantial doubt about the Company's ability to continue as a going concern, it was appropriate to record a full valuation allowance for the tax asset, for the obvious reason that it could not be said that it was probable that there would be income against which the losses could be offset.

205 Wayland testified that his firm's view was that where the auditor's report identifies a going concern issue, it will be necessary to make a valuation allowance. Similar advice was given by PwC to WCC in connection with the preparation of the Q2 2008 statements. The existence of substantial doubt about the ability of WCC to continue as a going concern made it "less likely" that there would be future income against which the past losses could be applied. In the circumstances, then, it was appropriate to take the allowance.

206 Redmond's evidence was that in concluding that the tax asset should be substantially written off, he and management had regard to Handbook 3465 and to the fact that: (a) the Company had a history of tax losses, negative cash flow and working capital deficiency, among other things; (b) the Company needed external financing to meet its November 30, 2007 obligation to BNP; and (c) the Company needed bridge financing or capital to continue to operate until March 31, 2008, in view of its negative cash flows.

207 In my view, the evidence overwhelmingly establishes that the decision to substantially write down the tax asset was made on a reasonable basis, after due deliberation, with the advice of WCC's auditors and in accordance with

GAAP. Rosen's evidence to the contrary, which exceeds the boundaries of expert evidence, and is based on unfounded assumptions about WCC's motives, is neither balanced nor fair.

Inventory Write-Down

208 GAAP (Handbook s. 3030) requires inventory to be valued in each reporting period at the lower of cost and net realizable value — that is, the "estimated selling price in the ordinary course of business, less the estimated cost of completion and the estimated costs necessary to make the sale." WCC recorded a write down in inventory of $2.8 million in Q2 2008 to reflect the fact that the value at which the inventory could be realized was less than the value at which it was being carried for accounting purposes. Assuming that the facts support this conclusion, the proposition that the financial statements should show the realizable value of the inventory — even when its book value is higher — makes perfect sense.

209 Redmond explained this adjustment as follows, in his affidavit:

> Our coal inventory was sold pursuant to fixed prices, payable in American dollars. The Company's accounting policy was that inventory was recorded at the lower of cost or net realizable valuable [sic]. In this period, our costs were increasing due to performance and operational issues while at the same time, the net realizable value of inventory was falling as the value of the Canadian dollar rose against US dollar priced contracts. These two factors combined such that we were required to write off $2,803,000 from our inventory.

210 Redmond attached to his affidavit the working papers that were used to prepare WCC's inventory valuation for the Q2 2008 statements. The analysis indicated that the cost of the inventory on hand as of September 30, 2007 exceeded the contractually agreed selling prices by about $2.8 million.

211 The inventory write off was specifically highlighted in the "Summary of Quarter" portion of the MD&A, which explained that:

> Write-off of inventory of $2,803,000 due to the strengthening Canadian dollar and higher production costs. Production costs during the quarter were higher due to mining issues including equipment shortages, poor equipment uptime due to maintenance issues and low productivity due to an inexperienced work force.

212 In commenting on the Company's reasons for the write-down of inventory, Rosen made the following statements in his second report:

> The inventory write-down resulting in a decrease to assets and a decrease to quarterly net income of $2.8 million. As forensic accountants we are highly concerned that the write-down could have added to the overall unfairness of the September 30, 2007 financial statements. It is not clear whether the inventory was ultimately sold for a price in excess of its historical cost, which would render the write-down to be inappropriate.
>
> Overall, WCC recorded several adjustments to reduce its reported net assets and net income in its second quarter 2007 financial statements. At least some of these negative adjustments probably were arbitrary and have a high likelihood of being inappropriate. Suppressing net assets and net income would be consistent with a desire to convey a dismal financial picture of WCC so as to suppress its stock price.
>
> Unwarranted write-downs are in violation of the vital 'fairness' standards of GAAP and of the securities acts of Canada. Quite clearly, further investigations of the write-downs are called for, to obtain full facts and assess reporting balance and 'fairness'. Subsequent events would appear to contradict the stance that was adopted by the management of the Company.

213 These statements, which do not actually express an opinion that the write-down of inventory was inappropriate or inconsistent with GAAP, is a gratuitous, speculative and unjustified swipe at WCC. It suggests that the write-down was inappropriate and sinister without the slightest evidence. Redmond's evidence gives a complete and coherent explanation of the issue, which Rosen does not even examine.

214 Wayland's evidence is that the inventory write-off was made in accordance with GAAP and that it was appropriate to value the inventory as of the end of the quarter.

Conclusions on Accounting Adjustments

215 Although the allegedly improper accounting adjustments were not central to the plaintiff's misrepresentation and conspiracy claims, they were pleaded and argued as being supportive of those claims and were used to bolster the plaintiff's contention that the defendants deliberately manufactured a financial crisis in WCC.

216 The allegations have been thoroughly refuted by the evidence of those directly involved in the preparation of the Q2 2008 disclosures and by the defendants' expert who has shown, in a simple and common sense way, that the adjustments were based on the application of GAAP.

217 Rosen's evidence to the contrary suffers from the shortcomings I have identified earlier and is based on his own assessment of the motives of those involved. It fails to take into account the perfectly reasonable explanations for the adjustments given by the defendants' witnesses. It is also inconsistent with GAAP, and with common sense, and there is no reasonable possibility that it would be accepted at trial in preference to the evidence adduced by the defendants.

218 In any event, I agree with the defendants that the accounting adjustments are merely a side issue. They do not detract from the irrefutable facts that WCC needed $15 million by the end of November 2007 in order to meet BNP's demands and it did not have those funds. It also anticipated that, even if it obtained those funds, there would be a further covenant violation within twelve months. In the circumstances, the going concern note was required, whether the adjustments were made or not.

(f) Failure to Obtain a Comfort Letter from Cambrian

219 In June, 2007, Cambrian had provided WCC with a "comfort letter" to assist WCC in satisfying PwC that it would be able to fulfill BNP's requirement to have $10,465,000 in its collateral account.

220 The plaintiff claims that as part of the alleged conspiracy to misrepresent WCC's financial condition, WCC refrained from asking Cambrian for a similar letter of support in addressing its financial crisis in November of 2007, and to avoid the going concern note. He says that PwC told Redmond that the going concern language could be avoided if Cambrian provided another comfort letter, but that Redmond "never even asked Cambrian for a comfort letter in an attempt to avoid the supposed crisis". He relies on Rosen's evidence that "management's efforts to seek re-financing were slow and half-hearted and fell short of expected measures for a business that was supposed to be in financial distress".

221 Although Rosen does not appear to be specifically referring to the comfort letter in the above statement, his report did contain the following comment on the subject:

> PwC advised that going-concern disclosures could be avoided if the Company obtained an assurance letter from Cambrian, WCC's largest shareholder. We understand that such a letter was issued by Cambrian for the first quarter of fiscal 2008 (June 30, 2007), which purportedly stated that Cambrian would provide financial support to WCC in the event that its bank debt was called. For reasons that are not yet known to us, WCC did not obtain a similar letter for the quarter ended September 30, 2007. We have not seen any evidence that WCC's management acted appropriately upon PwC's suggestion to avoid adverse disclosures by obtaining another support letter from Cambrian.

222 In the paragraph immediately following, Rosen added:

> Based on the documents we have seen, management's efforts to address the company's financing needs during the Summer and Fall of 2007 lacked the sense of urgency that would be expected of an entity facing an impending threat of insolvency.

223 Later in his report, Rosen stated:

> None of the affiants on behalf of the Defendants have articulated that efforts were made to obtain (or renew) the support letter that was suggested by Mr. Boggio. We would expect that specific, extensive efforts would have been made by WCC management to follow this seemingly simple solution to avoid adverse financial disclosures.
>
> It is not clear why WCC seemingly did not successfully obtain a fresh support letter from Cambrian ...

224 Leaving aside Rosen's lack of demonstrated experience or qualifications to give evidence on matters of due diligence in relation to corporate financing, and his assumption of the role of a fact-finder rather than an expert, there is evidence, adduced by the defendants in response to Rosen's reply report, which establishes that Cambrian simply did not have the capability to give further support to WCC, whether by providing a comfort letter, lending it money, or making an additional investment in the Company. This was the evidence of Daniel Maling (Maling), the Group Corporate Finance and Treasury Manager of Cambrian at the material time.

225 Maling's evidence, which was not challenged, was that Cambrian itself did not have sufficient liquidity to provide this assistance and that its own lenders would not have permitted additional borrowings for the benefit of WCC. He added:

> As Cambrian was not able to borrow funds for the benefit of [WCC], it follows that Cambrian would not have been permitted to provide a commitment to provide funding to [WCC] to meet its financial obligations as they came due. [Cambrian's lenders] would certainly have objected given that Cambrian did not have adequate cash available to make that kind of commitment.

226 Redmond's evidence, in response to Rosen's evidence on this issue, was that Boggio of PwC had told him that the going concern language could be avoided, either by obtaining new financing or by obtaining an unconditional twelve-month letter of support from Cambrian, as had been done in the previous quarter. Redmond's evidence makes it clear that he was anxious to avoid the going concern language in the statements and that he would have sought a support letter from Cambrian if he had thought it would be possible to obtain one. He did not do so, because he knew that Cambrian would not be able to deliver an unconditional support letter and could not demonstrate an ability to meet WCC's obligations for twelve months.

227 Rosen's negative speculations and assumptions about WCC's conduct are, once again, clearly refuted by the evidence of those who were directly involved in the transactions.

(g) The Alleged Insider Trading

228 The statement of claim alleges that Hogg, Brodie and Chase purchased shares in WCC "with the benefit of inside knowledge that had not been publicly disclosed, in violation of securities laws", specifically s. 134(1) of the *Securities Act.* [14] It alleges that between the November 14, 2007 announcements and the November 22 news release announcing the financing with Audley:

(a) Chase acquired a total of 61,000 shares;

(b) Brodie acquired 10,000 shares; and

(c) Hogg acquired 40,000 shares.

229 The statement of claim does not claim any relief as a result of this alleged insider trading, presumably because the statutory remedy is in favour of only the seller or purchaser of the securities.

230 As I have noted earlier, in his affidavit in support of the certification and leave motions, Gould testified that after liquidating his debentures following the November 14, 2007 news release, he was surprised to learn of the Audley Financing eight days later. He swore that once he learned that some of the individual defendants had purchased "significant amounts of shares shortly before the Audley Financing was arranged", he became suspicious that the financing had in fact been arranged well in advance of November 22, 2007 news release.

231 The allegation of insider trading was made in Rosen's first report, where he stated:

> On November 16, 19, 20 and 21, 2007, three 'insiders' in WCC acquired a total of 111,000 shares of WCC in what should have been a prohibited trading period Such would be regarded for forensic accounting purposes as being oppressive to selling shareholders, given that the insiders possessed information that the sellers of the WCC shares did not know about a forthcoming financing.

232 I pause to note that this is another example of Rosen engaging in fact-finding by concluding that the officer and directors purchasing the shares had knowledge of the forthcoming financing — a conclusion that is contrary to the unchallenged evidence given by those defendants.

233 Rosen's affidavit indicates that weighted average cost per share of the 111,000 shares acquired by Chase, Brodie and Hogg was 62 cents per share and the weighted average closing price of WCC for the five days following the completion of the Audley Financing was $1.19 per share.

234 The plaintiff's factum maintained the claim that the defendants fabricated the financial crisis in WCC, allowing the officers to "greatly increased their equity holdings in the Company at the depressed share price." It claimed that at the same time as investors like Gould were "stampeding towards the exits", the three individual defendants, who were privy to very different information, were moving to increase their equity stakes.

235 The evidence of Chase, Brodie and Hogg, which has not been challenged, is that at the Board meeting of WCC on November 17, 2007 the directors discussed the possibility of personally acquiring shares in order to send a positive signal of support to the market. In fact, it was Chase's wife and not Chase himself who bought a total of 61,000 shares on November 16 and 19, 2007. The transactions were conducted with the authorization of corporate counsel for WCC, both orally and in writing, confirming that the directors had no undisclosed information and that they were permitted to trade. This advice was set out in an affidavit of WCC's internal counsel, which has not been challenged. The trades were reported in accordance with the System for Electronic Disclosure by Insiders (SEDI) operated by the Canadian Securities Administrators. There is no evidence that Chase, Brodie or Hogg had any material undisclosed information when they made their trades and it is their unchallenged evidence that they did not. Chase's unchallenged evidence is that he did not give any undisclosed information to his wife.

236 I find that the acquisition of these relatively modest quantities of shares, openly transacted by these three individual defendants, was done for perfectly appropriate reasons and in a proper manner, and was not done as part of any master plan or conspiracy. There is no evidence to support them. The allegations are inserted solely for colour, are based solely on suspicion. To the extent they were pleaded as part of the plaintiff's theory of a conspiracy or scheme, they fall flat on their face.

3. Conclusions on the Leave Motion

237 This is a case in which there is conflicting expert opinion on the central issue of whether WCC's financial statements contained a misrepresentation and were prepared in accordance with GAAP. A similar situation existed in *Green v. Canadian Imperial Bank of Commerce*, above, in which I concluded that there was a reasonable possibility that the evidence of the plaintiff's experts would be accepted in preference to the defendants' experts — at para. 249:

> At the end of the day, however, on virtually all issues, I am unable to say, applying the requisite low threshold, that there is no possibility that the evidence of the plaintiffs' expert witnesses will not be accepted in preference to some or all of the evidence of the defendant's witnesses.

238 Accordingly, in that case, I granted the plaintiff leave to pursue the statutory misrepresentation claim under the *Securities Act*.

239 In this case, I have come to a different conclusion. I have concluded that the plaintiff's claim has no reasonable possibility of success at trial and that there is no reasonable possibility that a trial judge would accept Rosen's evidence in preference to the defendants' expert evidence. There are a number of reasons for my conclusion.

240 *First*, I have concluded Boggio's advice to Redmond and the Audit Committee about the need to make the going concern note was consistent with GAAP and with WCC's legal obligations. The note was factual. It disclosed the requisite doubt about the Company's ability, using its own resources, to meet its obligations, but expressed management's confidence that outside financing would be obtained. To paraphrase the language of Binnie J. in *Kerr v. Danier Leather Inc.*, [2007] 2 S.C.R. 331, [2007] S.C.J. No. 44 (S.C.C.) at para. 55, this would give potential investors the current facts, along with management's business judgment about the future outcome, and investors would be entitled to accept — or reject — management's opinion. As Binnie J. went on to observe, in the same paragraph, "the disclosure requirements under the [*Securities*] *Act* are not to be subordinated to the exercise of business judgment."

241 In accurately stating the circumstances facing WCC, without embellishment, and also stating management's belief that funds would be available in the future, as they had been in the past, the Company was doing precisely what the law required it to do. It was not for the directors of WCC to suppress disclosure of the risk because they believed, in the exercise of their business judgment, that financing would be obtained.

242 *Second*, Rosen's evidence to the contrary is not consistent with the plain meaning of the relevant GAAP principles and accounting standards. Specifically, Handbook section 1400, para. 8A, requires the disclosure of "material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern". Rosen's evidence that the disclosure of doubts about the Company's ability to continue as a going concern was not appropriate under GAAP flies in the face of the language of the Handbook and is inconsistent with the uncontroverted evidence that the reclassification of WCC's long-term debt put it in a position where it was not able to meet its liabilities as they came due, without obtaining additional debt or equity financing.

243 In this regard, Rosen's second report made the following statement:

> An unavoidable threat to WCC's ability to continue operations as a 'going concern' in late 2007 simply did not exist. Thus, in our opinion, management's decision to mention strong words, such as 'going concern' was not justified, as would have been prohibited or at least be highly unusual under Canadian GAAP as it existed at the time.

244 This misstates the requirement of the Handbook — the going concern note disclosure is not triggered by an "*unavoidable* threat" — it is triggered by "material uncertainties" related to "events or conditions" that "may cast significant *doubt* upon the entity's ability to continue as a going concern". The evidence is clear that there were material uncertainties about WCC's ability to raise financing which, if not resolved in a positive manner and in a timely fashion, would indeed cast significant doubt on WCC's ability to continue as a going concern.

245 I accept the evidence of Wayland that the going concern note does not portray an "impending insolvency" or an "unavoidable threat" of insolvency, as suggested by Rosen. It simply states, in accordance with GAAP, that the statements have been prepared on a going concern basis, but that readers should be alerted to the fact that uncertainty exists concerning events or conditions that cast significant doubt upon the ability of the Company to continue as a going concern. This ensures that the reader is not misled if those uncertainties or risks materialize. Handbook s. 1000.19 permits the issuer of financial statements to assume that "readers have a reasonable understanding of business and economic

activities and accounting, together with a willingness to study the information with reasonable diligence." Reading Note 1 fairly, in context, and in conjunction with the information contained in the statements, a reasonably informed reader would not assume that the Company was facing impending insolvency, although he or she would understand, quite properly, that funding was required to avoid that possibility. It would be up to the reader to make an assessment, based on the information disclosed, whether that possibility was likely to be avoided or not.

246 I also accept Wayland's evidence that where the available evidence raises doubts about the validity of the going concern assumption, management has a positive duty to ensure that those doubts are fairly presented to readers, because those doubts could impact the appropriateness of the carrying values and classifications used in the financial statements.

247 The going concern note could only have been avoided if there were no material uncertainties related to events or conditions that cast significant doubt on WCC's ability to continue as a going concern. While WCC management was confident in the Company's future, they were simply unable to convert a leap of faith into a representation on the financial statements and they quite properly in my view, on the advice of their auditors, included the note.

248 Rosen suggested that there was no need for the going concern note in light of the relatively small amount of WCC's debt that required re-financing, in comparison to its total and net assets. Wayland pointed out, however, that the key circumstances at the time were the breach of the debt covenant resulting in the re-classification of the long-term debt to current, the lack of liquidity to pay the debt on its due date, and the failure to raise the equity demanded by the lender as a condition of the waiver of the prior default. The fact remained that WCC rightly concluded that it would not have sufficient liquid assets to pay the debt as it came due, the debt was secured against the Wolverine Mine, and default would entitle the lender to obtain control over the Company's most important asset. Any attempt to restructure the debt, or to sell assets to discharge it, would be regarded as outside the normal course of business, which in itself would reinforce the doubt about the going concern assumption.

249 Rosen's evidence is also inconsistent with OSC Staff Notice 52-7194, discussed earlier, which recommends that there be a specific link between the material uncertainties affecting the entity and the effect of those uncertainties in creating doubt about the entity's ability to continue as a going concern.

250 Moreover, Rosen's evidence on this issue simply does not make sense. Rosen contends that the use of "strong words" or "harsh references" such as "going concern" was not justified. How else could the Company explain that there were uncertainties about events or conditions that may cast doubt upon its ability to continue as a going concern, notwithstanding that the statements had been prepared on a going concern basis? The proper thing to do was to make the required disclosure, express management's opinion, and leave it to the reader to assess the risk. It would have been entirely wrong for WCC to have sugar-coated the disclosure based on management's assessment of the risk.

251 Elsewhere, as I have noted earlier, Rosen stated that the going concern disclosure should not be made "unless failure was unavoidable". This statement makes no sense, in my view, because it would mean that the issuer would be expressing uncertainty about the going concern assumption in circumstances in which insolvency was inevitable. Disclosure of this kind would be both confusing and inadequate.

252 *Third*, Rosen plays fast and loose with terminology and at times equates the going concern note disclosure with the abandonment of going concern accounting. WCC did not abandon going concern accounting for Q2 2008 — the statements were prepared on a going concern basis. Nor did it threaten to change its accounting basis. It simply alerted the reader to the fact that the statements had been prepared on a going concern basis, but that there was significant doubt about its ability to continue as a going concern, due to the events and conditions identified in the note.

253 Similarly, Rosen categorizes the disclosures as being claims of "impending insolvency", suggesting that the language used in the disclosures (that the Company "... does not expect to have sufficient funds in the near term to meet its financial obligations as they come due") was close to a declaration of bankruptcy. This is simply not accurate. The disclosures were accurate statements of the events and conditions that were confronting WCC. A reasonably informed reader of the

financial statements would understand that there were a number of positive factors favouring the long term prospects of WCC. The same reader would also understand that there were serious short term issues that had to be resolved, failing which there was in fact a risk of insolvency proceedings by the Company's principal secured creditor.

254 Rosen improperly focuses on evidence that WCC was not insolvent as of November 15, 2007. That is not the issue. It is not impeding insolvency that triggers the "going concern" obligation. It is the existence of "material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern". The existence of "uncertainty" about the use of the going concern assumption is not a statement that the company is on the verge of insolvency.

255 The plaintiff makes much of the fact that he was not the only one who believed that WCC's financial statements portrayed a company on the brink of insolvency. He notes that Mark Potter, one of the principals of Audley, stated that on reading Note 1 to the financial statements he understood that WCC was facing potential insolvency. Julian Treger of Audley testified that when he read WCC's financial statements he believed that WCC was on the verge of bankruptcy.

256 In contrast to this, however, Rosen's own report indicated that "the financial statements of WCC for the interim period ended September 30, 2007 did not portray the image of an insolvent or soon-to-be insolvent entity".

257 In my view, these apparently conflicting statements can be reconciled largely on the basis of a "glass half full"/"glass half empty" analysis. There is no doubt that from one perspective WCC's substantial assets, highly-regarded coal and business opportunities, including the potential FMC acquisition, augured well for the future. There is equally no doubt — and there was no doubt at the time — that without financing it would default on its obligations to BNP with potentially disastrous consequences. The evidence establishes that the possibility of a CCAA filing was being actively pursued by WCC in the event external financing was not obtained. The disclosures looked at the glass from both perspectives and attempted to paint a fair balance. The fact that some people, like Mr. Gould, focused on the part of the glass that was half empty does not mean that the disclosures were inappropriate.

258 *Fourth*, Rosen's opinion is inconsistent with the law and policy underlying disclosure obligations and distorts the standards of disclosure. The law, as expressed in *Danier Leather*, is that shareholders and investors are entitled to the facts and they are entitled to management's assessment of the facts. Armed with this information, they are able to make their own decisions. It would be wrong for management to withhold bad news to avoid upsetting shareholders. Doing so would only serve to confuse and mislead shareholders. The issue was confronted head-on by WCC and PwC and the decision was made, correctly in my view, to give shareholders and the markets the facts and management's assessment of the facts, and to let them make their own decision.

259 *Fifth*, the evidence of those directly involved in the preparation of the financial statements and public disclosures, particularly Redmond the acting CFO, Boggio of PwC, Brodie, the Chair of the Audit Committee and Chase, who was a member of the Audit Committee, satisfies me that the Q2 2008 financial disclosures made by WCC, particularly the going concern note, were the product of a reasoned, thorough and careful consideration of WCC's financial circumstances, the requirements of GAAP and the Company's obligations to its shareholders and investors. The individuals involved in the preparation, review and approval of these disclosures were knowledgeable and experienced in such matters and discharged their obligations in a conscientious manner. Further, there is no evidence that would support Rosen's suggestions that the disclosures were made with the intent to misrepresent WCC's financial condition and in fact they did not represent WCC's financial condition. I have found that there is no merit to the plaintiff's complaints about the other adjustments made in the financial statements.

260 *Sixth*, the evidence of the defendants' expert, Wayland, accords with the facts, with GAAP and with basic common sense.

261 *Seventh*, and last, the evidence of Rosen does not come close to the standard for acceptable expert evidence and his evidence is, in any event, unsupported by the facts, inconsistent with GAAP and does not make sense. For the

reasons expressed above, Rosen's evidence is severely compromised by his failure to stick to matters within his expertise, by engaging in impermissible fact-finding and by becoming an advocate on behalf of his client, rather than an impartial expert seeking to assist the court. Rosen's exaggerated and speculative assertions only serve to undermine his credibility and independence. In light of these infirmities, I have no confidence whatsoever in his evidence and there is no reasonable possibility that his evidence will be accepted at trial.

262 For all these reasons, I am satisfied that there is no reasonable possibility that the claim under s. 138.3 of the *Securities Act* will be resolved at trial in favour of the plaintiff. The plaintiff's claim has been shown to be based purely on "speculation or suspicion rather than evidence", to employ the words of van Rensburg J. in *Silver v. Imax (Leave)* at para. 330, and has been demonstrated to be unfounded. Accordingly, leave will not be granted.

4. The Reasonable Investigation Defence

263 The defendants relied on the reasonable investigation defence contained in s. 138.4(6) of the *Securities Act*. Although it is not necessary to do so in light of my findings, I will briefly set out my conclusions on this issue.

264 Section 138.4(6) provides, in part:

> (6) A person or company is not liable in an action under section 138.3 in relation to,
>
> (a) a misrepresentation if that person or company proves that,
>
> (i) before the release of the document or the making of the public oral statement containing the misrepresentation, the person or company conducted or caused to be conducted a reasonable investigation, and
>
> (ii) at the time of the release of the document or the making of the public oral statement, the person or company had no reasonable grounds to believe that the document or public oral statement contained the misrepresentation ...

265 Subsection (7) identifies the factors to be considered by the court in determining whether an investigation was reasonable:

> (7) In determining whether an investigation was reasonable under subsection (6), or whether any person or company is guilty of gross misconduct under subsection (1) or (3), the court shall consider all relevant circumstances, including,
>
> (a) the nature of the responsible issuer;
>
> (b) the knowledge, experience and function of the person or company;
>
> (c) the office held, if the person was an officer;
>
> (d) the presence or absence of another relationship with the responsible issuer, if the person was a director;
>
> (e) the existence, if any, and the nature of any system designed to ensure that the responsible issuer meets its continuous disclosure obligations;
>
> (f) the reasonableness of reliance by the person or company on the responsible issuer's disclosure compliance system and on the responsible issuer's officers, employees and others whose duties would in the ordinary course have given them knowledge of the relevant facts;
>
> (g) the period within which disclosure was required to be made under the applicable law;

(h) in respect of a report, statement or opinion of an expert, any professional standards applicable to the expert;

(i) the extent to which the person or company knew, or should reasonably have known, the content and medium of dissemination of the document or public oral statement;

(j) in the case of a misrepresentation, the role and responsibility of the person or company in the preparation and release of the document or the making of the public oral statement containing the misrepresentation or the ascertaining of the facts contained in that document or public oral statement; and

(k) in the case of a failure to make timely disclosure, the role and responsibility of the person or company involved in a decision not to disclose the material change.

266 The defence has two requirements: (1) the person or company must have conducted a reasonable investigation or caused such investigation to be conducted; and (2) the person or company had no reasonable grounds to believe that the document contained a misrepresentation.

267 In *Silver v. Imax (Leave)*, van Rensburg J. summarized the elements of the defence at paras. 361-363:

> The first part of the "reasonable investigation" defence involves a consideration of such matters as the measures and systems in place at the Company respecting the recognition of revenue for financial reporting, the roles and responsibilities of various persons in the revenue recognition and reporting processes, policies and procedures, and oversight and assurance measures, including the performance of audit functions by PwC.
>
> Factors applicable to the individual respondents are also relevant, including their qualifications, knowledge and experience and their roles and responsibilities within or in relation to the organization and in connection with the Company's financial reporting.
>
> The second part of the "reasonable investigation" defence involves a consideration of the specific knowledge of each respondent and the knowledge someone in his or her position ought to have had with respect to the misstatement of the Company's financial results. The second part of the test focuses on a consideration of the true state of affairs — what was known to whom, and which of the respondents, if any, ought to have known that when the Representation and misstatements were made, they were untrue?

268 I have found that there was no intentional attempt to misrepresent WCC's financial circumstances. I have also found that the language of Note 1 was the product of active and informed discussion and debate between WCC management, the auditor and the Audit Committee. The evidence establishes that the note was included on the advice of the auditor based on a careful analysis of the requirements of GAAP and after consultation with other professionals at PwC.

269 The onus on this issue is on the defendants. The defendants have adduced substantial evidence, from the very people involved in the disclosure process, to show that there was a rigorous procedure for the preparation of the Q2 2008 disclosures, including:

- initial fact-finding and preparatory work by WCC management;
- discussions among management, the Audit Committee and the auditor;
- preparation of draft financial statements by management;
- review of the draft statements by the auditor and further discussions with management;
- delivery of the draft statements and the auditor's report to the Audit Committee;

- discussions of the issues (including, specifically in this case, the going concern issue) within the Audit Committee, with the participation of management (including Redmond) and the auditor, Boggio;

- further review and discussion of the going concern issue between the auditor and management;

- revisions to the financial statements;

- further discussions in the Audit Committee at its November 13, 2007 meeting;

- review and approval by the full board of WCC; and

- certification of the accuracy of the financial statements by management.

270 It is of particular note that Redmond was a chartered accountant and Brodie, the Chair of the Audit Committee, was also a C.A. with considerable experience in audit standards. Chase, who was also a member of the Audit Committee, was also a C.A. and also had extensive experience with audits, GAAP and disclosure issues. These professionals were in a position to challenge — and did challenge — the advice of the auditor and did not blindly accept his advice. They were ultimately persuaded on a reasoned analysis of the issue that the auditor's recommendations were appropriate and should be followed and that management's views should be expressed in the MD&A and the news release, as well as in Note 1.

271 The plaintiff has adduced no evidence to show that WCC's system relating to continuous disclosure was deficient in any way. He says, however, that the reasonable investigation defence is not available for a variety of reasons, which I will briefly discuss.

272 *First*, he says that there was no "investigation" — I disagree. The issue was thoroughly investigated by management, the audit committee and the Board, assisted by the auditor.

273 *Second*, he says that the individual defendants were directly involved in the operation of the system. This is true, but it is not a defect in the system. The presence of independent directors with accounting experience enhanced the system.

274 *Third*, he claims that the decisions made by the defendants were aimed at exaggerating a financial crisis. I have found that this allegation is wholly without merit.

275 *Fourth*, he argues that management was aware that the disclosure contained material facts that were not true. That is not the case. Concerns were expressed by Redmond that the proposed wording might be misleading, but he and the Audit Committee were satisfied that the disclosure was required and that the going concern note could be balanced by the reference to management's expectations that financing would be obtained, as well as by the full discussion of WCC's circumstances that was contained in the MD&A.

276 *Fifth*, he claims that by virtue of their roles in the release of the Q2 2008 statements the defendants ought reasonably to have known that the disclosure contained material facts that were untrue. There is no factual basis for this allegation.

277 *Sixth*,, and finally, Gould alleges that the responsibility for the preparation and release of the financial statements rested with WCC and not with PwC and could not be abdicated to PwC. That is true, but the defendants were entitled to rely, as part of the system, on the expert and specialized advice of the auditor.

278 I have found that there was no intent on the part of the defendants to represent WCC's financial position. If the going concern note, taken in its context together with the other information in the financial statements, is found to have painted an unduly bleak picture of WCC's financial circumstances, as asserted by Rosen, it was the result of a *bona fide* attempt of the defendants, guided by an independent and experienced professional and after careful investigation and full discussion, to comply with their obligations to their shareholders and investors.

279 This case is nothing like *Silver v. Imax (Leave)*. In that case, there were admitted deficiencies in Imax's internal controls that contributed to the accounting errors and there was specific knowledge on the part of the individual defendants that some of the information in the disclosures was false. In this case, WCC and the individual defendants made a reasonable investigation of the issue and came to a *bona fide* and reasoned decision that the disclosure was accurate and required.

280 I find that the second part of the reasonable investigation defence has been met — the Company and the individual defendants had no reasonable grounds to believe that the disclosures contained the alleged misrepresentation. The disclosures were factual. The Company and the individual defendants had reasonable grounds to believe, based on management's advice and the recommendations and advice of the auditors, that the disclosures were true and that they were required to be made in the form in which they were made.

281 I also find that it was reasonable for the Company and the individual defendants to rely on WCC's disclosure compliance system and on management, particularly Redmond, and on the Audit Committee, which was composed of experienced accounts and business people, and on the experience and advice of the auditor.

282 For these reasons, I would have found that there is no reasonable possibility that the defendants' reasonable investigation defence would be unsuccessful.

B. The Conspiracy Claim

283 I have found that there is no reasonable possibility that the statutory misrepresentation claim will be resolved at trial in favour of the plaintiff. I now turn to the conspiracy claim.

1. The Conspiracy Allegations

284 This action was originally commenced by statement of claim filed on November 20, 2009. The claim named only WCC, Hogg, Chase and Brodie. The claim asserted the cause of action for misrepresentation under Part XXIII.1 of the *Securities Act*. There were also claims for negligence and negligent misrepresentation. There was no claim for either oppression or conspiracy. The pleading alleged that the defendants knew, at the time of the release of the Q2 2008 disclosures on November 14, 2007, that WCC would obtain financing from Audley or was likely to obtain financing from Audley. It was alleged that the three individual defendants profited from the alleged misrepresentation by purchasing shares at artificially depressed prices after release of the disclosures and before the Audley Financing was generally disclosed.

285 The plaintiff subsequently delivered a fresh as amended statement of claim, dated May 28, 2010. It added Audley, Cambrian, Byrne, Conlon and Pitcher as defendants. It also added the claims for oppression and conspiracy. The conspiracy allegations are made only against WCC, Cambrian and Audley and not against the individual defendants.

286 Under the heading "The Nature of the Action", the pleading described a "scheme", whereby WCC, Audley and Cambrian were alleged to have "misrepresented the true state of [WCC's] finances to enable Audley, together with Cambrian, to acquire a controlling interest in WCC on highly favourable terms." It added that the scheme had the effect of significantly diluting the shareholdings of the class members.

287 As I have noted in the discussion of the misrepresentation claim, the pleading alleged selective write-downs and misrepresentation of the financial situation of the Company through the going concern note and by failing to disclose details of the allegedly pre-arranged Audley Financing.

288 The allegations of conspiracy in the fresh as amended statement of claim are that part of the conspiracy consisted of misrepresenting WCC's finances in order to reduce its share price, enabling the defendants to increase their interests in WCC and diluting the interests of class members. It is alleged that the misrepresentation "served a strategic purpose" for WCC, Cambrian and Audley, because they knew that it would result in a "precipitous drop" in the share price and

would enable them to acquire control of WCC "on highly favourable terms." It alleged that the Audley Financing, the FMC acquisition and the Cambrian loan resulted in a dilution of the interests of class members.

289 The acts undertaken in furtherance of the conspiracy allegedly included:

• causing WCC to make a number of accounting write-downs in Q2 2008 to create a greater loss;

• structuring WCC's accounting to "manufacture a financial crisis";

• causing WCC to make its November 14, 2007 disclosures to misrepresent the true state of its finances and to cause a reduction in its share prices;

• providing convertible debentures to Audley Europe and warrants to Audley Capital Management at 75 cents per share;

• avoiding obtaining shareholder approval of the issuance of securities under the Audley Financing; and

• re-pricing the Cambrian Loan to increase its entitlement to shares in WCC.

290 The plaintiff pleads that this conduct was unlawful, because, among other things, it resulted in an artificial price for the securities of WCC, included an untrue or misleading misrepresentation and breached s. 126.1 and 126.2 of the *Securities Act.* [15] He pleads that the conspiracy was directed towards the plaintiff and the other class members.

291 He also alleges, alternatively, that the predominant purpose of the conspiracy was to (a) profit financially, (b) increase the defendants' shareholding in WCC at reduced prices and (c) control a greater proportion of WCC.

292 There is no question that the alleged misrepresentation is at the root of the conspiracy claim. The plaintiff acknowledges this in his factum, where he states:

> The alleged misrepresentations which make up the foundation of the misrepresentation claim are integral to the Plaintiff's claim for oppression and conspiracy. The same set of facts applies to all of these causes of action.

293 As I have noted earlier, by the time the plaintiff delivered his factum, the allegation that the Audley Financing had been pre-arranged, and was part of the "scheme" or conspiracy, had evaporated. On the hearing of the motion, the plaintiff's submission was that WCC had "delayed" obtaining financing until after the release of the Q2 2008 results. This softening of the plaintiff's position was undoubtedly due to the overwhelming evidence that Audley had no prior knowledge of, or involvement in, the disclosures on November 14, 2008, and that it did not become involved in financing discussions until after the Q2 2008 results had been released.

294 The defendants contend that since the plaintiff's misrepresentation claim is based on a "scheme" to enhance their interests by misrepresenting WCC's condition and since I have found that there is no reasonable possibility of establishing that misrepresentation, the conspiracy and oppression claims must fall with it.

2. Pleading Conspiracy

295 Canadian law recognizes two forms of conspiracy — what has been referred to as "predominant purpose" conspiracy or conspiracy to injure, and unlawful means or unlawful conduct conspiracy: *Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.*, [1983] 1 S.C.R. 452 (S.C.C.). In *Normart Management Ltd. v. West Hill Redevelopment Co.*, [1998] O.J. No. 391, 37 O.R. (3d) 97 (Ont. C.A.), the Court of Appeal approved the following statement about the requirements for a pleading of conspiracy, at para. 21:

> The statement of claim should describe who the several parties are and their relationship with each other. It should allege the agreement between the defendants to conspire, and state precisely what the purpose or what were the

objects of the alleged conspiracy, and it must then proceed to set forth, with clarity and precision, the overt acts which are alleged to have been done by each of the alleged conspirators in pursuance and in furtherance of the conspiracy; and lastly, it must allege the injury and damage occasioned to the plaintiff thereby. [16]

296 More recently, the elements of these two types of conspiracy were nicely summarized by Perell J. in *EnerWorks Inc. v. Glenbarra Energy Solutions Inc.*, 2012 ONSC 414, [2012] O.J. No. 2272 (Ont. S.C.J.) at paras. 66-69:

> The elements of a claim of conspiracy are: (1) two or more defendants make an agreement to injure the plaintiff; (2) the defendants (a) use some means (lawful or unlawful) for the predominate purpose of injuring the plaintiff, or (b) use unlawful means with knowledge that their acts were aimed at the plaintiff and knowing or constructively knowing that their acts would result in injury to the plaintiff; (3) the defendants act in furtherance of their agreement to injure; and, (4) the plaintiff suffers damages as a result of the defendants' conduct. See: *Hunt v. T & N plc*, [1990] 2 S.C.R. 959; *Canada Cement Lafarge Ltd. v. British Columbia Lightweight Aggregate Ltd.*, [1983] 1 S.C.R. 452; *Normart Management Ltd. v. West Hill Redevelopment Co* (1998), 37 O.R. (3d) 97 (C.A.).
>
> . . . . .
>
> The elements of conspiracy to injure are: (1) the defendants acted in combination; (2) the defendants intended to harm the plaintiff; and (3) the defendants' conduct caused harm to the plaintiff.
>
> The elements of conspiracy to perform an unlawful act are (1) the defendants acted in combination; (2) the defendants committed an unlawful act, i.e. a crime, tort, or breach of statute; (3) the defendants knew or should have known that injury to the plaintiffs was likely to occur from their misconduct; and (4) the defendants' misconduct in furtherance of the conspiracy caused harm to the plaintiff.

297 A pleading of the first form of conspiracy, conspiracy to injure, must assert a predominant purpose of the infliction of harm on the plaintiff: see *Harris v. GlaxoSmithKline Inc.*, 2010 ONCA 872, [2010] O.J. No. 5546 (Ont. C.A.) at para. 39:

> To make out a conspiracy to injure, the defendant's predominant purpose must be to inflict harm on the plaintiff. It is not enough if harm is the collateral result of acts pursued predominantly out of self-interest. The focus is on the actual intent of the defendants and not on the consequences that the defendants either realized or should have realized would follow.

298 I agree with the defendants that the plaintiff has not properly pleaded conspiracy to injure, because there is no allegation that the predominant purpose of the conspiracy was to injure the plaintiff. On the contrary, the pleading is to the effect that the predominant purpose of the alleged conspirators was to enrich themselves: see *Harris v. GlaxoSmithKline Inc.*, at paras. 41 and 44. Where the predominant purpose of the defendants is to advance their own commercial interests, there cannot be a predominant purpose conspiracy, even though it may have an adverse economic impact on others.

299 The elements of the "unlawful means" conspiracy were set out by the Court of Appeal in *Agribrands Purina Canada Inc. v. Kasamekas*, 2011 ONCA 460, 334 D.L.R. (4th) 714 (Ont. C.A.) at para. 26:

> For the appellants to be liable for the tort of unlawful conduct conspiracy, the following elements must therefore be present:
>
> (a) they act in combination, that is, in concert, by agreement or with a common design;
>
> (b) their conduct is unlawful;
>
> (c) their conduct is directed towards the [plaintiffs];
>
> (d) the [defendants] should know that, in the circumstances, injury to the [plaintiffs] is likely to result; and

(e) their conduct causes injury to the [plaintiffs].

300 The pleading of unlawful means conspiracy must be set out with particularity. In *Normart Management Ltd. v. West Hill Redevelopment Co.*, above, the Court of Appeal observed, at para. 21:

> The statement of claim should describe who the several parties are and their relationship with each other. It should allege the agreement between the defendants to conspire, and state precisely what the purpose or what were the objects of the alleged conspiracy, and it must then proceed to set forth, with clarity and precision, the overt acts which are alleged to have been done by each of the alleged conspirators in pursuance and in furtherance of the conspiracy; and lastly, it must allege the injury and damage occasioned to the plaintiff thereby.

301 I agree with the defendants' submission that the pleading of unlawful means conspiracy is deficient and I respectfully adopt the observations of Horkins J. in *Martin v. AstraZeneca Pharmaceuticals PLC*, 2012 ONSC 2744, [2012] O.J. No. 2033 (Ont. S.C.J.), at paras. 168 - 170:

> Claims for conspiracy have been struck out where they were bald, overly speculative, or simply restated legal principles rather than pleaded material facts. As the court stated in*Penson Financial Services Canada Inc. v. Connacher*, 2010 ONSC 2843 at para. 15:
>
>> Rule 25.06(1) mandates a minimum level of material fact disclosure and if this level is not reached, the remedy is a motion to strike out the pleading. A proper pleading of conspiracy should enable a defendant to know the case he or she must meet. Conspiracy is a serious claim. A recitation of a series of events coupled with an assertion that they were intended to injure the plaintiff is insufficient, nor is it appropriate to lump some or all of the defendants together into a general allegation that they conspired: *Normart Management Ltd. and J. G. Young & Son Ltd. v. Tec Park Ltd.* [Emphasis added and footnotes omitted.]
>>
>> The plaintiffs are not entitled to plead a deficient case in conspiracy on the theory that more detailed evidence of the claim will arise from discovery. The "plaintiff cannot go on a fishing expedition at discovery to gather the facts to make a proper plea": see *Research Capital Corp. v. Skyservice Airlines Inc.*, [2008] O.J. No. 2526 (S.C.J.) at para. 23, var'd on other grounds, 2009 ONCA 418 ("*Research Capital*").
>>
>> The pleading of conspiracy in this case offends all of the above requirements. It lacks clarity, precision and the material facts necessary to support the constituent elements. For the reasons set out below, it is plain and obvious that the conspiracy claim will fail.

302 The pleading fails to set out the alleged agreement with particularity, lumps the defendants together, fails to provide full particulars of the unlawful acts committed by each defendant and gives no particulars of damages.

303 In view of my conclusion that there is no basis for the existence of common issues arising from the conspiracy claim, I need not consider whether the plaintiff should be given leave to amend.

3. The Conspiracy Common Issues

304 The plaintiff proposes the following common issues arising from the conspiracy claim:

> 3. Did the Defendants, or any two or more of the Defendants, act in combination to create a scheme to enable the Audley Defendants, together with Cambrian, to acquire a controlling interest in [WCC]?
>
> 4. Did the Defendants, or any two or more of the Defendants, act in combination to cause a temporary collapse in [WCC's] share price?

5. If the answer to [either or both of the preceding questions] is yes, was the Defendants' conduct unlawful, in that it resulted and/or contributed to an artificial price for WTN securities, it involved a Misrepresentation that was misleading, untrue and did not state a fact that was required to be stated or that was necessary to make the statement not misleading, and/or it breached sections 126.1 and 126.2 of the *Securities Act*?

6. Should the Defendants have known that, in the circumstances, injury to the Class was likely to occur as a result of the Defendants' actions?

305 Common issue #5, which relates to the alleged misrepresentation, is at the core of the conspiracy claim and focuses on the allegedly unlawful conduct of the defendants in breach of the *Securities Act*.

4. Should the Conspiracy Common Issues be Certified?

306 Section 5(1) of the *CPA* requires that the claims or defences of class members raise "common issues". These are defined in s. 1 as common but not necessarily identical issues of fact; or (b) common but not necessarily identical issues of law that arise from common but not necessarily identical facts. The common issues requirement has been described as a "low bar".

307 The underlying foundation of a common issue is whether its resolution will avoid duplication of fact-finding or legal analysis: *Rumley v. British Columbia*, [2001] 3 S.C.R. 184 (S.C.C.) at para. 29. Many of the principles applicable to the common issues were set out in *McKenna v. Gammon Gold Inc.*, 2010 ONSC 1591, [2010] O.J. No. 1057 (Ont. S.C.J.), at paras. 125-126, var'd 2011 ONSC 3782, [2011] O.J. No. 3240 (Ont. Div. Ct.).

308 There must be a basis in the evidence before the court to establish the existence of common issues. The plaintiff is required to establish "a sufficient evidential basis for the existence of the common issues", in the sense that there is some factual basis for the claims made by the plaintiff and to which the common issues relate: *Dumoulin v. Ontario* (2005), 19 C.P.C. (6th) 234, [2005] O.J. No. 3961 (Ont. S.C.J.) at para. 27.

309 A certification motion is a procedural step and not a merits-based analysis. That said, the application for leave to pursue an action (whether an individual action or a class action) under s. 138.3 of the *Securities Act* is merits-based, albeit using a screen wider than the balance of probabilities. In determining whether to certify claims that are derivative of a claim that has failed to pass through this generous screen, I cannot ignore the fact that the cornerstone of the claim has been assessed and found wanting. If the claim of misrepresentation has no reasonable possibility of success, how can a claim of conspiracy to make the misrepresentation have any reasonable possibility? And if it has no reasonable possibility of success, why would I put the defendants, the court and class members through the time, expense and disruption of a complicated class proceeding?

310 The "basis in fact" requirement answers this question. There is simply no basis in the evidence for the proposition that the defendants conspired to cause a collapse of WCC's share price by misrepresenting its financial position so that they could enhance their positions in WCC. In fact, the evidence is so clearly against this proposition that the plaintiff was forced to re-position his case in argument to the effect that WCC "delayed" obtaining financing. Gone was the suggestion that the financing had been pre-arranged as part of the conspiracy. Indeed, the plaintiff now alleges, not that there was a deliberate misrepresentation of WCC's financial condition, but rather that the statement of its condition was too harsh.

311 I am not prepared to certify the conspiracy claim because there is absolutely no basis in fact for the existence of:

(a) a combination, agreement or scheme by any two or more of the defendants to enable Audley and Cambrian to acquire a controlling interest in [WCC] (common issue 3);

(b) a combination, agreement or scheme by any two or more of the defendants to cause a temporary collapse in [WCC's] share price by making inappropriate write downs, manufacturing a financial crisis or misrepresenting [WCC's] financial condition; (common issue 4); or

(c) the making of a misrepresentation under Part XXIII.1 or of fraud or market manipulation under s. 126.1 or the making of misleading or untrue statements under s. 126.2 of the *Securities Act*.

312 The core of the conspiracy claim, the alleged misrepresentation, has been shown to be groundless and has no reasonable prospect of success. The suggestion that there was a conspiracy to spread alarm about WCC's financial condition is inconsistent with the expression of management's belief in the disclosures that financing would be obtained. It is also inconsistent with the evidence of Byrne that the directors wanted to ensure that management's confidence in the Company was expressed in the news release.

313 The allegation that the Audley Financing had been secretly pre-arranged has been shown to be groundless and it has been conclusively established that Audley had no dealings with WCC before November 15, 2007. The financial crisis facing WCC in November, 2007, was not "contrived" or manufactured. It was real. This is demonstrated by the extensive efforts made by WCC and Cambrian before and after November 14, 2007 to obtain financing. It is also demonstrated by the evidence of Chase that between November 15 and 30, 2009, WCC took steps to prepare for a potential CCAA filing in the event that the financing could not be obtained.

314 The plaintiff's fall-back position, that WCC's efforts to find financing were intentionally delayed or were half-hearted is refuted by the evidence of Redmond, Byrne, Burridge and Chase concerning the extensive efforts they made to obtain financing. In the period prior to November 14, 2007, Endeavour Financial International Corporation made a concerted effort to obtain financing on behalf of WCC and various proposals were discussed at WCC's board meetings on October 24 and 25, 2007. Other attempts were made by both WCC and Cambrian.

315 In the period between November 15 and 22, 2007, WCC made real and substantial efforts to obtain financing from sources other than Audley, including Mitsui, Baosteel, Canaccord, Gibraltar, GMP (Griffiths McBurney) and Cenkos PLC. These efforts are described in the affidavits of Byrne, Burridge, Chase and Redmond. They ultimately resulted in proposals from both Audley and Canaccord and a subsequent proposal from Second City. This evidence is entirely inconsistent with the allegation that the Audley Financing had been pre-arranged. On the contrary, the evidence clearly establishes that the Audley Financing was the result of a highly organized and thorough competitive bidding process that produced the best available offer.

316 The process established for the approval of the Audley Financing was fair and independent. An independent committee of non-executive and non-Cambrian directors, chaired by Chase, together with Pitcher and Brodie, was established to review the proposals received from Audley and Canacccord and recommended that WCC proceed with the Audley proposal, subject to any more favourable proposal that might be obtained. A subsequent proposal received from Gibraltar's subsidiary, Second City, was received on November 22, 2007, after the issuance of a news release announcing the Audley Financing. The independent committee considered that Second City proposal and concluded that it was not more favourable than Audley's proposal. In addition, the Audley, Canaccord and Second City financing proposals were reviewed by Cenkos PLC, which was WCC's nominated advisor ("NOMAD) under the rules of the AIM exchange and was required to determine whether the financing was fair and in the best interests of WCC. Cenkos determined that the Audley Financing was superior to the other two and approved it as fair and reasonable and in the interests of WCC's shareholders. The conclusion that the Audley Financing was the best available financing was supported by the expert evidence of Mr. Lowe of Deloitte who gave an opinion on the fairness of the transaction.

317 It was a condition of Audley's agreement to provide financing that WCC exercise its option to acquire FMC from Cambrian pursuant to an agreement made with Cambrian in April 2007. The negotiation of the terms of the acquisition was a matter of real negotiation between Burridge on behalf of Cambrian and Chase on behalf of WCC. Chase was required to report to the independent committee, which included Pitcher and Brodie, with respect to the negotiations. The agreement ultimately reached was the subject of a fairness opinion given by Capital West and was recommended by the special committee. The shareholders of WCC ultimately, by a 99.9% vote almost unanimously approved the FMC acquisition and approved the amendment of the Cambrian Loan by about a 74% majority.

318 In light of my finding that there is no factual basis for the existence of common issues of conspiracy, I do not propose to deal with the defendants' alternative submissions that the claim is barred based on issue estoppel and abuse of process.

C. The Oppression Claim

319 The claim for oppression is set out in para. 90 of the statement of claim, which alleges that the affairs of WCC were conducted, and the powers of the individual defendants were exercised, in a manner that was oppressive to and unfairly prejudiced the rights of class members. In particular, the plaintiff pleads that the following actions diluted class members' holdings in WCC:

(a) the terms of the Audley Financing allowed Audley to acquire a higher percentage of WCC securities than it would have been able to acquire prior to the alleged misrepresentations;

(b) WCC issued 4.24 million warrants to Audley at a price of $0.75 per share; during the nine month period ended December 31, 2009, Audley exercised 2,431,833 warrants;

(c) as part of WCC's acquisition of FMC from Cambrian, WCC issued Cambrian 18,740,898 shares for a total value of $13,306,000, which represented approximately $0.71 per share; at that time, the market price of WCC shares on the TSX was $5.85;

(d) the February 2008 amendment to the Master Agreement between WCC and Cambrian, which provided Cambrian with the option to elect the manner in which the deferred payment for FMC would be satisfied, was ultimately valued at $1,134,000;

(e) on June 30, 2008, Cambrian elected to take a further 4,534,088 common shares of WCC to satisfy the deferred payment of $14,056,000; these share represented a total value of $15,190,000 or approximately $3.35 per share; on that date, the market price of WCC shares on the TSX was $8.96; and,

(f) as a result of the re-pricing of the September 2007 Cambrian loan from $2.35 per share to $0.75 per share, Cambrian received approximately 3.13 times more shares than it would have received under the original terms of the loan agreement.

320 The plaintiff's oppression claim is based upon s. 227 of the British Columbia *Business Corporations Act*. Section 227(1) provides that a shareholder or "any other person whom the court considers to be an appropriate person" may make an application under the section. Subsection (2) provides:

(2) A shareholder may apply <u>to the court</u> for an order under this section on the ground

(a) that the affairs of the company are being or have been conducted, or that the powers of the directors are being or have been exercised, in a manner oppressive to one or more of the shareholders, including the applicant, or

(b) that some act of the company has been done or is threatened, or that some resolution of the shareholders or of the shareholders holding shares of a class or series of shares has been passed or is proposed, that is unfairly prejudicial to one or more of the shareholders, including the applicant.

[Emphasis added.]

321 Section 1 of the *Business Corporations Act* defines "court", for the purposes of s. 227, as "the Supreme Court", which is in turn defined in the British Columbia *Interpretation Act*, RSBC 1996, c. 238, as "the Supreme Court of British Columbia".

322 The defendants contend that the s. 227 claim is purely statutory, that the statute confers exclusive jurisdiction on the Supreme Court of British Columbia, and that the Ontario Superior Court of Justice has no subject-matter jurisdiction over the claim.

323 The primary submission of the plaintiff in response is based on the recent decision of the Supreme Court of Canada in *Van Breda v. Village Resorts Ltd.*, 2012 SCC 17, [2012] S.C.J. No. 17 (S.C.C.). In particular, he relies on the observation of LeBel J., who delivered the judgment of the Supreme Court, to the effect that if there is a "real and substantial connection" with the forum in respect of a particular factual and legal situation, the court can — indeed must — assume jurisdiction over all aspects of the case. LeBel J. stated, at para. 99:

> I should add that it is possible for a case to sound both in contract and in tort or to invoke more than one tort. Would a court be limited to hearing the specific part of the case that can be directly connected with the jurisdiction? Such a rule would breach the principles of fairness and efficiency on which the assumption of jurisdiction is based. The purpose of the conflicts rules is to establish whether a real and substantial connection exists between the forum, the subject matter of the litigation and the defendant. If such a connection exists in respect of a factual and legal situation, the court must assume jurisdiction over all aspects of the case. The plaintiff should not be obliged to litigate a tort claim in Manitoba and a related claim for restitution in Nova Scotia. That would be incompatible with any notion of fairness and efficiency.

324 The plaintiff says that, following this rationale, and because this court clearly has jurisdiction over the defendants for the *Securities Act* and conspiracy claims, "fairness and efficiency" require the court to assume jurisdiction over the oppression claim.

325 The plaintiff refers to this, perhaps infelicitously, as the "bootstrap" argument — that if the plaintiff establishes that the court has jurisdiction over the defendants for the purposes of one claim, the other claims over which it does not have jurisdiction can be pulled up by the bootstrap into the action.

326 In my view, *Van Breda* is not on point. The issue in *Van Breda* was territorial jurisdiction or jurisdiction *simpliciter*. The issue here is jurisdiction over the subject matter. The distinction was noted by the British Columbia Court of Appeal in *Conor Pacific Group Inc. v. Canada (Attorney General)*, 2011 BCCA 403, 343 D.L.R. (4th) 324 (B.C. C.A.) at para. 38:

> It is important to appreciate the distinction between territorial jurisdiction and subject-matter jurisdiction. Territorial jurisdiction, known at common law as *jurisdiction simpliciter*, is concerned with the connection between the dispute and the court's territorial authority. A Canadian court may only assume territorial jurisdiction over a proceeding where there is a real and substantial connection between the action and the territory over which the court exercises jurisdiction: *Morguard Investments Ltd. v. De Savoye*, [1990] 3 S.C.R. 1077; *Hunt v. T&N plc*, [1993] 4 S.C.R. 289. In contrast, subject-matter jurisdiction is concerned with the court's legal authority to adjudicate the subject-matter of the dispute. For example, the Provincial Court does not have subject-matter jurisdiction with respect to claims for libel, slander or malicious prosecution: *Small Claims Act*, R.S.B.C. 1996, c. 430, s. 3(2).

327 The fact that a court may have territorial jurisdiction over a particular party in relation to a particular cause of action cannot give it jurisdiction over that party in relation to a subject matter that is outside its jurisdiction.

328 There is substantial recent authority of this court and of other Canadian and American courts directly on point and against the plaintiff's submission. In *Ironrod Investments Inc. v. Enquest Energy Services Corp.*, 2011 ONSC 308, [2011] O.J. No. 544 (Ont. S.C.J. [Commercial List]), C.L. Campbell J. was concerned with a claim for negligent misrepresentation and oppression against two Alberta corporations. The individual plaintiff had acquired convertible debentures in a corporation that was a predecessor of one of the defendants and pleaded that, as a result of misrepresentations by the president of the predecessor company, he had been induced to convert his debentures to shares. The plaintiffs argued that the oppression claims could be brought in Ontario by invoking the jurisdiction of the

Ontario Superior Court under the oppression remedies of the Ontario *Business Corporations Act*, R.S.O. 1990, c. B. 16, which were similar, if not identical, to the Alberta statute.

329 Justice Campbell found, at para. 14, that only an Alberta court had jurisdiction to grant a remedy for oppression brought in respect of an Alberta corporation. He concluded, at para. 16:

> In this case, not only is Alberta the place of incorporation but the *Alberta Business Corporations Act* give the Courts or [sic] that Province complete jurisdiction of the regulation and governance over that corporation. Section 1(m) defines "Court" for the purpose of the statute, including the oppression remedy, to mean "the Court of Queen's Bench of Alberta."

330 While there were other grounds on which the action was stayed, the conclusion of Campbell J. on subject matter jurisdiction stands on its own — the court simply had no jurisdiction over the oppression claim.

331 A similar conclusion was reached by Killeen J. in *Incorporated Broadcasters Ltd. v. Canwest Global Communications Corp.*, [2001] O.J. No. 4882, 20 B.L.R. (3d) 289 (Ont. S.C.J. [Commercial List]), at paras. 97-100 and 112-11, affd on other grounds, [2003] O.J. No. 560, 63 O.R. (3d) 431 (Ont. C.A.), leave to appeal to S.C.C. refused, [2003] S.C.C.A. No. 186 (S.C.C.). The action involved an oppression claim against a Manitoba company. The defendants moved to dismiss or stay the action on jurisdictional grounds. In connection with the "substantial connection" principle, Killeen J. held that the reasonable expectations of the corporation's shareholders were that their affairs, and disputes, would be dealt with by the Manitoba courts.

332 Killeen J. also discussed the effect of the Manitoba *Companies Act*, R.S.M. 1987, c. 225, which he described as a "complete code for corporate life in Manitoba" (at para. 109). The relevant provision dealing with the oppression remedy was similar to the British Columbia statute and conferred jurisdiction on the Manitoba Court of Queen's Bench. [17] He concluded, at para. 113:

> Thus, it seems inescapable but to conclude that only the Manitoba Court of Queens Bench has jurisdiction to grant a remedy for oppression brought in respect of a Manitoba corporation such as Broadcasting.

333 While the Court of Appeal affirmed the decision of Killeen J., holding that Manitoba was the "convenient forum" for the resolution of the litigation, it held that the motion judge failed to consider that the plaintiffs were invoking a remedy under the *Canada Business Corporations Act*, R.S.C. 1985, c. 44, not the Manitoba statute. It found, however, that his reasoning on the exclusive jurisdiction of the Manitoba court was sound — at para. 53:

> If the availability of the s. 241 remedy [under the *CBCA*] was before the motions judge and if he was correct in his conclusion that the remedy was not available to these appellants then his conclusion on convenient forum is unassailable. In fact, if he is correct, it is not a question of choosing the forum with the closest connection to the action and the parties, since <u>only</u> Manitoba is the appropriate forum.
>
> [Emphasis added.]

334 Similar views were expressed by Marrocco J. in *CAE Wood Products G.P. v. Coe Newnes/McGehee ULC*, 2011 ONSC 1617, [2011] O.J. No. 1140 (Ont. S.C.J.) at para. 31:

. . . . .

> The plaintiffs allege oppression. They rely upon the *BCBCA*. The plaintiffs have suffered no harm if they were not owed Contingent Consideration. Quite separately, issues surrounding the determination of the reasonable expectations of the plaintiffs and the extent to which those expectations were frustrated are matters assigned by the Legislature of British Columbia to the jurisdiction of the Supreme Court of British Columbia, not the Ontario Superior Court of Justice (see the definition of "court" in ss. 1 and 227 of the *BCBCA*).

See also the conclusions of the New Brunswick Court of Queen's Bench in *Nord Resources Corp. v. Nord Pacific Ltd.*, 2003 NBQB 201, [2003] N.B.J. No. 192 (N.B. Q.B.) at para. 14, and of the British Columbia Supreme Court in *Voyage Co. Industries Inc. v. Craster*, [1998] B.C.J. No. 1884 (B.C. S.C. [In Chambers]) at para. 12.

335 The same result was reached by the Supreme Court of Delaware in concluding that it had no jurisdiction to grant an oppression remedy under s. 241 of the *Canada Business Corporations Act*: *Taylor v. LSI Logic Corp.*, 715 A.2d 837, 1998 Del. Ch. Lexis 326 (U.S. Del. Super. 1998); see also *Locals 302 and 612 of Intern. Union of Operating Engineers — Employers Const. Industry Retirement Trust v Blanchard*, 2005 WL 2063852 (S.D.N.Y. Aug. 25, 2005) (No. 04 CIV. 5954 (LAP)) at paras. 12-14.

336 In *Zi Corp. v. Steinberg*, 2006 ABQB 92, [2006] A.J. No. 313 (Alta. Q.B.), Wittman A.C.J. considered a number of the above authorities (as well as the decision of Ground J. in *Cira v. Rico Resources Inc.* (2004), 41 B.L.R. (3d) 206 (Ont. S.C.J.)) and concluded, at paras. 76-79:

> These cases demonstrate that there are two considerations that drive the conclusion that the domicile of the corporation is the proper jurisdiction to deal with matters of internal corporate governance and the status of the corporation: the language of the governing statute and considerations of comity and, perhaps more generally, public policy.
>
> In relation to the first consideration, section 180 of the *Act* designates the "Court of Queen's Bench" as the court to which application should be made for relief under that section. Section 28(k) of the *Interpretation Act*, R.S.A. 2000, c. I-8 states that: "[the] Court of Queen's Bench' means the Court of Queen's Bench of Alberta".
>
> The wording of the section, together with the authorities cited above, lead to the conclusion that the intent of the legislature was to provide this Court with exclusive jurisdiction in relation to the relief available under section 180 of the *Act*.
>
> As to the second consideration, I agree with Ground J. [in *Ciro v. Rico Resources Inc.*], the requisition of shareholders' meetings and the provision of shareholders' lists for the purpose of allowing majority shareholders to elect their own slate of directors, are matters of internal governance. As such, they should be dealt with in the jurisdiction in which the corporation is domiciled.

337 In response, the plaintiff relies on *620637 Ontario Ltd. v. Axton*, [1992] O.J. No. 13 (Ont. Gen. Div.) and *Factor Gas Liquids Inc. v. Jean*, [2007] O.J. No. 2883 (Ont. S.C.J.). These were distinguished by Campbell J. in *Ironrod Investments*, above, at para. 15, on the basis that the issue of the jurisdiction of the province of incorporation had not been raised in those cases. I distinguish them for the same reasons.

338 Nor do I find *Jasinski v. Jasinski*, [2006] B.C.J. No. 1325, 2006 BCSC 878 (B.C. S.C.), of assistance. The issue in that case, discussed at paras. 24-26, was the application of a contractual choice of law clause, incorporating the law of another province. Where the law of another province is the proper law, there is no question that an Ontario court is entitled to apply that law, just as it is entitled to apply the law of another foreign jurisdiction, based on conflict of laws principles, in an appropriate case. There is a difference, however, between applying another jurisdiction's law and assuming an adjudicative jurisdiction that can only be exercised by a court of another province or state. The constraint is more than just comity, in my view. It is a matter of constitutional competence.

339 The oppression remedy applicable to this dispute is a creation of a British Columbia statute. The statute confers the remedy and describes the manner in which it is to be enforced. I have no jurisdiction to grant the remedy because the statute expressly grants jurisdiction to the British Columbia Superior Court. It is irrelevant that the defendants may be otherwise subject to this court's jurisdiction, or may have attorned to the jurisdiction. I have no jurisdiction over the subject matter. The oppression claim should therefore be struck.

V. Conclusion

340 For these reasons, the plaintiff's motion for leave pursuant to s. 138.3 of the *Securities Act* is dismissed. The motion for certification is also dismissed. Costs may be addressed by written submissions to me, care of Judges' Administration.

Motion dismissed.

Footnotes

1 The issue of the three-year limitation period in s. 138.14 of the *Securities Act*, raised by the decision of the Court of Appeal in *Sharma v. Timminco Ltd.*, 2012 ONCA 107, [2012] O.J. No. 719 (Ont. C.A.), does not arise in this case because the parties entered into a tolling agreement which was approved and incorporated by reference into an order of this court.

2 The statement of claim summarizes the claim as follows in para. 6: "This action alleges a scheme by which, among other things, Western Coal, the Audley defendants and Cambrian misrepresented the true state of Western Coal's finances to enable Audley, together with Cambrian, to acquire a controlling interest in WC on favourable terms." The plaintiff's factum contains a similar summary: "This action involves claims against the Defendants based on their fabrication of a supposed financial crisis in November 2007 at the Defendant Western Coal Corporation ("WCC" or the "Company"), which artificially drove down WCC's share price and allowed the other Defendants, who were major insider shareholders and officers at WCC, to greatly increase their equity holdings in the Company at the depressed share price."

3 SEDAR is the System for Electronic Document Analysis and Retrieval, a filing system developed for the Canadian Securities Administrators to, among other things, facilitate the electronic filing of securities information as required by the securities regulatory agencies in Canada.

4 A company's current ratio represents its current assets divided by its current liabilities. It is an indication of the company's ability to meet its short term debt obligations.

5 The Perry Creek Mine referred to in this note was a deposit forming part of the Wolverine Project.

6 "Financial statements are prepared on the assumption that the entity is a going concern, meaning it will continue in operation for the foreseeable future and will be able to realize assets and discharge liabilities in the normal course of operations. Different bases of measurement may be appropriate when the entity is not expected to continue in operation for the foreseeable future."

7 These provisions, in para. 8A of section 1400, and para. 8B, were issued as amendments in June 2007 and were stated to be applicable to financial statements related to fiscal years on or after January 1, 2008; however, earlier adoption was encouraged and it was therefore appropriate for WCC to consider these provisions in connection with the preparation of its Q2 2008 financial statements.

8 Handbook section 1400 — General Standards of Financial Statement Presentation, para. 8A: "When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. Financial statements shall be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, those uncertainties shall be disclosed. When financial statements are not prepared on a going concern basis, that fact shall be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not regarded as a going concern."

9 Handbook section 1400, para. 8B: "In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the balance sheet date. The degree of consideration depends on the facts of each case. When an entity has a history of profitable operations and ready access to financial resources, a conclusion that the going concern basis of accounting is appropriate may be reached without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate."

10 Where there is covenant violation on the balance sheet date, giving the creditor a right to demand repayment, the committee concluded that the debts should be reclassified as a current liability unless both the following conditions are satisfied: "(i) the creditor has waived in writing, or subsequently lost, the right, arising from violation of the covenant at the balance sheet date, to demand repayment for a period of more than one year from the balance sheet date; or the debt agreement contains a grace period during which the debtor may cure the violation, and contractual arrangements, which significant economic consequences to the parties if breach, and which the parties have little, if any, discretion to avoid, have been made which ensure that the violation will be cured within the grace period; and (ii) a violation of the debt covenant giving the creditor a right to demand repayment at a future compliance date within one year of the balance sheet date is not likely."

11 As discussed above, Rosen's report frequently engaged in advocacy, using pejorative and exaggerated language to score points. The use of quotation marks around "liquidity crisis" was presumably intended to emphasize his opinion that the liquidity crisis was contrived.

12 Section 1000.21 is entitled "Reliability" and provides, in part: "For the information provided in financial statements to be useful, it must be reliable. Information is reliable when it is in agreement with the actual underlying transactions and events, the agreement is capable of independent verification and the information is reasonably free from error and bias. Reliability is achieved through representational faithfulness, verifiability and neutrality. Neutrality is affected by the use of conservatism in making judgments under conditions of uncertainty ... When uncertainty exists, estimates of a conservative nature attempt to ensure that assets, revenues and gains are not overstated and, conversely, that liabilities, expenses and losses are not understated ..."

13 Rosen made a number of excessive comments in this regard, as noted in Deloitte's second report, including references such as an "unavoidable threat" and "impending insolvency". He stated that, "[M]any indications exist that WCC was not insolvent ..." when the note made no such statement. He stated that, "[A]dmissions of insolvency (and invalidity of the 'going concern' assumption) are tantamount to a company declaring imminent business failure." He went on to say that, "[D]isclosure of financial distress would not be made unless it was unavoidable and plainly required in the circumstances."

14 The remedy for insider trading under s. 134(1) of the *Securities Act* is in favour of the "seller or purchaser of the securities". The plaintiff was not a seller or purchaser of securities from the defendants and does not seek any remedy on behalf of the class for the alleged insider trading. The section provides: "134. (1) Every person or company in a special relationship with a reporting issuer who purchases or sells securities of the reporting issuer with knowledge of a material fact or material change with respect to the reporting issuer that has not been generally disclosed is liable to compensate the seller or purchaser of the securities, as the case may be, for damages as a result of the trade unless, (a) the person or company in the special relationship with the reporting issuer proves that the person or company reasonably believed that the material fact or material change had been generally disclosed; or (b) the material fact or material change was known or ought reasonably to have been known to the seller or purchaser, as the case may be."

15 126.1 A person or company shall not, directly or indirectly, engage or participate in any act, practice or course of conduct relating to securities, derivatives or the underlying interest of a derivative that the person or company knows or reasonably ought to know, (a) results in or contributes to a misleading appearance of trading activity in, or an artificial price for, a security, derivative or underlying interest of a derivative; or (b) perpetrates a fraud on any person or company.

126.2 (1) A person or company shall not make a statement that the person or company knows or reasonably ought to know, (a) in a material respect and at the time and in the light of the circumstances under which it is made, is misleading or untrue or does not state a fact that is required to be stated or that is necessary to make the statement not misleading; and (b) would reasonably be expected to have a significant effect on the market price or value of a security, derivative or underlying interest of a derivative.

16 Per O'Brien J. in *H.A. Imports of Canada Ltd. v. General Mills Inc.* (1983), 42 O.R. (2d) 645 (Ont. H.C.), at 646 -7, quoting from Bullen, Leake and Jacob's Precedents of Pleadings, 12th ed. (London: Sweet & Maxwell, 1975).

17 Section 234 conferred the oppression remedy. Section Section 234(1) provided that "[a] complainant may apply to a court for an order under this section." Section 1(1) defined "court" as "the Court of Queens Bench".

End of Document

TAB 3

2012 ONSC 7068
Ontario Superior Court of Justice

Vipond v. AGF Private Investment Management

2012 CarswellOnt 15991, 2012 ONSC 7068, 224 A.C.W.S. (3d) 246

Gordon Vipond, Plaintiff and AGF Private Investment Management, a Division of AGF Funds Inc., William J. Smith, Scott Luik and Laura Wallace, Defendants

Pepall J.

Judgment: December 11, 2012
Docket: 02-CV-231826CM

Counsel: Helen A. Daley, Daniel Bernstein, for Plaintiff
Janice Wright, Greg Temelini, for Defendants

Subject: Corporate and Commercial; Securities; Civil Practice and Procedure

ACTION by plaintiff for damages for breach of fiduciary duties, breach of contract and negligence.

***Pepall J.*:**

Introduction

1 This action involves claims by an investor arising from the provision of discretionary investment management services.

2 The Plaintiff, Gordon Vipond, claims damages in the amount of $5 million for breach of fiduciary duties, negligence and breach of contract from the Defendant AGF Private Investment Management, a Division of AGF Funds Inc. ("AGF"), and from AGF's employees, the Defendants William J. Smith, Scott Luik and Laura Wallace. The claim for punitive damages in the amount of $500,000 was withdrawn during closing argument.

Facts

Mr. Vipond

3 Mr. Vipond was born in Montreal in 1946. He completed grade eleven at high school and then worked for a number of years in clerical positions in the banking, textile and food industries. He also did manual work. His father was a senior executive at Bell Canada. By 1982, Mr. Vipond was dependent on his parents for his financial needs. As of that year, he received $5,000 a month from them. His only sibling had died at a young age so Mr. Vipond was in essence an only child.

4 Mr. Vipond's father died in August 1984 and his mother died on November 19, 1997. Mr. Vipond was appointed as the executor of his mother's estate and was her principal beneficiary. Among other things, he inherited a portfolio of securities with an approximate value of $6.5 million. The securities were in certificate form in his mother's name and were kept in her safety deposit box. They mainly consisted of common shares of Nortel Networks Corporation ("Nortel"), BCE Inc. ("BCE") and TD Bank. Mr. Vipond's father, having been a lifelong Bell Canada employee, had held Bell Canada shares which had been converted into Nortel and BCE shares.

5 Prior to his mother's death in 1997, Mr. Vipond had not owned any stocks and had never had an account with a stockbroker. He had never had a professional adviser and indeed had not filed income tax returns for about ten years.

Mr. Vipond's passion was automotive racing. It certainly was not investments. In spite of this, after his mother's death, Mr. Vipond did keep track of the securities in the estate and would go to the library to check their progress, albeit somewhat irregularly.

Mr. Campbell

6 Michael Campbell was a financial planner with Campbell Graham Cartier Partners in Kingston, Ontario. He was licensed to market mutual funds and life insurance but not stocks. Mr. Vipond's mother had been his client since 1984. She had had mutual funds that had been managed by him. Mr. Campbell had a complete understanding of her financial situation.

7 After Mrs. Vipond died, Mr. Campbell continued to manage the mutual funds that had belonged to her, and Mr. Campbell's firm did Mr. Vipond's income tax returns and the estate returns. Mr. Campbell and Mr. Vipond met regularly to discuss the estate and his inheritance and they became friends. They did not discuss individual stocks to any degree apart from acknowledging that the estate was very highly concentrated in a few stocks. Mr. Campbell told Mr. Vipond that he could run into a bad time if he adopted the family philosophy of simply buying and holding.

Investigation of Investment Alternatives

8 In the two years after his mother's death, the value of the stock portfolio increased until 1998 when there was a decrease. By the latter part of 1999, Mr. Campbell had persuaded Mr. Vipond that he should investigate professional investment options.

9 Mr. Campbell and Mr. Vipond discussed both a discretionary managed account ("managed account" or "discretionary account") and a traditional brokerage account. Mr. Vipond understood that with the latter, a broker would call with a suggestion and Mr. Vipond would then have to make the purchase or sale decision himself. In contrast, with a managed account, the professional would make all of the purchase and sale decisions and maintain all of the records. Someone else could put together a portfolio, remove the risk and diversify the shareholdings. Mr. Campbell's preference was that Mr. Vipond use a managed account.

10 Mr. Vipond and Mr. Campbell made some inquiries. Mr. Vipond contacted his friend Larry Fraser of Goodman Private Wealth Management ("GPW") and received some literature from him and also from TD Bank. He also discussed AGF with Mr. Campbell.

Introduction to AGF

11 Mr. Campbell had a relationship with AGF and had invested client funds in their mutual funds. AGF is a Canadian public financial services corporation with more than 40 years of money management experience. Mr. Campbell liked AGF's Canadian Equity Fund, which was managed by Laura Wallace. Mr. Campbell had also heard Scott Luik of AGF speak at a promotional meeting in 1999.

12 Mr. Luik graduated from the University of Toronto in 1993 and began his investment career in 1995. He became a Chartered Financial Analyst in 1998 and joined AGF that same year. From February 2000 until February 2001, he was the Director of Business Development & Client Services at AGF Private Investment Management. His role was to work with financial advisors and to direct clients so as to educate them on how AGF managed money. He also developed investment policies for clients and serviced clients. Although he was licensed to be a portfolio manager, he had no involvement in trading at AGF. He was the client relationship manager at AGF.

13 Mr. Campbell exchanged a few telephone calls with Mr. Luik. According to Mr. Campbell and Mr. Vipond, in March 2000, they met with Mr. Luik at Mr. Campbell's office in Kingston. Mr. Vipond described the meeting as a sales meeting. AGF was proposing the managed option in which their representatives would be the decision makers. Mr. Vipond had no specific recollection but assumed that the materials given to him that day included a sample portfolio

showing Nortel comprising 12.05% of the total portfolio and another showing Nortel at 2.6%. He also assumed a portfolio summary was given to him which showed benchmarks consisting of the TSE 300 Total Return Index, the S&P 500 Total Return Index (Converted to Canadian Dollars), the Scotia Overall Mid-Term Bond Index, and Cash (Scotia McLeod 91 Day T-Bills). He had no understanding that the benchmarks described in that document were the benchmarks to be used for his portfolio.

14 Mr. Luik did not recall this meeting. Mr. Luik testified that he did not meet Mr. Vipond until June 2000, but for the reasons described below, I find that Mr. Luik's recollection is inaccurate on this point.

March 2000 Proposal Letter

15 Mr. Campbell asked Mr. Luik to provide a proposal for Mr. Vipond's consideration. Mr. Campbell had provided Mr. Luik with some information about Mr. Vipond and Mr. Luik sent him a draft proposal letter dated March 27, 2000. It contained neither a model portfolio nor any details of proposed investments. On March 28, 2000, Mr. Campbell wrote an e-mail to Mr. Luik advising that Mr. Vipond's first question would be: "What investments will you make?" Mr. Campbell noted that if Mr. Vipond kept all the BCE, Nortel and TD shares, AGF's proposed portfolio would be less growth. He wrote:

> You can suggest, or cover in your letter, that a further meeting with him and me could help finalize the direction and Laura could then put together a proposed stock list based on then current market activity.

16 The reference to Laura in the e-mail was to Laura Wallace, AGF's portfolio manager. It is clear from this e-mail that at this time it was not known whether Mr. Vipond would be transferring the Nortel, BCE and TD shares to AGF for management. It would appear that Mr. Luik did meet with Mr. Vipond and Mr. Campbell prior to the June meeting, as otherwise Mr. Campbell would not have spoken of "a further meeting". Mr. Luik was mistaken when he testified that he did not meet Mr. Vipond until June 2000.

17 Mr. Luik incorporated Mr. Campbell's feedback into his proposal and after receiving his approval, sent a revised proposal letter to Mr. Vipond dated March 29, 2000. In the letter, Mr. Luik thanked Mr. Vipond for including AGF in his search for a discretionary investment manager.

18 In the letter, Mr. Luik provided some information on how AGF managed investments for clients and specifically how they proposed to manage Mr. Vipond's investments. The letter made numerous representations on the service and capabilities of AGF. It committed to provide the highest level of personal service. Mr. Luik wrote that AGF believed in a long-term approach to both money management and client relationships, and their primary commitment to their clientele was to provide superior investment results with lower risk and volatility at a reasonable cost. He wrote that he understood that Mr. Vipond's profile and investment needs were as follows:

- you are single and do not have any dependants
- you do not spend frivolously and have learned to live with very little
- you have an "average" level of investment knowledge and would like to increase that going forward (you are considering doing the Canadian Securities Course)
- you are the lone beneficiary of an investment portfolio which has a current market value of approximately $6,500,000
- a large percentage of this investment portfolio resides in three securities (approximately 75% in BCE, Nortel and TD Bank)
- you require an after-tax income of between $90,000 - $120,000 per year.

19 In the letter, Mr. Luik described risk as the volatility of returns and not the permanent loss of capital. He wrote "the latter is dealt with through proper diversification. Portfolio volatility should be above average and consistent with the primary objectives of growth and inflation protection. The portfolio should have a high degree of equity exposure, to provide capital growth and inflation protection, and should be oriented to *long-term* considerations."

20 He wrote that if a portfolio were to be liquidated or seriously reduced within a given time frame, AGF would describe it as having a "time horizon" of that term. This would affect the asset mix if there was insufficient time for equities to realize their full potential and would also control the maturity schedule of the bond portfolio. The time horizon on Mr. Vipond's investment portfolio was described as being long-term. He was described as being in the highest tax bracket and that from a taxation point of view, returns on capital gains and dividends were preferable to returns from interest. Most desirable were unrealized capital gains.

21 Under the heading 'Recommended Strategy', AGF recommended a growth portfolio with an equity content between 75% and 100%, of which 20% to 50% would be Canadian. Mr. Luik wrote under the heading 'Constraints' that "[n]o one issuer will account for more than 8% of the equity portfolio". He went on to add that within the equity markets, the funds held in the portfolio "would be invested in different sectors of the economy to diversify risk". AGF and Ms. Wallace admitted that more than 8 to 10% in any one stock would represent undue concentration.[1]

22 The letter contained a model growth portfolio which was stated to be subject to change. It consisted primarily of equities with no individual equity accounting for more than 4.06% of the portfolio. Nortel, BCE and TD Bank accounted for 2.94%, 2.83% and 2.03%, respectively, of the total model portfolio. It was conceded that this was a reasonable portfolio for Mr. Vipond at the time.[2]

23 Mr. Luik noted that Mr. Vipond's portfolio was primarily invested in a mixture of Canadian stocks and internationally based mutual funds, and that a large percentage of the existing portfolio was held in BCE, Nortel and TD Bank (48%, 12%, and 23%, respectively). He wrote:

> Upon receipt of the assets AGF Private Investment Management will review all securities and make any required changes based on the agreed upon structure. The recommended strategy may vary depending on the securities you choose to have us manage and the corresponding percentage they represent of your overall investment portfolio. For example, if you choose to maintain all of your BCE, Nortel and TD Bank, we may recommend that the portfolio we are actively managing take on a more balanced approach (less stock).
>
> The above is a preliminary proposal to be used as a starting point for further discussion. It would be advisable to have additional in-depth discussions with you and Michael in order to come up with the optimal asset mix and investment strategy. After this meeting, we should be able to ascertain your intended direction and we could then further refine our recommendation.

While this letter did set forth a model portfolio, the proposal was preliminary in nature and the portfolio was expressly stated to be subject to change. Mr. Luik testified that at the time, there was no certainty about what AGF would be managing. There were a lot of things they did not know about the Plaintiff. That being said, he knew that the letter would form part of Mr. Vipond's and Mr. Campbell's decision-making process.

24 As stated in the letter, if he chose the classic broker option, Mr. Vipond was considering taking the Canadian Securities Course. At the time the letter was sent, he understood diversification to mean changing the portfolio from what he had. Diversification would lessen the risk; not all of his eggs would be in one basket. "Long term" to him meant looking for good investments and holding on to them. He knew that if the entire portfolio came over to AGF, it would not fit into the 8% cap described on page four of the letter. This was why he was looking for diversification. He knew that the model growth portfolio described on page five was subject to change. It was just a model, a preliminary proposal; a starting point for further discussion. These were not shares AGF was thinking of buying, but the model indicated how

the portfolio would be diversified. The model was an example of how the portfolio would be broken down. No one said that the shares in the model were the stocks that the AGF would buy on diversification of the portfolio. This was not a formula. It was not a requirement for instance that Nortel would be 2.94% but it was showing that no stock would be more than 8%.

25 Mr. Vipond agreed that it would be advisable to have additional in-depth discussions with Mr. Campbell and AGF in order to come up with the optimal asset mix and strategy. After that meeting, they would be able to ascertain Mr. Vipond's intended direction. AGF could then further refine its recommendation.

BCE Spins out Nortel

26 Nortel had been wholly owned by BCE and comprised a large portion of BCE's value. On May 10, 2000, BCE spun out Nortel. This resulted in a rise of the estate's holdings in Nortel from 3,600 shares to 38,000 shares.

27 On June 16, 2000, Mr. Luik wrote to Ms. Wallace and Mr. Smith, advising that AGF would receive a minimum of $2 million from Mr. Vipond, and that the amount fluctuated to a great extent as Mr. Vipond had approximately 55% to 60% sitting in Nortel.

Discussions of Alternatives with Mr. Campbell

28 Mr. Vipond met with Mr. Campbell to discuss his alternatives. Mr. Campbell outlined Mr. Vipond's options in correspondence dated May 25, 2000 and sent a blind copy to Mr. Luik.

29 Mr. Campbell described to Mr. Vipond the alternatives of a professionally managed account at TD Evergreen Private Investment Management, AGF or Dundee (Goodman Private Wealth Management) and a retail brokerage account at either TD Waterhouse Securities or Dundee Securities. Mr. Campbell strongly suggested that Mr. Vipond go with a professionally managed account.

30 Ultimately, Mr. Vipond would choose AGF to manage his portfolio on a discretionary basis.

31 Mr. Vipond understood that as a professional manager, AGF would take care of all aspects of his portfolio. AGF would make the decisions of what and when to sell. Its representatives did not need to call him about what had to be done. Mr. Vipond's purpose in going to a managed account was to have it diversified. He thought his account would look something akin to the model described in AGF's March 29, 2000 letter and that the breakdown in the model was representative of what he would expect; no one security would represent a great proportion of the account.

June 29, 2000 Meeting

32 On June 24, 2000, Mr. Campbell wrote to Mr. Luik about a meeting that had been scheduled with AGF. Mr. Vipond and he would be bringing stock certificates with a value in excess of $6 million. An asset protection trust in Bermuda was also contemplated. In addition, Mr. Campbell advised that in February 2001, Mr. Vipond would need $1.2 million to meet the tax liability that arose from the transfer of assets into the account. Mr. Campbell wrote that if AGF needed forms to be signed to open the account, then to please have them ready for signature. He also wrote:

> We would like to have a discussion with Bill and Laura on how they may restructure the portfolio. There are no sacred cows on the asset list but Gord would like to see a holding of some of the better names. The asset protection trust will hold mostly foreign funds but that is no reason for you not to use foreign assets in your holdings. Gord would like to have the MSCI World Index as the benchmark.

Mr. Luik responded that he would have the account opening forms ready when they came in. He also described BMO's requirements as the custodian of the securities.

33 Mr. Vipond and Mr. Campbell met with AGF's representatives, namely Mr. Luik, Ms. Wallace and Mr. Smith, on June 29, 2000 at AGF's office in Toronto.

34 Ms. Wallace and Mr. Smith were the co-executive directors of AGF's Private Investment Management Division. The two split responsibilities for managing the division. Ms. Wallace had been a portfolio manager since 1980 and at AGF she was responsible for the investment management of all the portfolios. In essence, she was the decision maker on investment management. She was also the author of AGF's market commentary that accompanied the quarterly reports sent to clients. While Mr. Smith had portfolio management experience, he attended to the business and administrative functions of the Division. In the 1997/1998 timeframe, the Division was in the process of getting established. Ms. Wallace testified that it had miniscule assets and no presence. Mr. Vipond's account would become one of its largest at the time.

35 The recollections of the attendees at the meeting differed.

(a) Ms. Wallace's Recollection

36 Ms. Wallace's recollection of the meeting was that it was long in duration. Amongst other things, the attendees discussed AGF's investment philosophy. They discussed Mr. Vipond's portfolio and diversification. AGF was a growth-oriented investor rather than a value investor that would buy stocks at a discount. Its focus was long term and not active trading; that is, AGF generally bought a position with a three to five year horizon. At the meeting, AGF gleaned information on Mr. Vipond, including what kind of investment mandate he wanted, his liquidity needs, the time frame and information on objectives and constraints.

37 Ms. Wallace knew that Mr. Vipond's portfolio was concentrated and knew the source of that concentration. The goal would be to diversify as they managed and as they moved forward. At the meeting, she said that obviously they were going to diversify and that typically when taking high-quality companies, it would take three to five years to diversify positions. She testified that she talked about the three to five year diversification strategy. She said it would be a staged reduction and that typically it would take three to five years to fully execute the diversification. She testified that she remembered saying that. While she thought that Mr. Smith might have said something about this, she had no such specific recollection. Similarly, she had no recollection of Mr. Luik or Mr. Campbell having said anything on the subject. She testified that Mr. Vipond acknowledged that he needed to diversify his portfolio but seemed concerned that AGF would eliminate the three stocks completely. He wanted to maintain a position particularly in Nortel. Ms. Wallace testified that Mr. Vipond expressed concern that AGF would eliminate concentration in Nortel and TD in a "fast fashion".

38 Ms. Wallace maintained handwritten notes of the meeting. They record "*diversify — end not all." She testified that this note reflected Mr. Vipond's desire to maintain some of the concentrated shares. He also wanted to protect his assets but according to Ms. Wallace, more importantly, he wanted to make his assets grow. The notes also stated "small % to more aggressive", which reflected Mr. Vipond's desire to have some aggressive management.

(b) Mr. Smith's Recollection

39 Mr. Smith testified that diversification was discussed at every meeting — they had to diversify and would do so on a staged basis. He could not recall the specific meeting at which this was discussed but testified that it was discussed at each meeting. The June 29, 2000 meeting was mostly directed to administrative matters. Mr. Smith took notes at the meeting. The notes refreshed Mr. Smith's memory. Amongst other things, the notes referred to diversification of the portfolio (although with no reference to over what time frame), a tax liability of $1.2 million due next April and that Mr. Vipond was looking for something aggressive. Mr. Vipond wanted the portfolio to grow and then after five years, to be less aggressive. Mr. Smith could not recall if Ms. Wallace discussed the timing of the long term diversification plan at the June 29 meeting or indeed at the July 20 or September 12 meetings with Mr. Vipond. He had no specific recollection that the timing of the proposed diversification was discussed with Mr. Vipond or Mr. Campbell.

40 He testified that a long term policy was prudent because otherwise, one might miss out on good pricing if all of the shares were sold at one time. Tax smoothing was another rationale to sell slowly; that is, if there were unrealized capital gains, the shares could be sold over a number of years so that the gains were not all realized in one year. Ms. Wallace's strategy was not to put all the stock into the market at one time.

41 There was no discussion of the 8% threshold at the June 29 meeting.

(c) Mr. Luik's Recollection

42 On the issue of diversification, Mr. Luik had no recollection of specific discussions, but diversification was to take place. He distinctly recalled Ms. Wallace using the term 'staged reduction over time'. Although he could not recall the timing of this comment at his examination for discovery, at trial he now believed it was made at the June 29 meeting. In my view, his evidence on when he heard Ms. Wallace say this is too vague to be reliable. I therefore reject his evidence at trial that this statement was made at the June 29 meeting.

43 Mr. Vipond hired Ms. Wallace to use her discretion to diversify the portfolio over a period of time. The time frame, according to Mr. Luik, was open. Ms. Wallace would manage the account and it would be her opinion on how long it would take.

(d) Mr. Vipond's Recollection

44 Mr. Vipond testified that there was no discussion on how long the diversification would take, but that he or Mr. Campbell said they wanted diversification to occur as soon as possible. He had no recollection of a discussion at that meeting concerning the timing of the diversification of the portfolio. Mr. Vipond came to the meeting with the share certificates in bearer form. They were still in his mother's name. He thought that once these share certificates were turned over and he had signed all of the paperwork, AGF could commence work on his portfolio. He thought that AGF would take the portfolio described in their March proposal letter and diversify the account. He expected to receive $10,000 in income each month. AGF was not sure if they could pay him this monthly amount by mid-July, so AGF would cash $20,000-$30,000 in Canada Savings Bonds ("CSBs") immediately to take care of that. He expected the diversification to take place as soon as possible, although he acknowledged that it would take some time to re-register the stocks, create a portfolio, and go into action.

45 He shook hands with the AGF representatives. He thought he was their client and that he had an account with them; he expected that AGF would diversify his holdings and he would await a report. Mr. Vipond testified that he understood that no one company would have more than 8% of the portfolio, but the 8% threshold was not discussed at the meeting. Diversification would provide him with protection. There was no discussion that it would take a long time to diversify his account. According to Mr. Vipond, AGF would commence work on June 30th.

(e) Mr. Campbell's Recollection

46 Mr. Campbell only had a vague recollection of the meeting and he did not take notes. Furthermore, his server was stolen and he lost all copies of his e-mail correspondence. He testified that the discussion at the meeting was a repeat of the contents of the March proposal. AGF would manage the account on a discretionary basis; Mr. Vipond's portfolio would be adjusted so as to be aligned with AGF's model portfolio for private clients; and it would be a growth portfolio with diversified holdings representing a range of 20 to 40 companies. His understanding was that Mr. Vipond's future portfolio would be somewhat similar to the portfolio described in the AGF March proposal letter. Mr. Campbell recalled a discussion of taxes. The adjusted cost base ("ACB") of the shares in the estate would be the date of disposition of the shares from the estate to Mr. Vipond. It was anticipated at the meeting that this would occur with the transfer of the shares at the meeting. Mr. Campbell did not say that AGF was not to incur any capital gains in the 2000 taxation year.

47 Mr. Campbell testified, and I accept, that Mr. Vipond only decided at the meeting to transfer all of the shares in the estate to AGF. Mr. Campbell did not recall any of the AGF representatives discussing a long term approach to the diversification of Mr. Vipond's shares, nor that diversification would take place in stages. He did not hear AGF state that diversification would take place over a number of years. He confirmed that both Mr. Luik and Mr. Smith told them that it would take four to six weeks to transfer the assets over, and then trading in the account would begin. He believed that Mr. Smith understood that both Mr. Vipond and AGF wanted the portfolio to be diversified.

(f) Findings

48 I find that the Defendants knew that Mr. Vipond had come to AGF to have his concentrated positions in Nortel, BCE and TD Bank sold down, although not eliminated, and reinvested in a diversified basket of securities.

49 I also conclude that while diversification was discussed with Mr. Vipond and Mr. Campbell at the June 29, 2000 meeting, the staged reduction plan was not discussed, nor was any three to five year horizon. I make this determination for the following reasons. Firstly, there is no written note or record referring to the plan or the horizon in any of AGF's handwritten notes of the meeting. They are also not referenced in any of the documents AGF prepared for Mr. Vipond's signature, including either of the Investment Policy Statement ("IPS") that was signed on September 9, 2000 or the March 29 proposal (although I appreciate that the Defendants' expert, Mr. Katz, opined that one would not make such a reference in an IPS). None of Mr. Luik, Mr. Vipond or Mr. Campbell had such a recollection and Mr. Scott's recollection was very imprecise.

50 While I did not find Mr. Vipond to be a very precise historian, I did find Mr. Campbell to be credible. Although his recollection of the meeting was admittedly vague, he had no recollection of a discussion of a staged reduction plan at the meeting. Among other things, had he wished to portray a version of events that supported Mr. Vipond's position in the lawsuit, he would not have been so forthright in acknowledging that he understood that it would take four to six weeks to get the assets transferred over to AGF, a view not shared by Mr. Vipond. Where the evidence of the AGF representatives and Mr. Campbell differ, I prefer that of Mr. Campbell.

51 I find that Ms. Wallace was in error when she testified that she described the staged reduction plan and stated at the meeting that it would take three to five years to diversify. If such a statement had been made, someone at the meeting other than Ms. Wallace herself would be expected to have a more defined recollection. Even if I were to find that Ms. Wallace had described the staged reduction plan to Mr. Vipond at the meeting, AGF certainly made no effort to ensure that Mr. Vipond had an understanding of this plan, nor were the risks associated with this strategy discussed with him or indeed with Mr. Campbell. Mr. Vipond was neither a sophisticated investor nor a savvy businessman and it was incumbent on AGF to explain the risks associated with their proposed strategy to him. AGF and its representatives failed to do so.

(g) Execution of Documents

52 Mr. Vipond turned the share certificates over to AGF and signed a number of documents at the meeting. These included an Investment Management Agreement ("IMA") dated June 29, 2000. Ms. Wallace testified that its purpose was to set out AGF's responsibilities and liabilities. The IMA stated that by signing the document, Mr. Vipond would be entering into a binding agreement with AGF and that AGF's duties as Mr. Vipond's investment manager began on June 29, 2000. However, it also said that AGF would invest the assets in Mr. Vipond's account in accordance with the investment objectives "that we have mutually agreed upon and which are outlined in the Investment Policy Statement ('IPS')". Ms. Wallace could not recall whether she said at the meeting that without the IPS, AGF could not trade, although this fact is obvious from reading the IMA. AGF's plan had been to deal with the IPS at the June 29 meeting but they ran out of time. Mr. Luik believed that Mr. Vipond knew that AGF needed the IPS to trade and, in my view, this was a reasonable belief.

53 The IMA described the account as being discretionary in nature: "We will make all investment decisions on a discretionary basis, including buying, selling, or otherwise dealing with your investments. We will, however, comply with any restriction on the amount or type of investments you add to the IPS."

54 In the IMA, Mr. Vipond acknowledged that market movements may cause changes in the price or value of his investments. For its part, AGF agreed to exercise the diligence, care and skill that one could reasonably expect from an experienced and competent investment manager. AGF would not be liable for making, holding or selling any investment, nor for any loss resulting from such actions unless such loss was caused by any act or omission done or caused by AGF in bad faith, or caused by its negligence, fraud, willful misconduct or that of its employees or agents under its direct supervision, management or control.

55 Fees would be based on the total value of the assets under management and paid out of the assets. AGF would provide quarterly reports to Mr. Vipond. Any amendments to the IMA had to be in writing and signed by both parties and the IMA constituted the entire agreement between AGF and Mr. Vipond.

56 At some point, AGF reviewed a questionnaire entitled 'AGF Private Investment Management Personal Financial Profile' with Mr. Vipond. It was designed to provide information about Mr. Vipond to AGF. It stated that Mr. Campbell was his financial adviser and described Mr. Vipond's investment knowledge as average, that is, he had some investment experience and some understanding of investment markets. His investment history consisted of ownership of GICs, CSBs, T-Bills, stocks and mutual funds and in the questionnaire he was described as currently owning GICs, CSBs, stocks and mutual funds. Mr. Vipond described the time horizon for his investment as being over ten years.

57 On June 29, 2000, Mr. Vipond also signed a document indicating that he declined to receive material relating to annual or special meetings of security holders or the audited financial statements of the issuers whose securities he held. AGF was appointed as the authorized investment manager in respect of his account.

58 Mr. Vipond authorized AGF to send portfolio information to Mr. Campbell. Materials were to be sent to Mr. Campbell by AGF so that Mr. Vipond and he could look at the same document at the same time. Mr. Vipond wanted to share information with Mr. Campbell and wanted AGF to share his information with Mr. Campbell. Mr. Campbell described his function as being a liaison between Mr. Vipond and AGF. He would be the relationship manager. He was not authorized by Mr. Vipond to give instructions to AGF. Mr. Campbell was not Mr. Vipond's decision maker. To use Mr. Campbell's description, he was an intermediary between AGF and Mr. Vipond.

59 Mr. Vipond received and signed correspondence from Mr. Smith dated June 29, 2000 advising that as Mr. Campbell referred Mr. Vipond to AGF, a referral fee of 35% (based on the annual investment management fee charged to Mr. Vipond's account) would be paid to Mr. Campbell on an ongoing basis for as long as Mr. Vipond's account was held with AGF. Mr. Vipond's total fee remained the same whether or not a referral fee was paid. The payment was in recognition of the referral and the continuing service provided by Mr. Campbell to Mr. Vipond. Mr. Vipond had no concern about this arrangement. Based on the fees for the quarter ending December 2000, Mr. Campbell would receive approximately $16,000 annually. There was therefore a financial incentive for Mr. Campbell to try and maintain Mr. Vipond as an AGF client. Mr. Campbell did not give trading instructions to AGF on Mr. Vipond's behalf.

60 Mr. Vipond also signed an Investment Custody Account Agreement in favour of the Bank of Montreal ("BMO") at the meeting. BMO would serve as the custodian for Mr. Vipond's account with AGF. The agreement noted the $10,000 monthly remittance to be paid to Mr. Vipond and described the start date as August 15, 2000. Mr. Campbell stated that this was because it would take four to six weeks for the account to be sent over.

61 By the end of the meeting, many details of AGF's mandate had not been discussed. As a result, the attendees decided to hold a second meeting to discuss the contents of the IPS. Ms. Wallace would call Mr. Campbell to schedule the meeting for the end of July. I find that Mr. Vipond knew that the IPS needed to be signed for AGF to commence its trading. This was, at a minimum, clear from the language of the IPS itself and the scheduling of the second meeting.

While the IMA stated that AGF's duties as his investment manager began June 29, 2000, the investments were stated to be as mutually agreed upon and as outlined in the IPS.

62 Ms. Wallace knew that Mr. Vipond's portfolio was concentrated and was volatile in part because of the concentration and in part because of the securities in the portfolio. Nortel was the volatile security. It was admitted by Ms. Wallace that Mr. Vipond and/or Mr. Campbell conveyed to her or the people at AGF that they wanted the portfolio to be diversified.

63 On July 11, 2000, Mr. Luik wrote to Mr. Smith, stating that Mr. Vipond had a proposal recommending a Growth Mandate (70-100% equity) and that based on the last meeting "we may be running an Aggressive Growth mandate (95-100%)."

July 20, 2000 Meeting

64 On July 20, 2000, Mr. Smith and Ms. Wallace met with Mr. Vipond and Mr. Campbell again. Mr. Luik was not there. Mr. Campbell and Ms. Wallace's recollections of this meeting were hazy. Mr. Vipond's was non-existent. Mr. Smith and Ms. Wallace both had notes of the meeting.

65 The focus of the meeting was the mandate for the account. AGF was still searching for possibly lost dividends and cleaning up the transfer of the share certificates. The CSBs had to be re-registered and cashed in. There was also discussion about the tax payment that would be due in 2001. It was confirmed that the ACB would be based on the date of Mr. Vipond's mother's death, namely November 19, 1997, and the tax of approximately $1.2 million arising from the deemed disposition of the shares would therefore be due on February 19, 2001.

66 At the meeting, the attendees spent a fair amount of time discussing the type of account Mr. Vipond wanted. He wanted an aggressive growth portfolio. They looked at a growth portfolio valuation with a Canadian tilt as at July 20, 2000. This document showed an 18.26% weighting for Nortel and differed from the portfolio in the March 29, 2000 proposal, but not much time was spent on it.

67 Mr. Smith's notes refer to diversification of the portfolio, but no time frame was documented. As mentioned, he believed that a long term diversification plan was discussed at every meeting and that sales would occur on a staged basis but he could neither recall specifics, nor the timing of when this was discussed. More significantly, he had no specific recollection that the timing of the proposed diversification was discussed with Mr. Vipond or Mr. Campbell.

68 Ms. Wallace's handwritten notes made no reference to either diversification or a staged reduction over any time frame.

69 After the meeting, the attendees went out for lunch. Later that day, Mr. Smith sent an e-mail to Mr. Luik, Ms. Wallace and Kerri Robinson, an AGF administrative assistant. Mr. Smith asked Mr. Luik to draft Mr. Vipond's IPS based on an aggressive growth mandate with a maximum of 15% in the Driehaus, Aggressive Growth Fund and the Money Market and 85% in a standard Aggressive Mandate. Mr. Luik was to set out the ranges and an appropriate benchmark.

70 Mr. Smith noted that the valuation date to be used for the ACB of the shares was November 19, 1997, and that on February 19, 2001, approximately $1.2 million was to be paid in tax. He then wrote that Mr. Vipond and Mr. Campbell "have been told it will take about a month to complete the transfer and set up the portfolios at the BMO at which point Laura will be able to trade."

71 Mr. Vipond denied that by July 20, he had been told of a staged diversification strategy over three to five years. His purpose in going to a professionally managed account was to diversify relatively soon. In his testimony, he questioned why he would pay a fee if AGF was going to do nothing with his portfolio. On July 20, 2000, Mr. Smith wrote to Mr.

Luik, stating that Mr. Campbell and Mr. Vipond had been told it would take about a month to complete the transfer and set up the portfolios at the BMO, at which point Ms. Wallace would be able to trade.

72 The benchmark established as a proxy for how Mr. Vipond's account would be managed consisted of the TSE 300 Total Return Index, S & P's 500 Total Return Index (Canadian dollars), Scotia Overall Mid-Term Bond Index and Cash (Scotia McLeod's 91 Day Treasury Bills.)

73 I conclude that there was no discussion of a staged reduction over three to five years at this meeting.

The IPS

74 Mr. Luik proceeded to draft the IPS based on Mr. Smith's e-mail. On August 1, 2000, he sent it to Ms. Wallace and asked her to ensure that it coincided with their last meeting. Ms. Wallace reviewed the IPS and was satisfied that it reflected the discussions at the two meetings AGF had had with Mr. Vipond. On August 2, 2000, she advised Mr. Luik that the draft IPS was fine.

75 On August 3, 2000, Mr. Luik sent the draft IPS to Mr. Campbell for review. Mr. Campbell responded that same day, stating that it looked fine to him. He added that the tax liability was now higher, as Nortel's share value had increased from $98 per share to approximately $115 per share. He suggested that Mr. Luik might want to address this fact in the preamble to the IPS. He also told Mr. Luik that Mr. Vipond might move some money offshore and some to Dundee. As such, the quantum to be under AGF's management was uncertain although it would be no less than $2.5 million.

76 On receipt, Mr. Luik made some minor revisions to the IPS, again sent it to Mr. Campbell for review and the latter again said it looked fine to him. Mr. Campbell wrote that if the IPS did not come back as fast as Mr. Luik expected, Mr. Luik should let Mr. Campbell know if there was something he could do. He wrote that he would be away on holidays for the next two weeks but could follow up with Mr. Vipond on his return.

77 Mr. Luik commenced the finalized IPS by thanking Mr. Vipond for choosing AGF to meet his discretionary investment management needs. Based on the information discussed and provided, Mr. Luik proceeded to provide some information on how AGF proposed to manage Mr. Vipond's investments. He reiterated Mr. Vipond's profile and investment needs that had been described in the March proposal, including the reference to BCE, Nortel and TD, but changed the current market value of the portfolio from approximately $6,500,000 to approximately $7,000,000. He deleted the reference to an after-tax income of between $90,000 and $120,000 per year and stated instead that Mr. Vipond would be drawing an income of $10,000 per month from the portfolio. He also added:

- A tax liability of approximately $1.475 million exists and is to be paid from the portfolio around February 19, 2001

- The total size and tax liability of the investment portfolio is very dependent on the value of Nortel, as this currently represents an extremely high percentage of the portfolio, and

- You are comfortable investing in an equity oriented portfolio even though there exists the possibility that additional amounts may be required from the portfolio that AGF Private Investment Management is handling (i.e. Offshore trust, other manager).

78 Under the heading 'Risk Tolerance', the IPS stated that "risk is defined as the volatility of returns, and not the permanent loss of capital. The latter is dealt with through proper diversification" and that "the portfolio should have a high degree of equity exposure, to provide capital growth and inflation protection, and should be oriented to *long-term* considerations."

79 The time horizon on the investment portfolio was described as being long term. Mr. Vipond was described as being in the highest tax bracket and from a taxation point of view, returns from capital gains and dividends were preferable to returns from interest. Most desirable were unrealized capital gains. The IPS noted Mr. Vipond's interest in having up to 15% of the portfolio managed using an aggressive/momentum style of equity management.

80 The recommended strategy was a growth portfolio with an equity content of between 85% and 100%. A maximum weighting of up to 15% would be held in short-term (money market) instruments. Under the headings 'Equities', the percentage ranges were stipulated. Canadian equities would be between 30 to 80%; non-domestic between 20-55% and aggressive equities between 0-15%. The IPS stated, "Within these equity markets, the funds held in the portfolio will be invested in different sectors of the economy to diversify risk."

81 Unlike the March proposal, the IPS no longer included any reference to an 8% concentration restraint. AGF knew that the percentage that the share certificates would represent on receipt far exceeded the 8% and the constraint would be inapplicable.

82 That said, Ms. Wallace generally used an 8 to 10% threshold to reflect diversification in her portfolios. She testified that more than that would represent undue concentration. Academic studies and her experience led her to that conclusion.

Delay in Execution of the IPS

83 On August 3, 2000, Mr. Luik sent the IPS to Mr. Vipond by registered mail with a copy to Mr. Campbell. He wrote:

> It is the formal record of our discussions and the agreement as to how the portfolio is to be structured. If there are material differences from what I have recounted please inform me immediately.
>
> The IPS is the document by which you can control the investment relationship with AGF Private Investment Management. You have hired AGF Private Investment Management to recommend a strategy to which you have agreed; to implement the strategy, and to monitor and make changes within the bounds of the authority given to us as described in the IPS....If you have reviewed and agreed to the attached IPS, please keep a copy, and return the *original* in the enclosed self-addressed envelope.
>
> Please feel free to contact me at any time if you have any questions.

84 Mr. Luik heard nothing. The IPS was sitting in Mr. Vipond's unopened mail. Mr. Vipond had no knowledge of how long the IPS had sat awaiting his signature before he opened the envelope. In addition, at some point his phone had been cut off.

85 On August 23, 2000, Mr. Luik wrote to Mr. Campbell stating that once AGF received the signed IPS, they could commence managing the account. Mr. Campbell responded that the management of the account should start prior to the September payment of the first monthly cheque.

86 In late August or the beginning of September, Mr. Vipond received a telephone message from Mr. Luik asking Mr. Vipond to contact him to sign documents. Mr. Luik stated that AGF could not function until the IPS was signed and he also advised that Nortel's price was decreasing. Mr. Vipond read the IPS and realized it had not been signed by him and that nothing had transpired in his account. He tried unsuccessfully to reach Mr. Luik and Ms. Wallace but got lost in AGF's phone mail system. He went to the corner of Yonge St. and St. Clair Ave. in Toronto looking for Mr. Luik whom he had been told was meeting another client at a building nearby. Not surprisingly, he was unsuccessful.

87 Mr. Vipond called Mr. Campbell and said they had a problem. Mr. Vipond was upset because nothing had been done. In his mind, there had been no suggestion of any urgency in getting the IPS signed and it had been sent simply by registered mail. Mr. Campbell arranged a further meeting with Mr. Vipond on September 9. Mr. Vipond read and reviewed the IPS with Mr. Campbell before he signed it. Long term to him meant being in a long programme of being a client or that AGF and he would be in business together. He did not see "long term" as being five to ten years to get the functions done. It meant they were looking forward to a client relationship for a long term and the horizon of the account would be five to ten years. In my view, this was a reasonable interpretation of the IPS.

September 12, 2000 Meeting

88 On September 12, 2000, Mr. Vipond and Mr. Campbell met with Mr. Smith and Ms. Wallace. Mr. Vipond gave the signed IPS to AGF at the meeting. When he returned the IPS to AGF, Mr. Vipond did not notice that the 8% provision contained in the March proposal was not included. Mr. Vipond knew that his portfolio did not meet the 8% threshold. Mr. Vipond thought his fees started in June but it is not disputed that the fees started to accrue as of September 12.

89 At the meeting, Mr. Vipond explained that he was unhappy. Some concern was expressed by him or by Mr. Campbell on his behalf that communications were not very good. Nortel had risen to $124 per share over the summer but by September 12, it was trading in the $100 range. Mr. Campbell described Mr. Vipond as being upset that he was still holding so much Nortel and that he hoped that he would not be sold out at a ridiculous price around $93. Ms. Wallace understood Mr. Vipond to be angry about the change in price. In her handwritten notes made that day at the meeting, Ms. Wallace referenced "new procedure — courier IPS" and "new procedure — email." She also wrote "prudent profit taking". She told Mr. Vipond that they would take advantage of the strength in prices to reduce his Nortel holdings. Ms. Wallace testified that he responded that perhaps they wanted to trade around the position and buy some stock if the price was low but that she responded that this was not AGF's style; AGF bought to hold for three to five years and, in addition, Mr. Vipond already had enough Nortel stock. Ms. Wallace's handwritten notes of the meeting make no mention of AGF's three to five year strategy and I do not accept that this strategy was communicated to either Mr. Vipond or Mr. Campbell.

90 The total value of Mr. Vipond's portfolio on September 11, 2000 was $6,562,906, of which Nortel, with a market price of $103.90 per share, represented $3,890,604, or 59.28%.

91 With the IPS in hand and the shares registered with the custodian, AGF could now start trading. Ms. Wallace also completed a client information form that reflected a "shorthand' of Mr. Vipond's objectives. The portfolio structure was described as a Growth Portfolio, with 85-100% equities, of which 0-15% would be Aggressive. Each quarter, AGF would send Mr. Vipond a letter enclosing AGF's Capital Market Review, which was written by Ms. Wallace. AGF also sent him a portfolio summary on a quarterly basis comparing his returns with the aforementioned benchmarks.

Follow Up E-Mails from Mr. Campbell

92 On September 13, 2000, Mr. Campbell sent an e-mail to AGF. In this communication, Mr. Campbell outlined some of Mr. Vipond's shortcomings. He described him as a terrible procrastinator and stated that he went with Mr. Vipond to the September 12 meeting because if he had not, AGF still would not have the executed IPS. He also told AGF about Mr. Vipond's relationship with Larry Fraser of Dundee who was "after the business". Mr. Fraser had been telling Mr. Vipond that at Dundee, his Nortel shares would have been sold at the peak. Mr. Fraser had called Mr. Vipond and told him that Nortel had fallen another $5.00 that Tuesday. Mr. Campbell wrote: "The tone and nature of the comments were relayed to me after he got off the phone. Gordon's comment however was 'I hope they don't sell me out at a loss.' I reminded him of Laura's comment of selling into strength and that Nortel is still a buy in the mind of many competent managers."

93 After receiving this email, Mr. Luik regularly tried to contact Mr. Vipond to review his portfolio, but he would never hear back from him.

94 On September 27, 2000, Mr. Campbell wrote to Ms. Wallace as a follow-up to the September 12, 2000 meeting. He wrote that hopefully she had "been able to use some of the good days to reduce the volatility due to the high concentration in Nortel while taking the long term view we spoke about."

Nortel Sales

95 During the course of their mandate, AGF sold three tranches of Nortel shares from Mr. Vipond's account. In six weeks, approximately 17% of the Nortel holding was sold by AGF. On September 21, 2000, 2000 shares were sold

for $98.183 per share. This would be evident from the September 30, 2000 valuation statements that Ms. Wallace sent to Mr. Vipond on October 23, 2000. On October 13, 2000, 3,500 shares were sold for $96.95 per share and on October 20, 2000, 1,000 shares were sold for $103.56 per share. After October 20, 2000, no more Nortel shares were ever sold by Ms. Wallace on behalf of Mr. Vipond.

96 Around this time, Mr. Campbell spoke with Ms. Wallace and understood from her that AGF was considering adding more Nortel to the portfolio. He was shocked at this suggestion. He said that Mr. Vipond was already overexposed. 2000 shares had been sold and he said it should have been 20,000. Ms. Wallace denies this discussion.

97 Ms. Wallace testified that AGF had not been considering adding Nortel to Mr. Vipond's account, although they had considered purchasing Nortel stock for portfolios with low Nortel weightings. She did think it prudent to wait until she knew the tax situation before she conducted more transactions though. She also thought that Nortel's October 24 below earnings report was just a stumble and not a fundamental change in outlook for the company. On October 25, 2000, Nortel's share price fell $25.00 in one day. Given that Mr. Vipond held Nortel shares, Ms. Wallace let the cash holdings in his portfolio rise to 15% and left the aggressive component of the portfolio at zero.

98 I accept Mr. Campbell's version of this conversation with Ms. Wallace. I conclude it unlikely that he fabricated this discussion and more likely that Ms. Wallace forgot it. I also note that the discussion Mr. Campbell described is consistent with the following October 25, 2000 e-mail Mr. Luik sent to Mr. Campbell.

99 On October 25, 2000, Mr. Luik wrote to Mr. Campbell and faxed the account valuation to him. Mr. Vipond was not returning his calls, so Mr. Luik was doing what he could to have contact. He said that as Mr. Campbell would see, AGF had been selling down Nortel over the last couple of weeks and with it being down so much that day, consideration was being given to adding some. Mr. Campbell responded that he was glad that Ms. Wallace had been selling Nortel and questioned whether it made sense to buy more. He also suggested weekly phone calls to Mr. Vipond. Mr. Campbell was going to do some work on the estate tax issue and proposed a further meeting for November.

100 Mr. Luik replied to Mr. Campbell and stated that with regards to Nortel and other options, it was up to Ms. Wallace at this point. As to the communication suggestions, he observed that Mr. Vipond had chosen not to return his phone calls and asked whether having Ms. Wallace call Mr. Vipond would be a better idea. Mr. Luik nevertheless still tried to contact him.

101 On October 31, 2000, Mr. Campbell contacted Mr. Luik by e-mail. He wrote: "I know that when Gord gets back he will have some questions as to why he had so much Nortel over the past few weeks (even though he did not want it sold at the ridiculously low price of $93.00)... It may also be helpful if you or someone in the research department can get the old information of the major drop in Nortel in early 1998 after the purchase of the San Francisco company. My recollection is that the share value dropped then by over 40% as well and had fully recovered in less than 8 months. This might allow us to show that there is no loss until he sells and that for the long term investor which he is [3] holding now is the best option."

102 Mr. Luik forwarded the email to Ms. Wallace. It reinforced her view that the Plaintiff was following the stock prices closely.

103 As a result of this request, Mr. Luik ran a chart from Bloomberg for Mr. Campbell. He believed that Mr. Campbell intended to use the chart in conversation with Mr. Vipond.

Taxes

104 On November 9, 2000, Mr. Smith received a telephone call from Mr. Campbell. He advised Mr. Smith that they were looking at re-registering the shares back into the name of the estate with Mr. Vipond as the executor and trustee. Mr. Campbell mentioned that tax savings were the reason for this. Mr. Campbell also raised this issue with Mr. Luik that day. Mr. Luik understood that Mr. Campbell was exploring the possibility of having it appear as though the estate was

not closed so that capital gains would not crystallize with the re-registration of the portfolio into Mr. Vipond's name. There would only be capital gains taxes payable on what had been sold so far. There would be an embedded unrealized gain, but it would not be taxable until the shares were disposed of. Originally, the tax liability would be triggered with the re-registration of the shares from the estate into Mr. Vipond's name. This would be considered to be a disposition and capital gains taxes would be crystallized. This was the anticipated tax payment to be made in February 2001. As a result of this re-registration, the tax considerations associated with managing the portfolio changed. Rather than paying a fixed amount of tax in February, the taxation would be controlled by AGF through the buying and selling that occurred in the portfolio. Ultimately the tax liability dropped to $150,000.

105 Mr. Luik testified at trial that this change would have a bearing on what Ms. Wallace was doing, whereas in his examination for discovery, he stated that he had no knowledge, information or belief that the change in the ACB would have a bearing on what Ms. Wallace was doing. Given that his examination for discovery was earlier in time, I find that he did not turn his mind to the impact the new ACB would have on the management of Mr. Vipond's portfolio.

106 Ms. Wallace testified that now, six weeks before the end of the taxation year, the September and October sales would generate capital gains of between $500,000 and $600,000 and not capital losses. Mr. Luik recalled a comment that he assumed came from Mr. Campbell about being sensitive about incurring capital gains but no one ever told Ms. Wallace or AGF to avoid further Nortel sales so as to avoid incurring capital gains.

November 16, 2000 Meeting

107 In late October or November 2000, Mr. Vipond received and reviewed the September account statement. It did not reveal much action. He asked Mr. Campbell to set up another meeting with AGF, which he did. Mr. Campbell also wrote an email to Mr. Luik dated November 14, 2000, outlining the issues and questions Mr. Vipond had as a result of his review of the September account statement. Nothing was mentioned on diversification, although this was raised in another email Mr. Campbell sent to Mr. Luik the same day. Mr. Campbell wrote, "I will also be expecting a review of current strategy re the diversification of the portfolio. G's comment to me on Friday is, 'I could have lost all the money in Nortel on my own. Why do I need to have AGF, are they not there to reduce my risk to this kind of market swing?" Mr. Vipond did not speak to AGF himself. He left that to Mr. Campbell, who advised AGF of Mr. Vipond's view.

108 Mr. Luik discussed the proposed meeting with Ms. Wallace. She knew that diversification was on the agenda. She maintained in her testimony that AGF's diversification strategy had been the three to five year staged diversification she said they had discussed at the June 29, 2000 meeting. Ms. Wallace considered it natural that Mr. Vipond would want to discuss AGF's thoughts on his holdings. He was aware that Nortel's price was down.

109 The meeting took place on November 16, 2000. Mr. Vipond believed that all three of the personal defendants were present, but Mr. Smith was not. No one from AGF was sure whether Mr. Luik was present. Ms. Wallace was there, as were Mr. Campbell and Mr. Vipond. Ms. Wallace described the two as being testy at the beginning of the meeting. There were a number of outstanding administrative irritants.

110 They discussed the fact that the ACB was going to change and the implications of this change.[4] Now they would be reverting back to the ACB of the shares as of the date of Mr. Vipond's mother's death. The ACB for Nortel would therefore be $18.50, the share value on the date of Mrs. Vipond's death, rather than $103.90, its share value on the date of re-registration from Mr. Vipond to AGF. The tax liability of approximately $1.45 million described in the IPS disappeared because the date of disposition had been changed. AGF's sales of Nortel had previously generated a capital loss based on an ACB of $103.90, but now with an ACB of $18.50, the sales resulted in capital gains of approximately $500,000 to $600,000. In addition, the capital gains inclusion rate was changed by the Canadian government on October 18, 2000. In February 2000, it had been 75%; it was then reduced to 66.66%; and by October 2000, it was 50%. Ms. Wallace was left with the impression that if she did not need to realize capital gains, she should not but she was not so instructed. At this time of year, she would look at portfolios and see whether taxes could be delayed. The November

15, 2000 portfolio valuation statement that Mr. Vipond saw at the meeting showed 32,174 Nortel shares in the account at a market price of $58.70 per share.

111 Ms. Wallace presented a chart illustrating how Nortel had in the past gone through difficult periods with sharp declines and increases and she noted that this happened from time to time with good companies. Companies may encounter problems but recover. They discussed Nortel's past history. By the end of the meeting, she thought that Mr. Vipond was quite cordial.

112 In her evidence from her examination for discovery that was read in as part of Mr. Vipond's case at trial, Ms. Wallace acknowledged that the risk of a decrease in the Nortel share price had increased by the third quarter of 2000.

113 Mr. Vipond's recollection of the meeting was that his dissatisfaction that nothing was happening was again addressed. He was still at risk, the account was not being diversified and Nortel was still dropping. Mr. Vipond maintained in his testimony that he or Mr. Campbell noted this and that the individual defendants responded by apologizing. Mr. Vipond testified that he left having been talked into staying with AGF and understanding that his account would be diversified. He had no recollection of any discussion about Nortel, its share price or taxes, but I find that his recollection was in error. Throughout, where it differed, I preferred Mr. Campbell's evidence to that of the AGF witnesses, and on this issue, to that of Mr. Vipond.

114 Mr. Campbell made it clear that they were not comfortable with the slowness of the Nortel share sales. Mr. Campbell felt optimistic that AGF understood Mr. Vipond's concerns, and would act on them and diversify the portfolio. Mr. Vipond wanted to move his account but Mr. Campbell persuaded him not to do so.

115 In the November/December timeframe, AGF related to Mr. Vipond that it was felt that Nortel would come back up in price.

Christmas Lunch

116 Mr. Vipond received the November 30, 2000 portfolio valuation statement on or about December 11, 2000. It still revealed 32,174 Nortel shares in the account at a share price of $57.60 per share.

117 In December 2000, Mr. Vipond had lunch with Mr. Luik and Ms. Wallace at the Toronto restaurant, Canoe. He had no recollection of discussing the account and described the get-together as a feel-good Christmas lunch. Mr. Vipond would not be prone to discussing business because Mr. Campbell was not there. Ms. Wallace recounted that Mr. Vipond asked whether AGF would consider sponsoring a NASCAR team. They also discussed the markets. It was a friendly and cordial meeting.

118 Thereafter, Mr. Luik made a number of attempts to contact Mr. Vipond and to set up a meeting to review the portfolio. He heard nothing back.

Ms. Wallace's Portfolio Management Approach

119 Ms. Wallace described her approach to portfolio management and her strategy of staged diversification when reducing a position in a high-quality company and her approach to Mr. Vipond's portfolio.

120 Nortel was a global leader in an expanding technology and telecommunications industry. It had a strong and liquid balance sheet and was 100 years old. In the past, Nortel had had a history of sharp declines and recoveries. In November 2000, UBS Warburg was also describing it as a strong buy.

121 BCE was a stable company with a large part of its business being regulated by the CRTC. Its earnings followed a more predictable pattern. TD was considered the strongest of the Canadian banks, all of which were strong given their oligopoly.

122 The three holdings were in different sectors, namely utilities, technological hardware and technology, and banking, and all were expected to perform differently; in that sense, there was a balance.

123 Considering Nortel's prospects, the counterbalance of BCE and TD Bank in the portfolio, the rising cash and the changed ACB, Ms. Wallace was reluctant to realize more capital gains.

124 In January 2001, there was a 10% increase in Nortel's stock price following the U.S. Federal Reserve's unexpected cut in interest rates.

125 On February 1, 2001, Ms Wallace wrote to Mr. Vipond and enclosed the financial statement for the period ended December 31, 2000. She noted that the year 2000 was a difficult one for global equity markets. She wrote "while short term performance of Nortel was disappointing, we are confident the stock will provide a good return over the immediate term." She noted that the U.S. Federal Reserve had lowered its key lending rate and stated that "we are encouraged by this aggressive action and confident that economic prospects will improve in the latter half of the year." At this time, Ms. Wallace still considered Nortel to be a high-quality company, as did others. It won a major contract and its CEO, John Roth, reiterated his positive outlook for the company. She decided to await Nortel's February 15, 2001 earnings release before she began selling Nortel again.

Termination of the Relationship

126 Mr. Vipond received Ms. Wallace's February 1, 2001 letter enclosing the December 31, 2000 statement. The statement still revealed a holding of 32,174 Nortel shares but now with a market price of $48.25 per share.

127 At the end of January 2001, Mr. Vipond spoke with Mr. Campbell and noted the inactivity in his account. He asked if Mr. Campbell could find some other investment company that Mr. Vipond might investigate.

128 Mr. Vipond himself then called Brendan Caldwell of Caldwell Partners and Don MacDonald of GPW. He explained the situation to Mr. MacDonald. He said he was losing value and AGF was not doing the diversification job.

129 On February 5, 2001, Ms. Wallace spoke with Mr. Campbell but he did not tell her of Mr. Vipond's inquiries of others. On February 22, 2001, Mr. Campbell wrote to Mr. Luik:

> You should know, if you have not already suspected, Gord is VERY upset over the recent drop in Nortel. He has a very large holding of this stock that has not been significantly pared in spite of the original reasons for moving to a discretionary manager, which was to diversify the portfolio and reduce risk. I am also concerned as the original objectives given when he opened the account, was that we would need about $2,000,000 in February 2001 for taxes and $2,000,000 to transfer to an offshore trust. We have also had discussions about the huge weighting in Nortel and that this needed to be reduced. In early meetings we discussed reducing Nortel significantly, yet that has not been done in any measure. If we proceed with the original redemptions and the values were within 10% of the original values, it would have left around $2,000,000 with AGF PIM, however with the massive loss in value and the volatility experienced by Gord since the account transferred the remaining assets would now be minimal!
>
> What are the current plans to reduce the volatility and or stop the massive drop in value on the account [from] continuing? Is there any clear plan at AGF designed to address this situation for Gord?

130 Mr. Luik felt that this letter did not sound as if it were written by Mr. Campbell. It seemed scripted and inconsistent with their history. Ms. Wallace's first reaction was that Mr. Vipond was terminating their services. She was right.

131 No one at AGF responded to Mr. Campbell's letter by referring to any staged reduction plan or that AGF had avoided any Nortel sales for tax purposes.

132 Mr. Vipond decided to leave AGF because he felt he had to do something to protect his assets. On February 22, 2001, he sent correspondence to Ms. Wallace terminating AGF's services and stating that no other transactions were to be entered into on his behalf. He then advised Mr. Campbell that he had terminated his relationship with AGF. Mr. Campbell said he understood as AGF had not done what they had promised. As of February 28, 2001, the portfolio continued to hold 32,174 Nortel shares at a share price of $28.50. Nortel now represented 22.53% of the portfolio, not because shares had been sold, but because their value had decreased. The value of the portfolio on February 22 was $4,097,235. This was in contrast to its transfer value of $6,562,906 on September 11, 2000.

133 Mr. Vipond entered into an account with GPW on February 23, 2001. GPW sent transfer instructions to AGF but it took until March 21, 2001 for the electronic transfer of shares to occur. On transfer, TD represented 36%, Nortel 23.7% and BCE 17% of Mr. Vipond's portfolio. 40 to 45% of the BCE and 44.21% of the TD holdings were sold immediately after the transfer.

134 GPW sold 32,174 shares of Nortel in two lots. The first lot of 16,174 shares was sold on March 22, 2001 for $26.21 per share and the second lot of 16,000 shares was sold on March 30, 2001 for $21.86 per share. Mr. MacDonald, Mr. Vipond's new portfolio manager, was of the view that one should not own more than 10% of a portfolio in one stock. This was a rule at GPW and an industry standard. GPW did hold more than 10% of TD stock in Mr. Vipond's account, but this was regularly discussed with Mr. Vipond, who was in agreement. As portfolio manager, Mr. MacDonald would consider tax if there were gains and losses, but tax would not drive the investment decision.

135 Mr. Vipond continues to be satisfied with GPW, who has now managed his account for about 11 years. They use a value style of investing that has emphasized a significant component of fixed income, with no aggressive component as found in Mr. Vipond's IPS with AGF.

Account Statements

136 Turning to the AGF account statements, Mr. Vipond got the portfolio valuation dated September 11, 2000 at the September 12 meeting. Mr. Vipond had been following Nortel. He would get news from the radio or television and he also tracked the value of his stocks in his mother's estate. He would go to the library and also went on the internet. He also received some information on Bell and Nortel from Mr. Campbell.

137 Mr. Vipond initially received quarterly reports from AGF and then monthlies as of September 12. The September statements came to him under cover of the October 23 letter. He never called AGF to discuss the monthly statements. At some point, he would go through them with Mr. Campbell. He did not have many questions because not much had changed. He would go to Mr. Campbell to have his questions answered, not to AGF. He would look at the statements to see whether his account was being diversified. He would particularly look at BCE, TD and Nortel. He was fully aware of Nortel's price when he got the statements and he would look at the market price.

Expert Evidence

(a) Plaintiff's Experts

Professor Eric Kirzner

138 Professor Eric Kirzner was qualified as an expert competent to give opinion evidence on the suitability of investments and investment strategies for individual investors, including asset allocation. He was called by the Plaintiff. He currently holds the John Watson Chair in Value Investing at the Rotman School of Management at the University of Toronto. As his title suggests, he is a professor and not a portfolio manager.

139 Professor Kirzner provided opinion evidence on whether AGF suitably managed Mr. Vipond's account and more specifically, whether the investments and the structure of Mr. Vipond's account were suitable in light of the circumstances, objectives and risk tolerances described in Mr. Vipond's account opening forms.

140 He commenced his analysis by examining the applicable industry standards. He considered the standards established by the Ontario Securities Commission, with whom AGF was registered. Although AGF was not registered with any of the self-regulating organizations that are responsible to the OSC, Professor Kirzner was of the view that those regulations shed additional light on industry standards. He discussed the Know Your Client ("KYC") rule and suitability. He opined that concentration is normally a violation of suitability standards unless the client has specifically requested it, understands the risk implications of concentration and has been suitably cautioned or warned about the risks of concentration. It is also a general principle of investment finance that equity investments should be diversified, that is, a portfolio should be spread over many investments and sectors to avoid excessive exposure to any one source of risk. Typically for diversified equity portfolios, the maximum concentration of the portfolio in a single security would be about 8%.

141 Professor Kirzner was of the view that unless Mr. Vipond had requested otherwise, the concentration in his account should have been removed immediately. The suitability standard was applicable whether an investor came with cash or an already concentrated portfolio. The account was at all times vulnerable to any downturn in (a) Nortel, (b) technology, given the Nortel and BCE account concentration, and (c) TD Bank. He opined that AGF had a continuous obligation to advise Mr. Vipond to substantially reduce his Nortel holdings since his account was dangerously concentrated, and that a downturn in this single stock would have serious financial consequences for the account. According to Professor Kirzner, this continuous obligation to warn is the industry standard in the case of excessive concentration in a stock or industry. While prudent, it need not be in writing.

142 In the absence of a request by Mr. Vipond, a staged diversification over three to five years made no sense. Risk is instant. If an account had a 15 to 20% concentration, it would be fine to have a phase-out over a period of time; but in this case, on September 11, 2000, Nortel amounted to about 60% of the portfolio and Nortel, BCE and TD Bank represented close to 95% of the value of the total portfolio. It was Professor Kirzner's view that the diversification should occur immediately.

143 The IPS did not mention a long term approach to selling the Nortel, BCE or TD Bank positions and in the absence of such a request, the normal standards of portfolio diversification would prevail. The long term investment horizon in the account did not mitigate the need to diversify. Furthermore, the potential tax factor was minor and should not have influenced the decision to sell Nortel.

144 Professor Kirzner calculated the loss that arose from the overconcentration in Nortel, BCE and TD. He identified the starting and closing values of the three positions as of September 11, 2000, adjusted for sales, and then subtracted the terminal value as of March 22, 2001 to reach the loss figure. To calculate the loss, he reduced the allocation of each security to a percentage of 3.3%, 6.7% and 8%. He determined that had the excess concentration been eliminated so that Mr. Vipond held 8% of Nortel, BCE and TD Bank each, he would have suffered a loss of $379,828. The actual loss he suffered was $2,399,038, and so the loss attributable to the excess concentration was $2,019,210. At 3.3%, he would have suffered losses of $145,121 rather than his actual loss of $2,399,038 resulting in a loss of $2,253,917 attributable to excess concentration.

145 While the market was weak at the time, Nortel substantially underperformed the market because of its unique nature. Had the cash been redeployed as it should have been, there would still have been some losses because the markets were in a state of decline. That said, in Professor Kirzner's calculations, the proceeds of the notional disposition of the Nortel, BCE and TD shares were not reinvested but simply held in cash. This was an evident weakness in his loss calculations and I do not rely on them as being reflective of any damages suffered by Mr. Vipond.

Richard Norman Croft

146 Richard Norman Croft, a portfolio manager and owner of RN Croft Financial Group, was qualified as an expert on the conduct, standards and practices pertaining to discretionary portfolio management. He does not generally manage segregated accounts holding individual securities akin to that of Mr. Vipond.

147 In his opinion, a 30-day transition period for the concentrated position, assuming no liquidity issues, would be considered reasonable within the generally accepted standards of the investment industry. There was no issue with liquidity in this case, so all three concentrated stocks could have been sold immediately. He would wish to be reinvested within 30 days; although there is no rule that states this, this would be reasonable. He had not heard of an approach to concentration that involved a staged sell-off of securities over a three to five year time frame.

148 Mr. Croft also compared the beginning and ending values of Mr. Vipond's actual portfolio (from October 11, 2000 to the end of March 2001) with the beginning and ending values of the AGF model portfolio contained in the March 2000 proposal (from September 12, 2000 to the end of March 2001). Assuming that Mr. Vipond transitioned to the model portfolio by October 11, 2000, Mr. Croft calculated Mr. Vipond's loss to be $1,939,812.

149 He calculated that loss as follows. On October 11, 2000, Mr. Vipond's portfolio had an actual value of $6,264,000. When Mr. Vipond transferred his account to GPW, its value was $3,703,913, leaving a loss of $2,560,087. Mr. Croft compared this actual loss to the notional loss that would have occurred if Mr. Vipond had been reinvested in the AGF model portfolio. This amounted to $378,931. Deducting that notional loss plus cash withdrawals of $241,344 from Mr. Vipond's actual loss resulted in a total loss of $1,939,812.

150 In cross-examination, Mr. Croft acknowledged that at the time of the March 2000 letter, AGF did not have Mr. Vipond's portfolio and did not know what securities were going to be transferred to them. In addition, the March proposal was preliminary in nature. Furthermore, the portfolio in the March proposal did not conform to the asset ranges in the IPS signed by Mr. Vipond. The IPS also had an aggressive component that was not present in the March proposal. The IPS made provision for 0 to 15% in short term investments and made no mention of bonds, unlike the March proposal. In addition, BCE's spin out of Nortel took place in early May 2000.

151 Mr. Croft acknowledged that the March 2000 model and the model given to Mr. Vipond at the July 20 meeting differed. The former had 6 international/U.S. securities and the latter had 21 U.S. equities.

152 There were some errors relating to Warner Lambert, Pepsico, Aim Global Technologies, and Canadian Hunter Explorations in Mr. Croft's model calculation.

(b) Defendants' Experts

Ian Katz

153 The Defendants called Ian Katz of Mackie Research Capital Corporation as an expert to give opinion evidence in connection with the conduct, standards and practices expected of a portfolio manager. He has 40 years of experience in the investment industry, and since 1991, has managed funds for individuals on a discretionary basis.

154 He referred to the KYC rule found in Rule 31-505 of the *Securities Act*, R.S.O. 1990, c. S.5, to which AGF was required to adhere. The IPS was the document prepared based on discussions with the client to determine the essential facts and to come up with an investment strategy to be used in investing the account.

155 He opined that it is a tenet of managing an individual's money that you take the individual's tax situation into consideration.

156 He noted AGF's practice of using a model growth portfolio as the basis for aligning a client's growth portfolio with his or her investment objectives. Given the long term horizon of the account, the IPS and the portfolio manager's discretion, it was not required that Mr. Vipond's account be immediately transitioned to conform to the model portfolio.

157 Mr. Katz was of the opinion that AGF had complied with the *Securities Act*, the IMA, and the IPS. It was his opinion that AGF handled the account in accordance with industry standards.

158 He disagreed with Mr. Croft's opinion on a 30-day transition period, stating that there was no such standard; and further, that there were no standards stipulating that a portfolio be transitioned within a specific period of time. In his opinion, each portfolio manager's style is unique and must be assessed based on the overall circumstances, including the client's investment objectives, cash needs and tax considerations.

159 As for Professor Kirzner's report, he made the following observations:

• AGF was under the regulatory jurisdiction of the OSC and was not a member of the IDA, whose rules are designed to regulate investment dealers and their registered representatives who work with regular retail brokerage accounts. Unlike with a brokerage account, a managed discretionary account portfolio manager does not make recommendations or seek approval for order execution; the investments are done on a discretionary basis based on the IPS.

• BCE and Nortel were two different types of companies and not in the identical industry, contrary to what Professor Kirzner suggested.

• Suitability is a measure of the appropriateness of an investment based on investment objectives and risk tolerance. The composition of the account cannot be considered a suitability issue because the securities in the account were inherited. The IPS included no specific details requiring immediate liquidation of securities, and therefore the realignment of the account to the model growth portfolio was at the discretion of the portfolio manager.

• The 8% threshold for concentration is not indicative of any industry standard. Had the client intended his security position to be immediately reduced, Mr. Katz would have expected to see such a direction from the client. In addition, GPW's Investment Guidelines, Policies and Goals treats 10% as the threshold as further indication of the absence of an industry practice on this issue. Mr. Katz himself uses 10%. The threshold should be picked depending on the security.

• A range of 15 to 30 stocks to properly diversify an equity portfolio is not a generally accepted diversification standard in the investment industry.

• The Vipond portfolio was inherited by AGF and not initiated or created by AGF.

160 Mr. Katz considered concentration to be a risk issue, not a suitability issue.

161 In cross-examination, Mr. Katz acknowledged that the objective of the KYC rule was to arrive at a suitable investment strategy or model. The KYC rule involved a discussion of the proposed strategy in which the risk features should be discussed. The portfolio manager should talk to the client and make sure he or she understands the possible risks and benefits. The portfolio manager should have a fulsome discussion of the risks and benefits of the strategy and make sure that the client understands. Mr. Katz stated that in this case, a growth strategy with equity as high as 100% was reflected in the IPS. The IPS then constituted a summary of what the portfolio manager had gleaned from the client. He confirmed that the investment strategy should be spelled out in the IPS. He agreed that an intention to slowly liquidate over three to five years was an investment strategy and he would hope that such a strategy was discussed because there are risks associated with that approach. He would want his client to know and understand what he was proposing. There should be a clear written record but he would not want the three to five years outlined in the IPS, because he would not want his hands tied. The strategy was long-term growth and there was no need, in his opinion, to put the time constraints into the IPS.

162 He noted that portfolio managers are held to a higher standard because they have control over the client's assets. On the issue of taxes, he acknowledged that: "The tax tail shouldn't wag the dog."

Errol Soriano

163 Errol Soriano of Campbell Valuation Partners Limited was called by the Defendants. He was qualified as an expert to give evidence on financial loss quantification. He calculated the loss for the period September 12, 2000 to February 22, 2001, the latter being the date of the termination of the relationship between Mr. Vipond and AGF.

164 Mr. Soriano determined the loss as follows. He took Mr. Vipond's actual portfolio as at September 12, 2000 and rebalanced or adjusted it so as to reflect immediate diversification using the asset classes described in the IPS. He then compared the market value of the actual portfolio as at February 22, 2001, with that of the rebalanced portfolio to arrive at the loss figure.

165 More particularly, the asset classes in the IPS were four in number and consisted of 0 to 15% in fixed income and cash and 85% to 100% in equities comprised of: 30 to 80% Canadian equities; 20 to 55% non-domestic equities; and 0 to 15% of AGF Aggressive Growth Fund. He used the midpoint of these percentages for each of the classes. This rebalancing required the notional sale of some of the investments in the actual portfolio.

166 The actual portfolio consisted of 11 stocks plus cash and cash equivalents. Assets were notionally bought and sold in the four asset classes to reach the proportions outlined in the IPS. The Canadian equities class of the rebalanced portfolio was to hold all stocks in the TSX 300 Index and in the same proportion so that the rate of return would mirror that realized by the TSE 300 Index. As all of the 11 stocks in the actual portfolio were on the TSX 300 Index, they were notionally reduced or increased to reflect the TSE 300 Index weighting.

167 For example, as of September 12, 2000, Nortel represented 57.1% of the market value of Mr. Vipond's actual portfolio. The mid-point of the Canadian equities' asset class was 50.88%. As of September 12, 2000, Nortel comprised 31.3% of the TSX 300 Index. Mr. Soriano therefore adjusted the actual portfolio so that in the rebalanced portfolio, Nortel represented 31.3% of 50.88% of the market value of the Canadian equities asset class in the rebalanced portfolio, or 15.9% of the total market value of the rebalanced portfolio, as of September 12, 2000. Nortel therefore was not eliminated from the account nor did it reflect the 8% figure that was contained in the March proposal, but was absent from the IPS.

168 Mr. Soriano used certain benchmarks to determine the rates of return for the rebalanced portfolio during the period September 12, 2000 to February 22, 2001. The TSE 300 Total Return Index was used for the Canadian equities; the S&P 500 Total Return Index for the non-domestic equities; the AGF Aggressive Growth Fund Return for the AGF Aggressive Growth Fund; and the Scotia McLeod 91 Day T-Bill Return for fixed income securities.

169 The rebalanced market value amounts as at September 12 were then adjusted to reflect the growth or decline in rates of return found in these benchmarks up to February 22, 2001.

170 As a result of the notional sales in the rebalancing exercise, notional capital gains tax was triggered and would have been payable in April 2001. Generally, Mr. Soriano would not consider taxes in calculating losses for the purposes of litigation, but the time period in issue in this case was unique because the capital gain inclusion rate was reduced from 66.67% to 50% on October 18, 2000. The ACBs of the holdings were disclosed in Mr. Vipond's 2000 and 2001 income tax returns.

171 Mr. Soriano calculated the capital gains taxes owing in the rebalanced portfolio. He also deducted Mr. Vipond's actual capital withdrawals from the account between September 12, 2000 and February 22, 2001.

172 A key distinction between the measurement of the actual portfolio and that of the rebalanced portfolio was the amount allocated for notional taxes payable. The market value of the actual portfolio was $4,097,235 on February 22, 2001. If the cash withdrawals of $235,494 are added to this latter figure, the amount is $4,332,729. The market value of the rebalanced portfolio $4,974,318 on February 22, 2001. If the cash withdrawals of $235,494 are added to this figure, the amount is $5,209,811. The actual taxes payable on actual transactions during the period September 12, 2000

to February 22, 2001 was $177,393, resulting in a projected market value net of actual taxes and cash withdrawals of $3,919,842 ($4,097,235 less $177,393). In contrast, the notional taxes payable on the rebalanced portfolio amounted to $1,003,265 and resulted in a projected market value net of taxes and cash withdrawals of $3,971,052. Accordingly, Mr. Soriano concluded that the financial loss was $51,210 [5], representing the difference between the market value of the two portfolios net of taxes and cash withdrawals as at February 22, 2001, that is $3,971,052 less $3,919,842. He was of the view that if taxes were ignored, Mr. Vipond would be overcompensated. Absent a tax calculation, the pre-tax loss was $877,083, that is, $4,974,318 in the rebalanced portfolio less $4,097,235 in the actual portfolio (or $5,209,811 less $4,332,729 if the cash withdrawals are considered).

173 On October 21, 2011, Mr. Soriano prepared a supplementary report. In it he calculated the impact that contingent taxes might have on Mr. Vipond's loss. Contingent taxes arise when an investment has increased in value but has not been sold. They would apply to both the actual and the rebalanced portfolios. In this report, he assumed that all share positions in both the actual portfolio and the rebalanced portfolio were sold on February 22, 2001. Based on this analysis, the actual portfolio would have suffered a greater loss ($457,570) than the rebalanced portfolio, but this calculation was made without any opinion on the actual tax treatment to be afforded any award of damages.

174 Mr. Soriano noted three significant differences between his calculation and that of Professor Kirzner. Firstly, Mr. Soriano's time period for calculation was September 12, 2000 to February 22, 2001 whereas Mr. Kirzner used September 11, 2000 to March 22, 2001 as the appropriate time frame. If one applied Mr. Soriano's time period to Professor Kirzner's calculations, Professor Kirzner's calculation of loss would be reduced by $326,177 using his 3.3% analysis or by $270,536 using his 8% analysis. Secondly, Mr. Soriano redeployed the capital generated from the notional sales based on the benchmarks whereas Professor Kirzner left the capital in cash. As the stock market indices generally declined in the September through February time period, this would result in an additional reduction in the loss calculated by Professor Kirzner ranging from $454,601 using the 3.3% analysis to $377,938 using the 8% analysis. Lastly, as mentioned, Mr. Soriano considered taxes whereas Professor Kirzner did not. In Mr. Soriano's opinion, if one is measuring the loss of equity, one must consider taxes. The adjusted losses arising from tax ranged from $1,165,160 using Professor Kirzner's 3.3% analysis to $991,272 using his 8% analysis.

175 Taking these three assumptions in aggregate resulted in an adjusted loss based on Professor Kirzner's analysis ranging from $294,996 ($2,240,934 less $326,177 less $454,601 less $1,165,160) using the 3.3% analysis to $386,649 using the 8% analysis ($2,026,395 less $270,536 less $377,938 less $991,272).

The Law

(a) The Regulatory Framework

176 The securities industry distinguishes between a dealer who buys and sells securities in accordance with his or her client's instructions and a portfolio manager to whom account management and investment decision-making authority have been delegated by the client. The former is referred to as a non-discretionary account and the latter as a discretionary account: see *Laflamme c. Prudential-Bache Commodities Canada Ltd.*, 2000 SCC 26, [2000] 1 S.C.R. 638 (S.C.C.) at paras. 23-24. The case before me involves a portfolio manager and a discretionary account.

177 A portfolio manager must be registered under the *Securities Act*, R.S.O. 1990, c. S.5. (the "Act") and is subject to the rules and regulations of that statute. The standards reflected in the Act do not determine civil liability but do assist in informing the court's analysis: *TechHi Holdings Ltd. v. Merrill Lynch Securities Inc.*, 2004 CarswellOnt 2191 (Ont. S.C.J.) at para. 157.

178 During the period in issue in this action, Rule 31-505 of the OSC Rules under the Act applied to the Defendants. It provided that a registered dealer or adviser shall deal fairly, honestly and in good faith with its clients. It also incorporated the "know your client" rule. The relevant portion of Rule 31-505 states in s. 1.5:

> (1) A person or company that is registered as a dealer or advisor and an individual that is registered as a salesperson, officer or partner of a registered adviser or an officer or partner of a registered adviser shall make such inquiries about each client of that registrant as ... (b) ... are appropriate, in view of the client's investments and the type of transaction being effected for the client's account, to ascertain the general investment needs and objectives of the client and the suitability of a proposed purchase or sale of a security of a client.

179 Information on age, income and net worth, investment knowledge, investment objectives and risk tolerance form part of the "know your client" inquiry. The rule is designed to ensure that portfolios are suitable for the client. The "know your client" rule is related to the financial advisor's duty to ensure that investments made are suitable for the client and in keeping with the client's investment objectives and risk tolerances.

180 The Supreme Court of Canada addressed the powers and obligations of portfolio managers in *Laflamme*. Although this case originated in Quebec and therefore operated within that province's regulatory framework, the principles described by Gonthier J. have been relied on elsewhere, including in Ontario in the case of *Davidson v. Noram Capital Management Inc.*, 2005 CarswellOnt 7243, 13 B.L.R. (4th) 35 (Ont. S.C.J.) at para. 52.

181 In *Laflamme*, Gonthier J. wrote at paras. 25-26, 29, and 33-34:

> The functions of a manager and the powers granted to the manager may be quite extensive. Beaudoin, supra, describes them as follows at pp. 25-26:
>
>> [Translation] Authorized management of a portfolio results from delegation by the client of his decision-making authority. This task covers the intellectual, tactical and strategic activities performed in respect of a portfolio. The manager acts in accordance with the investment objectives set with the client. His decisions are essentially guided by the concept of maximizing return on the portfolio, having regard to the risks this involves. The manager determines the portfolio's make up and the investments to make. On behalf of the client, he forwards orders to a securities dealer to buy or sell securities. ...
>
> Thus, the manager makes most of the decisions relating to the portfolio and the make up of the portfolio. The scope of his management authority and the exercise of his discretion will, however, depend on any restrictions that are imposed by law or agreement. In particular, the agreement may expressly circumscribe the manager's authority and discretion, for instance by giving the client the option of confirming certain transactions. Such limitations may also be implicit in the client's investment objectives or circumstances.
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> . . . . .
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> The content of the obligations that rest on the manager will vary with the object of the mandate and the circumstances. One of the most fundamental of these obligations is that the manager exercise reasonable skill and care of a prudent administrator (art. 1710 C.C.L.C.). The conduct expected is not that of the best of managers, nor the worst. Rather, it is the conduct of a reasonably prudent and diligent manager performing similar functions in an analogous situation. Thus the portfolio manager's conduct must [translation] "be analysed having regard to his role as a specialist in this kind of transaction, and to the practices of each profession" (L'Heureux, supra, at p. 425). ...
>
> . . . . .
>
> The duty to provide advice requires that the manager make his knowledge and expertise available to the client, and that he use them better to serve the client's interests in light of the client's objectives. ...
>
> The scope and nature of this duty will vary with the circumstances. Specifically, we note the importance of the client's personality... The substantive content of the duty to provide advice will vary inversely with the client's knowledge of investments. [Citations omitted.]

182 A portfolio manager has a duty to advise the client of the risks associated with the portfolio and those that are inherent in the underlying mandate. Again quoting from *Laflamme* at para. 33,

> This duty relates not only to the risks associated with certain initiatives, but also to the very nature of the matters agreed to between mandatary and mandator, especially where the mandatary is a lay person. Thus, the duty to advise extends to everything involved in the mandate to manage the portfolio, including the consequences for the client of any change in the object of the mandate.

See also *Davidson v. Noram Capital Management Inc.* at paras. 52-53.

(b) Causes of Action

183 Mr. Vipond advances three causes of action: breach of fiduciary duty, negligence, and breach of contract.

184 The relationship between a financial advisor and his or her client is not a fiduciary relationship per se: ***Varcoe v. Sterling*** (1992), 7 O.R. (3d) 204 (Ont. Gen. Div.) at para. 87, cited with approval in ***Hodgkinson v. Simms***, [1994] 3 S.C.R. 377 (S.C.C.) at para. 44. In ***Kent v. May*** (2001), 298 A.R. 71 (Alta. Q.B.) at paras. 51-53, aff'd (2002), 317 A.R. 381 (Alta. C.A.), Forsyth J. wrote:

> [O]ne should consider the broker-client relationship to be on a spectrum. At one end is a relationship of full trust and advice. The broker effectively makes all the decisions because of the great reliance and trust reposed in him or her by the client. ... This is exacerbated where the account is discretionary, such that the broker has the authority to make trades without the client's consent or even knowledge ... Obviously, there is a fiduciary relationship at this end of the spectrum. ...
>
> At the other end is a relationship where the broker is merely an "order-taker" for the client, the client does not rely on any advice from the broker, and the broker has no discretion. This was the case in *Varcoe* itself. Relationships at this end of the spectrum lack the elements of a fiduciary relationship. [Citations omitted.]

185 In ***Hunt v. TD Securities Inc.***, [2003] O.J. No. 3245 (Ont. C.A.) at para. 40, Gillese J.A. summarized the five interrelated factors to be considered when determining whether financial advisors stand in a fiduciary relationship to their clients. They are: vulnerability - due to such things as age, language skills, investment knowledge, education or experience in the stock market; trust - the degree of trust and confidence that a client reposes in the advisor and the extent to which the advisor accepts that trust; reliance - whether there is a long history of relying on the advisor's judgment and advice and whether the advisor holds him or herself out as having special skills and knowledge upon which the client can rely; discretion - the extent to which the advisor has power or discretion over the client's account; and professional rules or codes of conduct to help to establish the duties of the advisor and the standards to which the advisor will be held.

186 Turning to the breach of contract and negligence claims, the liability of a financial advisor may be concurrent: ***Davis v. Orion Securities Inc.***, 2006 CarswellOnt 4800 (Ont. S.C.J.) at para. 27. The extent of the duty of care owed by the financial advisor to a client is a question of fact and the content and scope of a broker's duty to warn is defined with reference both to the knowledge and skill of the client and to the nature of the relationship between the client and the broker: ***Abrams v. Sprott Securities Ltd.***, [2001] O.J. No. 597 (Ont. S.C.J.) at para. 33; ***Young Estate v. RBC Dominion Securities***, [2008] O.J. No. 5418 (Ont. S.C.J.) at para. 182. As noted by counsel for the Defendants, the appropriate standard of care will be informed by the applicable securities rules and regulations, the relevant jurisprudence and the contractual agreements between the two parties: ***Dulong v. Merrill Lynch Canada Inc.***, 2006 CarswellOnt 1783 (Ont. S.C.J.) at para. 24.

187 A financial advisor is not a guarantor. As stated by the Court of Appeal in ***Rhoads v. Prudential-Bache Securities Canada Ltd.***, 1992 CarswellBC 16 (B.C. C.A.) at para. 22:

> ... a financial advisor must be taken to assume duties similar to those of any other professional advisor — doctor, accountant, engineer, lawyer — in the sense of being obliged to take reasonable steps to ensure that customers or clients are aware of the available options, and of the main potential benefits and risk associated with them. Considerable discretion is, of course, allowed to the professional advisor in deciding, as a matter of judgment, on the nature and scope of the advice appropriate to any case. When called on to account the advisor is not, of course, answerable as "guarantor", "custodian" or "insurer"... but only to show that he or she reasonably applied the skill and care appropriate to the task undertaken and to the circumstances of the case.

Positions of the Parties

(a) The Plaintiff

188 In brief, the Plaintiff takes the position that the Defendants were fiduciaries who breached their fiduciary duties and preferred the interests of AGF's other customers or funds to those of Mr. Vipond so as to advantage itself and/or its other customers. Mr. Vipond pleads that the Defendants breached their contract with him and were negligent. They failed to reduce his exposure and diversify and to manage his portfolio in accordance with the professional standards with which they had agreed to act. They also failed to manage the portfolio in accordance with the standard of care applicable to portfolio managers of comparable expertise. AGF failed to undertake the very thing for which the Plaintiff came to them, namely diversification of his account. He denies that any staged reduction plan over a period of three to five years was communicated or agreed to by him and certainly there was no discussion of the risk that such a plan entailed or its suitability. In any event, such a plan was not suitable. The ratification defence and the alleged failure to mitigate are inapplicable on the facts of this case.

189 As for damages, Mr. Vipond submits that he has made reasonable efforts to put forward a sensible loss calculation and has done so based on the model growth portfolio that the Defendants provided to him in their March 29, 2000 proposal. Mr. Croft's evidence was that Mr. Vipond suffered a loss of $1,940,169. Mr. Vipond also requests that compound interest based on the GPW rate of return be awarded to him instead of pre-judgment interest under the *Courts of Justice Act*, R.S.O. 1990, c. C.43.

190 Lastly, based on the law and the fact that he has not derived any actual tax benefit, Mr. Vipond argues that his tax status should not be considered in the assessment of damages.

(b) The Defendants

191 The Defendants take the position that Mr. Vipond's allegations of breach of fiduciary duty, negligence and breach of contract are not made out in fact or in law. Ms. Wallace's management of the portfolio and the exercise of her discretion were reasonable and appropriate and Mr. Vipond has failed to establish that she breached any standard on how to diversify a concentrated portfolio inherited at the outset of the management of an account. The expert opinion proffered by the Defendants should be preferred to those of the Plaintiff. The latter do not reflect the realities of discretionary portfolio management.

192 The Defendants plead that the executed IPS contained the mutually agreed upon investment objectives and these included a long term staged diversification plan that took place over a number of years. These objectives included a portfolio of 85 to 100% equities and up to 15% aggressive equities. They also plead that Mr. Vipond and Mr. Campbell advised AGF not to incur any additional significant capital gains in the year 2000. The Defendants state that they managed the portfolio in accordance with Mr. Vipond's investment objectives and consistently with the long term plan of staged diversification.

193 The Defendants also argue that the Plaintiff was aware of the concentration in his portfolio, the related risks and the strategy of staged diversification, and also ratified AGF's management of his portfolio. There is no basis for any personal liability on the part of Messrs. Smith or Luik.

194 On the issue of damages, the Defendants state that Mr. Vipond did not suffer any as a result of the Defendants' conduct. If any damages are to be awarded, the only credible evidence on damages was that of Mr. Soriano. Furthermore, a tax benefit received or receivable by a plaintiff may be relevant to the quantum of damages. In this case, the change in the inclusion rates for capital gains should be considered so as to reduce any damage award.

195 Lastly, the pre-judgment interest term should be shortened in light of Mr. Vipond's delay in bringing this action to trial and his approach to damages. In addition, the rate should be that prescribed by the *Courts of Justice Act*.

Discussion

(a) Liability

196 The relationship between the parties commenced with the March 29, 2000 proposal letter. It was an informed solicitation and reflected AGF's knowledge of the concentration in Mr. Vipond's portfolio. In the recommended strategy section of the letter, the proposal stated that no one issuer would account for more than 8% of the equity portfolio. On the other hand, Mr. Luik noted in the letter that Mr. Vipond might choose to maintain all of his BCE, Nortel and TD stock. For her part, Ms. Wallace did not recall reviewing the proposal at the June 29, 2000 meeting and never reviewed it with Mr. Vipond or Mr. Campbell. The proposal may serve to assist in the interpretation, if necessary, of the actual contractual documents. The most noteworthy of these were the IMA and the IPS. The IMA contained an entire agreement provision and made express reference to the IPS.

197 The IMA provided that the account was to be invested in accordance with the investment objectives set out in the IPS. The IMA specifically noted that the account was to be invested at the discretion of AGF and that AGF would not be responsible for losses except those arising from, among other things, its negligence. AGF agreed to exercise the diligence, care and skill that one could reasonably expect from an experienced and competent investment manager.

198 The IPS was silent on any need for diversification, although on its face, it is clear that the account was concentrated. The IPS was also silent as to any staged diversification plan. Ms. Wallace knew by July 20, 2000 that the portfolio was concentrated and volatile due in part to the concentration and the high weighting of Nortel itself.

199 There is no issue that diversification of Mr. Vipond's portfolio was part of AGF's mandate. Mr. Smith admitted that Mr. Vipond and/or Mr. Campbell conveyed that they wanted the portfolio to be diversified. Mr. Luik testified that diversification was to take place. Mr. Vipond testified that the goal was to diversify and that he wanted to diversify as soon as possible. Mr. Campbell's February 2001 letter to Ms. Wallace (albeit after the fact) was to like effect. Ms. Wallace knew the account was concentrated and volatile. The issue was not whether to diversify. The real issue was the strategy to be used and how that diversification was to take place. The Defendants' position is that portfolio management is about the exercise of discretion and the evaluation of options available at any given time. They state that the losses were not the fault of the Defendants, but the result of the vagaries of the stock market.

200 As a client, Mr. Vipond left much to be desired. He was unresponsive to client communications, a procrastinator and uncommunicative generally. In my view, he was not a sophisticated investor. To borrow from Rudyard Kipling, he was not a person of great wisdom or sagacity. To borrow from Mr. Croft however, he knew enough to know he didn't know enough. He went to AGF to obtain professional management of his portfolio and to diversify his holdings.

201 In my view, Ms. Wallace and AGF are responsible for breaching duties they owed to Mr. Vipond be they fiduciary, contractual or tortious.

202 Firstly, Professor Kirzner testified that concentration is normally a violation of suitability standards, absent a specific request, an understanding by the client of the risk implications and a suitable caution and warning on the risks of concentration. Mr. Katz was of the view that concentration was not a suitability issue but a risk issue, although he did agree that the concentration in Mr. Vipond's account was significant. I accept Professor Kirzner's opinion. In addition,

the concentration should have been addressed in a timely fashion. Significantly, AGF and Ms. Wallace admitted that more than 8 to 10% concentration would represent undue concentration.

203 While Mr. Vipond did not wish to eliminate all of the concentrated position, he did not provide express instructions to maintain a concentrated account. Indeed, over the course of about 7 months, the Defendants never undertook the very thing for which Mr. Vipond came to them — diversification.

204 Secondly, both Mr. Katz and Mr. Croft agreed that a staged reduction plan was an investment strategy that needed to be explained and documented and that here there was insufficient detail in both the IMA and the IPS. I accept their evidence in this regard.

205 The Defendants themselves were unclear on the strategy of a staged reduction plan over three to five years and they did not act in a manner consistent with such a strategy. For instance, why would Mr. Luik write on October 25, 2000 that consideration was being given to purchasing Nortel stock as described in his email to Mr. Campbell? This would not constitute a reduction. In addition, on termination of the relationship, Mr. Campbell complained of the Defendants' conduct, yet no one responded by referring to any staged reduction plan over three to five years.

206 Even if there was such a strategy at the outset, it was inadequately explained and discussed with Mr. Vipond and the risks associated with such a strategy were inadequately addressed. The evidence does not support a finding that Mr. Vipond was warned of the risks and fully apprised of the strategy. The parties agreed that Mr. Campbell was not Mr. Vipond's agent, so any knowledge that he possessed could not be imputed to Mr. Vipond. In any event, the evidence does not establish that Mr. Campbell was apprised of the strategy either.

207 Here, the account came to AGF in a concentrated position. It was therefore incumbent on AGF to secure Mr. Vipond's agreement to a strategy of reducing that concentration in stages — a staged reduction over three to five years. This it did not do. Rather, it maintained the concentrated portfolio and exposed Mr. Vipond to losses. It was also incumbent on AGF to explain the strategy and risks to Mr. Vipond. This it did not do either. I accept Mr. Vipond's argument that this was an undocumented strategy that the client did not understand. There is also little or no likelihood that he would have agreed to such a strategy had he understood it. It would make little sense for him to pay a management fee based on a portfolio, most of which would be addressed over a three to five year period. While I recognize that there is a reference in correspondence from Mr. Campbell to AGF describing Mr. Vipond as a long term investor and taking a long term view, this does not reflect an understanding or agreement to a staged reduction plan over three to five years. It is inaccurate to state, as the Defendants do, that there was no substantive difference between the approach taken by Mr. MacDonald with respect to Mr. Vipond's TD shares and that taken by Ms. Wallace and AGF with respect to Mr. Vipond's Nortel shares. Mr. MacDonald discussed the holding regularly with Mr. Vipond and secured his agreement to the overconcentration. This was not the case with Ms. Wallace and AGF.

208 There is no doubt that Ms. Wallace viewed Nortel as a global leader with a strong balance sheet among other things and that others in the industry shared her view. I also accept that she attempted to manage the risk in the account by not investing in the Aggressive Growth Fund, by maintaining a high cash position, and by maintaining positions in BCE and TD, both of which she viewed as being in different industries. Even if one accepts that a portfolio manager considers the underlying investment in the exercise of discretion, this did not however obviate the need for AGF and Ms. Wallace to discuss its approach to overconcentration in the account with Mr. Vipond and to secure Mr. Vipond's initial agreement thereto. It should also be noted that AGF never complied with the asset mixes described in the IPS.

209 I do not accept that tax smoothing was the rationale for failing to diversify. Nortel reached its peak share price of $123.75 on August 25, 2000 and then declined. It closed on September 30, 2000 at $90.35. Mr. Vipond's ACB for his Nortel shares was $103.90 up to November 21, 2000. Except for three days in October, the stock never traded above $103.90 in October or until November 21, 2000. On November 21, 2000, the ACB was adjusted down to $18.50 and Nortel was trading at about $57.60. I also accept Mr. Kirzner's opinion that the tax smoothing benefits from November 21, 2000 onwards were minor, particularly in relation to the risk of remaining concentrated.

210 Thirdly, it cannot be said that Mr. Vipond ratified this conduct by AGF and Ms. Wallace. While he did receive statements and did follow the shares in his portfolio, in the seven months he was with AGF, with the exception of the Christmas lunch, his direct contacts with them were characterized by constant complaints. This included the September 12, 2000 meeting when Mr. Vipond was upset that Nortel stock had not been sold and the November 16, 2000 meeting where he was described as testy by Ms. Wallace. The ultimate reflection of any absence of concurrence with the plan or strategy was his abrupt departure from the relationship in February 2001, a mere seven or eight months after it had commenced.

211 While in my view there was a fiduciary relationship arising from the discretionary management of Mr. Vipond's portfolio by AGF and an absence of the skill and care expected of a fiduciary, any breach of duty in this case largely sounded in negligence and contract. There was no persuasive evidence that AGF or Ms. Wallace preferred their own interests to those of Mr. Vipond or conducted itself in a manner comparable to those cases in which a breach of a fiduciary duty by an investment advisor has been found. There was no self-dealing, no conflict of interest, no breach of any duty of loyalty or bad faith of any kind. Indeed, I reject any allegations to the contrary. There was some suggestion that Ms. Wallace was a block buyer of Nortel, but the evidence did not reflect any breach of a fiduciary duty in that regard. In addition, while AGF knew it had competition, I reject the suggestion that it or Ms. Wallace avoided risk disclosure for that reason. In any event, in *Hodgkinson v. Simms* at para. 26, the Supreme Court noted that where a fiduciary simply breaches a contract or his or her duty to act with skill, the damages analysis is akin to a claim for negligence or breach of contract.

212 Lastly, I see no basis for finding any breaches on the part of Mr. Luik or Mr. Smith, neither of whom had trading authority. The claim is dismissed in its entirety as against them.

Damages

213 Having determined that there was a breach, I must then consider what damage, if any, flows from that breach.

214 Damages are typically awarded against the employer as well as the portfolio manager on the basis that the employer owes duties to the client and is vicariously liable for the portfolio manager's conduct: *Ryder v. Osler, Wills, Bickle Ltd.* (1985), 49 O.R. (2d) 609 (Ont. H.C.); *Blackburn v. Midland Walwyn Capital Inc.*, [2003] O.J. No. 621 (Ont. S.C.J.), aff'd [2005] O.J. No. 678 (Ont. C.A.), leave to appeal to SCC refused, [2005] S.C.C.A. No. 196 (S.C.C.).

215 Both counsel agree that any damages assessment should reflect a reasonable rate of return for a suitable portfolio over the relevant time period: see *Hayward v. Hampton Securities Ltd.*, 2002 CarswellOnt 5919 (Ont. S.C.J.) at para. 217, aff'd 2004 CarswellOnt 2296 (Ont. C.A.) ; *Davidson v. Noram Capital Management Inc.* at paras. 66-67. This requires a discussion of three significant issues, namely, methodology, taxes and interest.

(a) Methodology

216 Mr. Vipond advocates use of the model portfolio found in the March proposal as an appropriate basis on which to calculate a reasonable rate of return for a suitable portfolio, for the period October 11, 2000 (30 days after the IPS was signed and delivered to AGF) to March 21, 2001 (the date of transfer of the portfolio to GPW). The Defendants in contrast argue that the methodology used by Mr. Soriano is more appropriate. He used the midpoint of the asset classes in the IPS to construct a hypothetical portfolio and then compared that portfolio to commonly used benchmarks that conformed to the asset classes. The benchmarks consisted of the TSX 300 Total Return Index, the S&P Total Return Index, the AGF Aggressive Growth Fund and the Scotia McLeod 91 Day T-Bill.

217 In my view, a better reflection of the actual loss is found in the IPS methodology used by Mr. Soriano rather than the March proposal methodology used by Mr. Croft.

218 Even though Mr. Vipond was solicited using the March proposal that contained the model portfolio, it was preliminary in nature, a "sales pitch", and at no time did he actually agree to that portfolio. Indeed, the model contained in the March proposal did not match the asset classes and ranges described in the IPS. In addition, it predated BCE's spin out of Nortel and the transfer of Mr. Vipond's portfolio by about six months. It was the IPS that Mr. Vipond agreed to. In my view, the IPS is a more appropriate basis on which to determine Mr. Vipond's loss than is the March proposal. In making this determination, I recognize that AGF did not produce a model that was applicable to the period in issue and that Ms. Wallace stated that she considered the March proposal model to be a reasonable portfolio for Mr. Vipond.

219 Mr. Soriano then compared the hypothetical portfolio containing the midpoint of the weightings in the IPS to widely and commonly used benchmarks. As Mr. MacDonald testified, the benchmarks are a scorecard. The indices used are all ones which Goodman itself uses.

220 In cross-examination, the benchmarks and weightings AGF sent to Mr. Vipond in February 2001 were put to Mr. Soriano. On October 23, 2000, AGF wrote to Mr. Vipond enclosing portfolio valuations for the period ended September 30, 2000 and advising that beginning next quarter, it would include an analysis of his investment results. On February 1, 2001, AGF sent that analysis using benchmarks and weightings that did not reflect the IPS and did not contain any aggressive growth fund component. According to Ms. Wallace, these benchmarks did not reflect the unique aspects of Mr. Vipond's IPS mandate. AGF never actually replicated an aggressive growth fund as prescribed by the IPS. This was because Ms. Wallace felt it would be inappropriate to do so, given Nortel's presence in the portfolio.

221 It seems to me that Mr. Vipond bargained for the benchmark weightings contained in the IPS. They are a legitimate and reasonable basis on which to calculate Mr. Vipond's losses. In my view, the damages should be calculated using them. I also agree with Mr. Soriano that the loss should be calculated as of February 22, 2001. By contract, Mr. Vipond was to give AGF 30 days' prior written notice of termination. During the period between notice and transfer, AGF could not trade. In addition, Mr. Vipond did not take issue with the manner in which his account was transferred.

222 In conclusion, I accept Mr. Soriano's pre-tax loss calculation of $877,082 as an appropriate reflection of Mr. Vipond's loss.

(b) Taxes

223 The next issue to consider is whether the damages should be reduced because of the change in the inclusion rate for capital gains. The Defendants' theory in brief is that if a damage award made today is taxed as a capital gain at the current 50% inclusion rate, the Plaintiff would be overcompensated because in 2001, he would have had to have paid capital gains tax at an inclusion rate of 66.67%. This issue requires a discussion of the relevant law followed by a review of the relevant facts.

224 There are two lines of authority on whether tax should be considered when assessing damages.

225 Dealing with the first line of authority, in *Cooper v. Miller*, [1994] 1 S.C.R. 359 (S.C.C.), the Supreme Court held at para. 126 that "the incidence of taxation is a concern extraneous to the assessment of damages as between plaintiff and defendant" and "is a matter solely between the plaintiff and Revenue Canada."

226 The rationale for this approach is obvious. Litigation would be unduly complicated and protracted should taxation be a consideration in the assessment of damages. This concern was described by the Supreme Court of Canada in *Jennings v. Cronsberry*, [1966] S.C.J. No. 31 (S.C.C.) at p. 12:

> The speculative and unsatisfactory result that may follow from a deduction for future income tax may be illustrated from the *Gourley* case itself. As pointed out in Street, *Principles of the Law of Damages*, p. 102, if Gourley had been able to postpone the trial for two years, he would inevitably have received several thousand pounds more by way of damages.

> The practical difficulties that arise from the application of the principle are many and they have been noticed. What is to be done with the young plaintiff who had a promising career ahead of him? If he is unmarried or newly married, how does the Court deal with his potential exemptions? How does it deal with the complexities that may arise from a wife's separate income? Why should it be assumed that investment income is necessarily permanent or that it will always remain taxable in the hands of the plaintiff? What will be done with the foreign plaintiff and foreign systems of taxation?
>
> In this country there are additional difficulties. Each of the provinces has the power to impose taxation upon income, and there is no assurance that the total impact of federal and provincial tax upon taxpayers in each of the provinces will remain the same. At the same time there is a considerable and increasing movement of people from one province to another. To deduct from an award of damages for loss of earning capacity an amount based upon the existing tax rates in the province in which he lived at the time of his injury might well create a hardship for a man who might reasonably have anticipated, in the future, a transfer of his employment to another province in which the rate of taxation is less.
>
> In the litigation itself there are practical difficulties. There will be discovery on income tax matters with its possibilities of oppressive and endless examination. There are also problems of onus of proof. I notice that *West Suffolk County Council v. W. Rought Ltd.*, [1957] A.C. 403 put the burden on the plaintiff. The Ontario Court of Appeal, in the present case, put the burden on the defendant. Finally, how does the principle fit in with lump sum awards either from a judge or jury or with jury trials at all in these cases?

227 A further objection is that a reduction in damages as a result of tax considerations effectively results in a transfer of funds from the public purse to the wrongdoer: *Treaty Group Inc. v. Drake International Inc.*, [2005] O.J. No. 5232 (Ont. S.C.J.) at paras. 48-49, aff'd [2007] O.J. No. 2468 (Ont. C.A.).

228 Under the second line of authority, a tax benefit may be considered by the court in assessing damages in certain circumstances. Evidence of a tax benefit received or receivable may be relevant to the quantification of damages: *Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of)*, [1997] O.J. No. 1968 (Ont. Gen. Div. [Commercial List]); *Davis v. Orion Securities Inc.* at para. 63.[6] However, the cases of *Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of)* at para. 6 and *Lemberg v. Perris*, [2010] O.J. No. 2794 (Ont. S.C.J.) at para. 94, stand for the proposition that a tax benefit should only be considered if actually realized or if it can be calculated with certainty; a hypothetical tax benefit should not be considered.

229 In my view, any tax benefits accruing to Mr. Vipond are speculative in nature, have not been realized and cannot be calculated with certainty. Mr. Soriano's hypothetical tax benefit analysis is premised on a number of speculative components including disposition dates, actual tax consequences after the portfolio was transferred, future losses available to erase gains incurred, consistency of inclusion rates in the future, and the quantum of any actual tax benefits. In addition, even though the taxes payable would arise from the damages award, Mr. Soriano expressly declined to render any opinion on the anticipated tax treatment of a damages award in this case. In my view, applying the considerations highlighted by the Supreme Court in *Jennings v. Cronsberry*, a reduction on account of potential future tax treatment would be inappropriate. I decline to reduce the loss calculation of $877,082 on account of tax implications.

(c) Pre-Judgment Interest

230 The Plaintiff seeks compound interest rather than the pre-judgment interest prescribed by the *Courts of Justice Act*. He argues that his losses would have been invested over the long term on a compounding basis. In addition, Mr. Vipond submits that it is appropriate to award him the same rate of return as he has in fact earned on his portfolio at GPW.

231 The Defendants make three arguments on pre-judgment interest. They submit that the term for which pre-judgment interest is granted should be shortened for two reasons. Firstly, the Plaintiff delayed and took eleven years

to bring this action to trial. He commenced the action in 2002 and between September 8, 2006 and October 9, 2009, he did nothing to advance his case.

232 Secondly, the Plaintiff repeatedly changed his approach to damages. In 2002, he claimed $5 million plus $500,000 in punitive damages. In May, 2011, he increased his general damages claim to $6,500,000. Three days before trial, he decreased the claim to approximately $4,375,000 and after the trial had commenced, he reduced the claim to approximately $3,240,000, not including punitive damages. At trial, he abandoned his request for punitive damages and in cross-examination, Professor Kirzner volunteered that his was not a damages report. The Defendants submit that these steps served to lengthen the proceedings and deprived the Defendants of the ability to properly assess the claims made against them.

233 Thirdly, the Defendants submit that the *Courts of Justice Act* rate ought not to be varied in the circumstances. The GPW portfolio contains a significant fixed income component and does not reflect the AGF mandate, which contained an aggressive component. The GPW return is not an appropriate gauge of the Plaintiff's loss.

234 Section 130 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 provides that the court may, where it considers it just to do so, vary the amount of pre-judgment interest. The court shall take into account such things as: changes in market interest rates; the circumstances of the case; the amount claimed and recovered; and the conduct of any party that tended to shorten or to lengthen unnecessarily the duration of the proceeding.

235 I agree with the Defendants that it would be inappropriate for the reasons advanced to calculate Mr. Vipond's pre-judgment interest entitlement using the GPW rate of return. However, while it is incumbent on a plaintiff, along with a defendant, to advance his or her lawsuit, in my view, in the circumstances of this case, Mr. Vipond should be entitled to interest calculated pursuant to the *Courts of Justice Act* provisions, but compounded. I would note that I am not persuaded that the change in the Plaintiff's damages calculations tended to lengthen the proceeding.

Summary

236 In summary, the Plaintiff's claim is granted. The Defendants AGF and Ms. Wallace are to pay him the sum of $877,082 together with pre-judgment interest calculated pursuant to the provisions of the *Courts of Justice Act* but averaged and compounded. If the parties are unable to agree on costs, they are to make brief written submissions.

Action allowed in part.

Footnotes

1 Laura Wallace, Examination for Discovery, Q432 and following.

2 Ms. Wallace stated at Q561 of her Examination for Discovery, which was read in as part of the Plaintiff's case, that it was a reasonable portfolio for Mr. Vipond when she came to know him.

3 There should be a comma here, as everyone who read this sentence in evidence paused at this point.

4 The ACB was actually changed on November 21, 2000.

5 His actual calculation was $51,211.

6 In *Hodgkinson v. Simms*, the Supreme Court of Canada upheld the trial judge's damage award which was adjusted for the tax benefits the plaintiff received as a result of the investments for which he was suing his tax advisor.

End of Document

TAB 4

2013 ONSC 4083
Ontario Superior Court of Justice

Ironworkers Ontario Pension Fund (Trustee of) v. Manulife Financial Corp.

2013 CarswellOnt 10277, 2013 ONSC 4083, [2013] O.J. No. 3455, 230 A.C.W.S. (3d) 604, 44 C.P.C. (7th) 80

Mark Dugal, Aaron Murphy, Harlen Bomberry, John O'Malley, Gaetan Siguoin, Armand Charbonneau, Paul Mitchell, Steven Moffatt, John Vasconcelos and David Thompstone as Trustees of the Ironworkers Ontario Pension Fund and Leonard Schwartz, Moving Parties / Plaintiffs and Manulife Financial Corporation, Dominic D'Alessandro, Gail C.A. Cook-Bennett, Arthur R. Sawchuk and Peter Rubenovitch, Responding Parties / Defendants

Edward P. Belobaba J.

Heard: June 5-7, 2013
Judgment: July 25, 2013 *
Docket: CV-09-383998-CP

Counsel: Dimitri Lascaris, Michael Wright, Daniel Bach, Amanda Darrach, for Trustees of the Ironworkers Ontario Pension Fund and Leonard Schwartz
Patricia Jackson, Andrew Gray, Sarah Shody, Laura Redekop, for Manulife Financial Corporation
Linda Fuerst, for Dominic D'Alessandro
Eric Block, Daniel Dawalibi, for Peter Rubenovitch

Subject: Corporate and Commercial; Securities; Civil Practice and Procedure; Torts

APPLICATION by pension fund under s. 138 of *Securities Act* for leave to commence action for damages against insurance company and its former CEO and CFO; APPLICATION by pension fund to have action for damages certified as class action pursuant to s. 5 of *Class Proceedings Act*.

***Edward P. Belobaba J.*:**

1 The trustees of the Ironworkers Ontario Pension Fund and Leonard Schwartz seek leave under s. 138 of the *Securities Act* [1] ("the OSA") to commence an action for damages against Manulife Financial Corporation and the company's former Chief Executive and Chief Financial Officers, Dominic D'Alessandro and Peter Rubenovitch. [2] The plaintiffs say that the corporate and individual defendants misrepresented the adequacy of Manulife's risk management practices and failed to disclose the enormity of the company's exposure to equity market risk over a five-year time period beginning April 1, 2004, when the first misrepresentations began to appear in the company's disclosure documents, and ending February 12, 2009, when "the truth" was "finally" revealed and MFC share prices plummeted.

2 The plaintiffs also seek to have the action certified as a class action pursuant to s. 5 of the *Class Proceedings Act, 1992* [3] ("the CPA"). They claim both statutory and common law damages (the latter in negligence, negligent misrepresentation and unjust enrichment) on behalf of persons and entities outside Quebec who purchased MFC common shares in either the primary or secondary markets between April 1, 2004 and February 12, 2009 ("the Class Period").

3 For the reasons that follow, I am satisfied that leave should be granted for the statutory action under the OSA and that the proposed class action, subject to some modifications, should be certified.

4 I hasten to add that the certification of a class action is simply a procedural measure that allows matters to proceed to a trial where the certified common issues will be adjudicated. Whether or not the allegations against MFC will prevail is a matter that will be decided at the common issues trial.

5 The plaintiffs' proposed list of twelve common issues is attached in Appendix A. I have certified proposed common issues 1, 2, 4, 5, 8, 9 and 10, albeit with some changes. I have not certified proposed common issues 3, 6, 7, 11 and 12. The seven certified common issues are attached in Appendix B.

Background

6 Manulife Financial Corporation ("MFC") is the largest life insurance company in Canada. In early 2004, just after its merger with John Hancock, MFC added several new guaranteed investment products ("the Guaranteed Products") to its segregated funds line-up.[4] Unlike with the older variable annuity products, MFC decided that the new products would not be hedged or reinsured. The risk of fluctuations in the equity market and in generating the money needed to provide the promised return on the Guaranteed Products would be fully borne by MFC itself.

7 The new Guaranteed Products line was a success. MFC proceeded to grow the business from about $71 billion in early 2004 to about $165 billion by year-end 2008. But all or almost all of it was unhedged and uninsured.[5] As economic storm warnings materialized, MFC bolstered its reserves by raising billions of dollars in debt and equity capital. Nonetheless, when the full force of the global financial crisis hit in the fall of 2008 and the Canadian and American equity markets fell by more than 35%, MFC found itself badly overexposed.

8 On February 12, 2009 MFC released its annual financial statements for year-end 2008. The financial statements noted that over the year, corporate profits had fallen by almost $3.8 billion (almost $2 billion of this attributed to the Guaranteed Products line) and earnings per share had dropped from $2.78 just one year earlier to 32 cents. The financial statements also made clear that the company had to increase its reserves by more than ten times, from $526 million at year-end 2007 to $5,783 billion at year-end 2008, because of its unhedged exposure to the equity market. Noting these losses and the fact that "unlike most of the other large writers of variable annuities and segregated funds in North America, [MFC] has not implemented a comprehensive equity hedging program", Moody's placed MFC's ratings on review for a possible downgrade.

9 The market reacted immediately. The MFC share price dropped 6% on February 12 on heavy trading volume. Over the next ten days the share price dropped another 37%. By the end of the first quarter of 2009, the shares were trading at $8.92, down from $38.28 just six months earlier — a drop of almost 77%.

10 On a conference call with analysts on February 12, 2009, Mr. D'Alessandro discussed the extent of MFC's exposure to equity market risk: "We were late in activating our hedging program. We had it ready to go; we hired all the people, set up all the systems. But it took us a while — longer than we should have - to get it going. And the markets got away from us. No one expected them as I said at the last call to collapse quite as significantly as they have."

11 Mr. Rubenovitch also acknowledged in a March 2009 interview that the "2004 to 2007 period is where we differentiated ourselves, in hindsight unfavourably, by assuming more risk than most of our competitors."

12 Don Guloien, the current CEO who replaced Mr. D'Alessandro in May 2009, admitted in a press interview that MFC was "catching up on hedging that should have been done before quite frankly." In a more recent interview, Guloien noted again that hedging "should have been in place in the beginning," and acknowledged that the lack of hedging, combined with the guarantees attached to the Guaranteed Products, "exposed the company to enormous risk."

13 These events attracted the attention of both the federal regulator, OSFI, and the provincial securities commission. In November 2008, according to news reports, OSFI advised MFC that it had identified "deficiencies" that could lead to "material safety and soundness concerns" if not dealt with promptly. In February 2009, OSFI levied MFC with its

second-highest composite risk rating. MFC was also the subject of an enforcement notice issued by OSC staff in June 2009 which was followed by an 18-month investigation. In April 2011, MFC issued a press release in which it stated that OSC staff had reviewed "information obtained from Manulife" as well as MFC's "current disclosure and current disclosure practices", and had decided not to seek any order from the OSC.

14 In the months following the events in question, MFC dramatically improved the nature and extent of its risk management disclosures and has done so even though it has been using hedging and reinsurance in its Guaranteed Products business to a far greater degree than during the Class Period.

Arguments and issues

(1) The plaintiffs' position

15 The plaintiffs acknowledge that MFC was entitled to make a business decision not to hedge or reinsure its equity market risk. The company, after all, is in the risk business. It takes calculated risks to generate profits for its shareholders. However, say the plaintiffs, MFC was obliged by law to fully and fairly disclose to investors its decision to abandon such techniques and the extraordinary risks that flowed from that decision.

16 Rather than make such disclosures during the Class Period, the plaintiffs say that MFC consistently misrepresented in its core disclosure documents (that is, in its annual financial statements, AIF's, MD&A's, prospectuses and prospectus supplements) that it had in place "effective, rigorous, disciplined and prudent" risk-management systems, policies and practices. The plaintiffs say that MFC also misrepresented its risk management, its diversification levels, and the extent that it was exposed to both equity market and interest rate risks.

17 According to the plaintiffs, MFC had "bet the farm" that equity markets would continue to rise. This bet did not pay off. Equity markets plummeted. MFC was disproportionately exposed because of its risk management decisions and had not disclosed that material fact to the market.

18 The members of the proposed Class, who are essentially non-Quebec residents [6] who acquired MFC securities in Canada during the Class Period, incurred losses when the price of MFC's securities collapsed as a result of the disclosure of the truth. This action is brought to recover the Class Members' damages.

(2) The "misrepresentations"

19 The plaintiffs have defined the key misrepresentation in terms of a Representation and an Omission. The Representation is defined as follows:

> The statement that MFC had in place enterprise-wide risk management systems, policies and practices that were comprehensive, effective, rigorous, disciplined and/or prudent, and the substantially similar statements that are particularized in the statement of claim.

20 The plaintiffs also say that the defendants failed to disclose material facts in the company's "core documents" as that term is defined in Part XXIII.1 of the OSA. These alleged omissions amounted to misrepresentations within the meaning of the OSA and made the Representation materially misleading. The plaintiffs point to the following five omissions and refer to them collectively as the Omission:

> (a) that MFC had substantially reduced or eliminated its hedging with respect to some or all of its Guaranteed Products;
>
> (b) that MFC's variable annuity guarantee dynamic hedging strategy was not designed to completely offset the sensitivity of policy liabilities to all risks associated with the guarantees embedded in these products;

(c) that there could be no assurance that MFC's exposure to public equity performance and movements in interest rates would be reduced to within established targets;

(d) that with regard to MFC's disclosed sensitivities and risk exposure measures for certain risks, these included the sensitivity due to specific changes in market prices and interest rate levels projected using internal models as at a specific date, and were measured relative to a starting level reflecting MFC's assets and liabilities at that date and the actuarial factors, investment returns and investment activity MFC assumed in the future. The risk exposures measured the impact of changing one factor at a time and assumed that all other factors remain unchanged. Actual results could differ significantly from these estimates for a variety of reasons; and

(e) the disclosure of the changes to net income attributable to shareholders that would result from change in public equity returns of -30%, -20%, -10%, +10%, +20% and +30%, along with disclosure of the impact of hedges and other risk mitigation strategies, if any, on such calculations.

21 I am satisfied for the purposes of both the leave and certification motions that the Representation, although referencing various examples in the statement of claim, can stand alone as a single Representation that is judicially manageable in a class proceeding. I am also satisfied that the same can be said about the Omission. Here, five specific omissions are listed but omissions (a) to (d) are, in essence, flip-sides of the Representation, albeit with some additional nuances. Omission (e), about the failure to set out the 20% and 30% market decline scenarios, is different. This is an omission that does not fall with the penumbra of the Representation and stands apart but, in my view, is also judicially manageable.

22 Put simply, contrary to the submission of the defendants, the common issues trial judge will not have to deal with multiple representations over a multi-year time frame. The alleged Representation and Omission are reasonably confined and, again, judicially manageable.

23 I pause here to note that the same cannot be said about the 68 additional misrepresentations that are listed in Schedule A of the statement of claim and referred to in Proposed Common Issue No. 1. In my view, none of the Schedule A "misrepresentations" adds anything significant to the plaintiffs' overall claim. All of them appear to be illustrations, worded differently, of the defined Representation. In my opinion, nothing will be gained by placing these additional 68 examples before the common issues trial judge. More importantly, if they are carried forward and adjudicated individually, this would transform what is thus far a fairly manageable lawsuit into an unwieldy one. Therefore, when I come to discuss the Proposed Common Issues, I will delete the reference to the Schedule A documents.

(3) The defendants' position

24 The defendants make three basic points.

25 One, the market knew everything. There were no misrepresentations or material non-disclosures. MFC disclosed all that was required and the market knew at all relevant times (via the company's core document disclosures or via analyst reports and credit rating agency reports) the full extent of the risk that MFC had assumed with its guaranteed products business. The market also knew the steps the company had taken, or not taken, to manage that risk.

26 Two, the global financial crisis of 2008 was completely unforeseeable. What happened in the fall of 2008, argues MFC, was a surprising and unprecedented equity market collapse. The plaintiffs are improperly relying on hindsight to suggest that MFC should have been able to predict the financial crisis. Hindsight cannot be used, says MFC, to measure materiality.

27 Three, no "truths" were "revealed" on February 12, 2009. The press release announcing the 2008 fiscal year-end financial results was in no way "corrective" of any previous disclosure that MFC had made; rather, it was timely disclosure of information, which updated information previously provided to the market as it became available. The

February 12, 2009 press release accurately, and at the appropriate time, disclosed MFC's financial results for the fourth quarter of 2008 and 2008 fiscal year. The decline in the stock price was nothing more than the reaction by the market to the timely and accurate disclosure by MFC of its year-end 2008 results.

(4) The issues and the evidence

28 It became abundantly clear from both the written material and the oral argument that the dispute actually centered on four discernible questions:

(i) Did MFC materially misrepresent the nature and extent of its exposure to the equity market or was this already known in the market?

(ii) Was MFC required to disclose the impact on net income of a 20 or 30% equity market decline or was the 10% disclosure sufficient?

(iii) Was the financial crisis of 2008 so unprecedented and unforeseeable that no disclosure obligations could arise therefrom?

(iv) Was any "truth revealed" on February 12, 2009 that could reasonably be viewed as a "correction" of earlier misrepresentations?

29 The plaintiffs filed more than 5,000 pages of material, including three expert reports. The first was from Professor Gregg A. Jarrell, a former chief economist at the SEC and now a professor of economics and finance at the University of Rochester; the second from Paul Winokur, an experience life insurance actuary; and the third from Robert Chambers, a chartered accountant and former head of the financial institutions, forensic accounting and risk strategy practice at KPMG.

30 Taken together, the plaintiffs' experts answered the four question posed above as follows:

(1) MFC did indeed misrepresent the nature and extent of its exposure to the equity market and these alleged misrepresentations and omissions were material to investors;

(2) The MFC Board of Directors was provided with annual DCAT reports during the 2003 to 2008 financial years that likely included 20% to 40% equity market decline scenarios and their related impacts on net income;

(3) The 2008 financial crisis, or at least a 40% market decline, was foreseeable; and

(4) The February 12, 2009 financial statements corrected earlier misrepresentations or omissions and these corrections caused losses to those MFC shareholders who purchased shares during the Class Period and held those shares through to the end of the Class Period.

31 The defendants filed no affidavit material and no expert reports. They decided instead to rely on their cross-examinations of the plaintiffs' experts and on publicly available documents whose authenticity was admitted.

Analysis

32 Most of the written and oral argument by counsel on these two motions was understandably focussed on the motion for leave under Part XXIII.1 of the OSA. The plaintiffs ask that leave be granted. The defendants argue that leave should be denied and if denied, the defendants say that the common law claims should fail as well and the motion for certification should be dismissed.

33 I will first deal with the motion for leave and then certification.

(1) Leave to commence the statutory action

34 Section 138.8(1) of the OSA provides that no action may be commenced under section 138.3 without leave of the court and that leave can only be granted where the court is satisfied that (a) the action is being brought in good faith and (b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.

35 The first hurdle, that "the action is being brought in good faith," is easily cleared. Given the force of the plaintiffs' argument and the content of their expert reports, I am satisfied that the plaintiffs have an honest and reasonable belief that the action has merit and that they have a genuine intent and capacity to prosecute the claim if leave is granted. [7] The defendants did not argue otherwise.

36 The dispute here is whether the second hurdle has been cleared — that is, whether the plaintiffs have established a reasonable possibility of success at trial. Much of this dispute is centered on the meaning of the phrase "reasonable possibility of success." Is this simply a screening mechanism to keep out "strike suits" that are plainly unmeritorious and have no chance of success? Or, is this a preliminary merits test that should have more bite?

37 Everyone agrees that a "reasonable possibility" is more than a mere possibility and less than a probability. If the weather forecast says that the chance of rain tomorrow is no more than 1%, would you conclude that there is a reasonable possibility that it will rain tomorrow? Probably not. What if the chance of rain is 20%? Most people, I would think, would describe this as a reasonable possibility of rain. How about 10%? Or 5%? Does a one in twenty chance amount to a reasonable possibility?

38 Judges convey meaning with words, not percentages. But what is the best way to convey the meaning of "reasonable possibility of success at trial?" There are two schools of thought. Most class action judges, at least in Ontario, seem to be satisfied with a "relatively low threshold" [8] — all the plaintiff has to show is "something more than a *de minimis* possibility or chance that the plaintiff will succeed at trial." [9] Of course, the conclusion that a plaintiff has a reasonable possibility of success at trial must be based on a reasoned consideration of the evidence. [10]

39 Defence counsel in securities actions like this typically press for a higher threshold and remind the court that the "reasonable possibility of success" standard that is part of the leave test in s. 138.8 originated in the Ontario Law Reform Commission's report on class actions. [11] The Ontario legislature declined to follow the OLRC's recommendation to include a merits-based hurdle as a pre-condition for certification under the CPA. However, when it came to drafting the leave provision under s. 138.8 of the OSA, the OLRC language was adopted. The OLRC was explicit that the "reasonable possibility of success" test was not intended merely to screen out impossible cases: "The test that we propose is not aimed at those cases where it is clear that the action cannot succeed". [12] There are already provisions under the *Rules of Civil Procedure* that allow such cases to be summarily disposed of, either by a motion to strike or a motion for summary judgment. Therefore, the "reasonable possibility of success" standard in s. 138.8, if the standard is not to be redundant, requires that plaintiffs prove something more than a mere possibility of success at trial. Otherwise, the leave application in securities class actions is nothing more than a speed bump.

40 For my part, I would interpret s. 138.8 along the lines suggested by the OLRC: that is, the plaintiffs have to show more than just a triable issue. In my view, the reasoning of the British Columbia Supreme Court in *Round v. MacDonald, Dettwiler and Associates Ltd.* [13] reflects the OLRC standard. Here is how Harris J. described the higher hurdle:

> Establishing a reasonable possibility of success at trial involves more than merely raising a triable issue or articulating a cause of action. Equally, it does not require a plaintiff to demonstrate that it is more likely than not that he or she will succeed trial. But it is clear, in my view, that the test is intended to do more than screen out clearly frivolous, scandalous or vexatious actions. An action may have some merit, and not be frivolous, scandalous or vexatious, without rising to the level of demonstrating that the plaintiff has a reasonable possibility of success. [14]

41 Although I would very much prefer to treat the s. 138.8 hurdle as more than just a speed bump, I fear, given a recent Supreme Court decision, that the battle may be lost. [15] In any event, in this case, I would have come to the same conclusion under both the relaxed Ontario approach and the more demanding B.C. / OLRC approach. As I explain below, the plaintiffs have easily cleared the "more than a chance" hurdle. They have also, in my view, cleared the higher OLRC hurdle on each of the four issues in dispute by showing not just a triable issue but a seriously arguable claim that has a reasonable possibility of success.

42 I will consider each of the four issues in turn.

(i) Did MFC materially misrepresent the nature and extent of its exposure to the equity market or was this already known in the market?

43 MFC argues that the allegations of misrepresentation and non-disclosure are misplaced and unfounded because all of the impugned information was well known to the market. MFC was closely followed by 18 analysts over the time period in question and by numerous rating agencies. For example, says MFC, analysts and rating agencies knew as early as 2005 that MFC was not hedging the new Guaranteed Products line and would not be doing so until late 2007.

44 MFC refers to the reports prepared by Moody's, Fitch Ratings and Genuity dated 2005 to 2007 that clearly pointed out that MFC was not hedging its new line of Guaranteed Products and was thus sensitive to equity market risk. Furthermore, says MFC, as the financial crisis deepened in 2008, these and other market analysts such as TD, RBC and Credit Suisse continued to write about MFC's vulnerability to equity market swings.

45 Indeed, says MFC, as early as October 2006 Moody's had assessed the risk of MFC's Guaranteed Products business and concluded that the company would be exposed to "catastrophic risk" if there was "a high severity, low frequency occurrence of a prolonged and steep equity market downturn". The Moody's report suggested that "Manulife was essentially writing a put option on the equity markets — that is, an option that protected purchasers of the Guaranteed Products in the event of an equity market collapse."

46 The plaintiffs say it is simply not true that all of the analysts knew what MFC was doing. Moody's may well have discussed "catastrophic risk" in their October 2006 report but other analysts, such as Keefe Bruyette Woods, were still reporting as late as December 2008 that MFC's primary risks were "political and regulatory risks" and were saying nothing about the company's unhedged exposure risks. Even if all 18 analysts that followed the company knew about the latter (which was not the case) it does not follow that "the market" knew. Nor did it help matters, argue the plaintiffs, when Mr. Rubenovitch provided analysts in a November 2008 conference call with the highly misleading information that MFC hedged "a substantial portion but not 100 per cent of the product." (In fact, only about 5% was hedged.)

47 The expert evidence of Robert Chambers was that MFC's decision not to hedge was material information that was not adequately disclosed. The defendants disparaged Mr. Chambers' expertise but filed no evidence in response to his or to the other two experts' reports.

48 In my view, whether the market knew about the extent of MFC's market risk exposure over the entire Class Period is a seriously arguable question given the competing evidence that is before me. The plaintiffs may not prevail at trial but there is at least a reasonable possibility that they may do so.

(ii) Was MFC required to disclose the impact on net income of a 20 or 30% equity market decline or was the 10% disclosure sufficient?

49 In the 2004 to 2007 annual MD&As, MFC disclosed the impact on "shareholders' economic value" of a 10% decline in equity markets. The sensitivity disclosure was presented in tabular form:

Impact on Shareholders' Economic Value of a Ten Per Cent Decline in Market Values of Variable Product and Other Managed Assets

As at December 31

Canadan (in matters)	**2004**	**2003**
Market-based fees	$(411)	$(213)
Variable product guarantees	$(204)	$(90)

50 There was no need, says MFC, to provide information about the impact of 20 or 30% equity market declines, Indeed, in a research paper published by the Canadian Institute of Actuaries in December 2009, a six-person working group concluded that the 10% sensitivity-measure was "an appropriate level of sensitivity" and "good disclosure practice." [16]

51 The plaintiffs respond as follows. One, the use of the internally-invented and non-GAAP financial measure called "shareholders' economic value" was itself misleading because it masked the potential effect of equity market declines on MFC's net income. [17]

52 Two, there was no good reason not to disclose the impact of a 20 or 30% equity market decline. Indeed, according to Mr. Winokur, the insurance industry expert, MFC's board and senior management were likely presented with DCAT reports showing equity market-sensitivity analyses not just for a 10% market decline, but for market declines of 20 to 40%, but decided to disclose only the 10% impact. Mr. Winokur also referred to a 2010 media report that indicated that the company's Chief Risk Officer made a presentation to Mr. D'Alessandro in 2006, warning that the company's balance sheet at the time "could not absorb the growing equity risk" due to its "unusually high exposure to stock markets because of its large segregated fund variable annuity business." [18]

53 Three, MFC was required to make full and accurate disclosure of the material risks arising from its lack of hedging, including the extent of its exposure to severe equity market and interest rate declines, information which MFC had at its disposal during the Class Period, and which it now belatedly discloses even though it now is subject to much less risk. Although MFC disclosed the impact on "shareholders' economic value" of a 10% reduction in equity markets, in line with the practice of some of its peers, MFC made far less use of hedging than its peers, and therefore its exposure to severe market corrections was far greater than theirs. Moreover, the magnitude of MFC's exposure to market corrections greater than 10% could not be extrapolated from its exposure to a 10% correction.

54 Four, the government-prescribed disclosure documents contemplated that disclosure of material information would include disclosure of material risks. This is consistent with the jurisprudence that has recognized that the risk of a future event can be a material fact requiring disclosure depending both on the significance of the event in question and on the chances of it occurring (the so-called probability/magnitude test). [19]

55 For example, the AIF form (Form 51-102F2) states that the AIF "is a disclosure document intended to provide material information about your company...and describes your company, its operations and prospects, risks and other external factors that impact your company specifically." The MD&A form (Form 51-1-2F1) contemplates that issuers will "discuss important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future", and that the analysis provided should discuss "commitments, events, risks or uncertainties you reasonably believe will materially affect your company's future performance". And, the prospectuses issued by MFC during the Class Period and actionable under Part XXIII. 1 as "core documents," [20] must make provide "full, true and plain disclosure of all material facts," [21] which include the undisclosed, potentially catastrophic risks at issue here.

56 Five, say the plaintiffs, one should look at what MFC does today because subsequent conduct is relevant to the materiality assessment. [22] After the events of February 12, 2009, MFC began to disclose the amount of hedging and reinsurance and the impact of an adverse 20 or 30% market decline using approved accounting measures such as "net income" rather than "shareholders' economic value." These recent disclosures have shown that the effects of equity market and interest rate declines on net income are substantially larger than their effects on "shareholders' economic value."

57 Six, even if these risks were not obvious in 2004 — which according to the plaintiffs is contrary to the evidence — they were obvious no later than mid-2007 when the global credit crisis was starting to emerge. However, MFC did not provide the required disclosure in its 2008 reporting even though by that point the market correction was fully underway. MFC had the required information and could easily have made the required disclosure.

58 Finally, the research paper relied on by MFC (that found that a 10% sensitivity analysis was sufficient) is not persuasive. The plaintiffs point out that it was only a working group's research paper, not a final publication of the Canadian Institute of Actuaries and that two of the six members of the working group were MFC employees.

59 In sum, whether MFC was obliged to go beyond the 10% analysis and disclose the impacts of a 20 or 30% market decline, and do so using a GAAP-approved measure such as net income rather than something called "shareholder's economic value" is a matter that can only be determined at trial. Based on the evidence presented thus far, I find that the plaintiffs have demonstrated that this is a seriously arguable issue and they have a reasonable possibility of prevailing at trial.

(iii) Was the financial crisis of 2008 so unprecedented and unforeseeable that no disclosure obligations could arise therefrom?

60 Drawing support from public comments made by the chairman of the OSC, MFC says it was completely "surprised" by the "unprecedented" market meltdown.

61 The plaintiffs do not agree. They remind MFC that a comparable market drop in the range of 40% had just occurred in 2000-01, three years before the Class Period. From August 2000 to September 2002, the S&P/TSX Composite Index fell by 44%. In 2008-09 the same index contracted at one point by 45%. Hence, a market correction of some 40% was neither "surprising" nor "unprecedented."

62 The plaintiffs further remind MFC that even if the market decline was not likely, the risk of it occurring was still material under the "probability/magnitude test" that was just discussed. Even less probable events are material when the magnitude of that event is high. [23] Here, say the plaintiffs, the magnitude — an existential threat to MFC's business — was extremely high.

63 In short, there appears to be an evidentiary basis for the plaintiffs' submission that the market meltdown of 2008 and market declines of even 40% were not entirely unforeseeable and unprecedented. In my view, the plaintiffs have shown a reasonable possibility of succeeding on this issue at trial.

(iv) Was any "truth revealed" on February 12, 2009 that could reasonably be viewed as a "correction" of earlier misrepresentations?

64 MFC argues that there were no new "revelations" on February 12, 2009 when it announced its fourth-quarter 2008 results. MFC had issued a press release on December 2, 2008, advising that, as result of equity market declines, it expected to increase its reserves for its Guaranteed Products "to approximately $5.0 billion at December 31, 2008". There was no significant movement in MFC's share price following the December 2, 2008 press release. Thus, it cannot be said that February 12, 2009 was the date that MFC's reserve increase was first disclosed.

65 On the contrary, argue the plaintiffs, there was a significant corrective disclosure on February 12, 2009. As a U.S. court has recently held, "A corrective disclosure need not be a 'mirror-image' disclosure — a direct admission that

a previous statement is untrue." [24] All that is required is that "the corrective disclosure must relate to the same subject matter as the alleged misrepresentation," [25] as was the case here. In other words, say the plaintiffs, the appropriate inquiry is whether the February 12, 2009 disclosure, as a whole, plausibly revealed to the market that MFC had undisclosed sensitivity to equity markets. [26]

66 Here, in Professor Jarrell's expert opinion, there was indeed a statistically significant stock price decline on February 12, 2009 and this decline was "directly attributable to news about Manulife's hedging problems and the related consequences." Professor Jarrell was asked on re-direct about the interaction between the December 2, 2008 and February 12, 2009 disclosures and about the fact that MFC had changed the CTE level from 80 to 65 for Q4 2008. He concluded that "had Manulife disclosed [in December] that the CTE level that they were using was a 65 as of December 2, then, that would have caused a negative stock price reaction on December 2 [and] instead we saw that reaction on February the 12th" when MFC disclosed the record-low CTE it had used, but arguably concealed, say the plaintiffs, in order to calculate the December figures. [27]

67 The plaintiffs submit that MFC manipulated its CTE level to obscure the true effect of the absence of hedging. Because volatility remained high throughout Q4 2008, MFC was no doubt aware that analysts expected MFC to employ a CTE on the higher end of the spectrum, as it had in Q3. When MFC announced on December 2, 2008 that it "expects to increase its reserves for variable annuity guarantees to approximately $5.0 billion," it did not disclose the CTE level employed to reach that figure. At the end of the Class Period, when it finally disclosed the truth, MFC revealed that it used CTE 65 — its lowest ever — and that it had increased reserves by $5.8 billion. Had MFC used CTE 80, the CTE it had used in the prior quarter, it would have increased reserves by an additional $2.2 billion, i.e. it would have increased reserves by $3 billion above the $5 billion announced on December 2. And the share price, one must assume, would have plummeted even more.

68 Both Professor Jarrell and Mr. Chambers provided uncontroverted opinion evidence that MFC's share price became artificially inflated because the decision not to hedge market risk had boosted MFC's short-term profitability and return on equity. They also provided evidence that MFC's lack of hedging and reinsurance, and the sensitivities arising therefrom, "would have assumed actual significance in a reasonable investor's deliberations," and were therefore material facts within the meaning of the OSA. [28] In short, say the plaintiffs, new material information was disclosed on February 12, 2009 and this in turn caused the severe drop in the MFC share price.

Conclusion on the leave application

69 I am satisfied that the plaintiffs have established a reasonable possibility of success at trial, certainly on the "more than a chance" standard, and even on the more demanding OLRC standard. That is, on each of the four main issues — what was known in the market, the need for more than a 10% impact disclosure, the foreseeability of the market downturn and the February 12, 2009 disclosures — the plaintiffs have demonstrated on the evidence before the court, much of it uncontroverted, that they have raised seriously arguable issues that have a reasonable possibility of success at trial. Again, the plaintiffs may or may not prevail at trial, but they have cleared the s. 138.8 hurdle and leave shall be granted.

70 The individual defendants, Messrs. D'Alessandro and Rubenovitch, are caught up in this action by virtue of the corporate positions held at the time. If any of the impugned documents in fact contained one or more misrepresentations, Mr. D'Alessandro may incur Part XXIII.1 liability by virtue of the fact that he was a director when the documents were released. [29] Mr. Rubenovitch, an officer, may incur Part XXIII.1 liability if he authorized, permitted or acquiesced in MFC's release of a document containing a misrepresentation. [30] I am satisfied on the evidence before me that there is a reasonable possibility (under either standard discussed) that the plaintiffs will show at trial that MFC released a document that contained a misrepresentation, that Mr. D'Alessandro was a director when that document was released

and that by certifying the contents of the impugned document, Mr. Rubenovitch "authorized, permitted or acquiesced in" the release of that document.[31]

71 Leave is therefore granted

(2) Certification as a class action

72 Section 5(1) of the *Class Proceedings Act*[32] states that the court shall certify an action as a class proceeding if (a) the pleadings disclose a cause of action; (b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff; (c) the claims of the class members raise common issues; (d) a class proceeding would be the preferable procedure for the resolution of the common issues; and (e) there is a representative plaintiff who (i) would fairly and adequately represent the interests of the class, (ii) has produced a workable litigation plan (iii) does not have a conflict of interest with the class.

73 I will discuss each of the five prerequisites in turn.

(i) Causes of action

74 In addition to the statutory cause of action under the OSA, the plaintiffs also plead three causes of action at common law — negligence, negligent misrepresentation and unjust enrichment. In my view all four actions as pleaded satisfy the test under s. 5(1)(a). It is not plain and obvious and beyond doubt that any of them will fail. Let me explain this in more detail.

75 *The statutory cause of action*. All of the essential elements of the statutory cause of action were properly pleaded. The only question is the limitation period. MFC argues that the statutory claim is time-barred because the action was not commenced within three years of the alleged misrepresentations as required by s. 138.14 of the OSA and the Court of Appeal's decision in *Timminco*.[33] Even if the Representation and Omission are seen as a single, continuing misrepresentation, says MFC, leave should have been obtained and the action commenced no later than February 12, 2012. It is not enough that the plaintiffs asked for leave to pursue the statutory action in their statement of claim dated July 29, 2009. As for the tolling agreement that was entered by the parties on March 31, 2011, adds MFC, this must mean that any claims relating to the period prior to March 31, 2008 are time-barred.

76 MFC is correct to remind me that I am bound by *Timminco* even though the issue in that decision is currently under review by a five-judge panel of the Court of Appeal. The plaintiffs are equally correct in noting that *Timminco* did not deal directly with this court's jurisdiction to grant leave *nunc pro tunc* and argue, on the basis of special circumstances, that leave should be granted as of July 29, 2009 when the statutory cause of action was first mentioned in the statement of claim. This would allow class members who acquired common shares of MFC in the secondary market from July 29, 2006 and held them to the end of the Class Period to be eligible for any damages awarded under the statutory claim.

77 The plaintiffs submit (correctly) that the essential elements of the statutory claim were disclosed in the statement of claim dated July 29, 2009; that they prosecuted this matter with reasonable diligence; and that no prejudice would be suffered by the defendants if leave was granted *nunc pro tunc* as of the date of the original statement of claim. More importantly, say the plaintiffs, in cases decided after *Timminco* this court has concluded that the limitation period established by 138.8(1) of the OSA is subject to the special circumstances doctrine.[34]

78 Having reviewed these decisions, I cannot say that it is plain and obvious that the limitation defence applies and the statutory action is certain to fail. Given the post-*Timminco* state of the law, I find that the statutory claim discloses a legitimate cause of action.

79 *Negligence*. The negligence claim is made against all of the defendants but only on behalf of prospectus purchasers, not secondary market purchasers. The essential elements of this cause of action (a duty of care to disseminate accurate

disclosure documents, breach of this duty, causation and damages) are all properly pleaded. Counsel for the two individual defendants, Messrs. D'Alessandro and Rubenovitch, submit that there is no specific allegation that the individual defendants owed any duty of care to *prospectus purchasers* in relation to the representations contained in those documents. All that is alleged in the statement of claim is that the duty of care was owed to the plaintiffs who purchased shares in the "secondary market" and "*persons and entities similarly situated*" to them. The latter phrase, say the individual defendants, cannot be interpreted to include prospectus purchasers.

80 I do not agree. Under a s. 5(1)(a) analysis, pleadings must be read generously with due allowance for drafting deficiencies. [35] I have no difficulty reading the pleadings reasonably and generously to mean that the individual defendants owed a duty of care not only to the secondary market purchasers but also to persons who were similarly situated, namely those in the primary market as well. This is not a case where such an interpretation would unfairly surprise or prejudice the individual defendants. The claim in negligence, limited to the class members who purchased MFC shares in the primary market, discloses a proper cause of action.

81 *Negligent misrepresentation*. The scope and content of this cause of action was revised during the hearing of the motion. The plaintiffs are claiming negligent misrepresentation on behalf of both prospectus and secondary market purchasers, but only as against MFC (and not the two individual defendants) and only on the basis of the Representation (and not the Omission.)

82 Here again all of the essential elements of this cause of action have been properly pleaded — the existence of a duty of care based on a special relationship between the parties; an untrue, inaccurate or misleading representation; negligence in the making of the misrepresentation; "direct or indirect" reliance by the plaintiff on the misrepresentation; and damages suffered as a result of the reliance. [36]

83 This court has previously found that it is not plain and obvious that there is no special relationship between issuers and secondary market purchasers. [37] Generally, a "special relationship" will be established if the reliance of the representee on the representor's statement was both foreseeable by the representor and reasonable on the part of the representee. [38] The negligent misrepresentation claim clears the s. 5(1)(a) hurdle. I will say more about the "reliance" issue when I discuss the Common Issues.

84 *Unjust enrichment*. The fourth cause of action is directed against both MFC and the individual defendants. It is directed at the individual defendants because both of them sold MFC shares in the secondary market over the course of the Class Period when the share prices were "artificially high" because of the "misrepresentations." Mr. D'Alessandro sold 922,240 shares for about $35 million. Mr. Rubenovitch sold 205,200 shares for a total of about $8 million. The unjust enrichment claim against MFC is brought on behalf of prospectus purchasers only.

85 Although I question the rationale for the unjust enrichment claims, [39] I am satisfied that all of the essential elements for this cause of action (an enrichment of the defendant, a corresponding deprivation of the plaintiff and an absence of any juristic reason for the enrichment) [40] have been properly pleaded as against all of the defendants.

86 The two individual defendants argue that the unjust enrichment claim is time-barred because the elements of the cause of action were only pleaded in the third revision of the statement of claim dated January 3, 2012. It is now too late to assert this claim as more than two years have passed since February 12, 2009 when "the truth" was allegedly discovered. [41]

87 The plaintiffs respond by noting (correctly) that the underlying facts to the unjust enrichment claim (that the two individual defendants sold their shares for millions of dollars during the Class Period) were pleaded in the amended statement of claim dated November 19, 2009, well within the two-year limitation period. The plaintiffs refer to recent decisions in this court that appear to stand for the following proposition: if the underlying facts needed to sustain the

"new" cause of action were pleaded in a timely manner, then the "new" cause of action is not time-barred.[42] I do not have to resolve the limitations issue. It is sufficient on this motion for me to conclude that it is not plain and obvious that the unjust enrichment claim is time-barred.

88 In sum, I am satisfied that all four causes of action — the statutory claim and the common law claims in negligence, negligent misrepresentation and unjust enrichment-clear the low s. 5(1)(a) hurdle.

(ii) Identifiable class

89 Section 5(1)(b) of the CPA requires that there be an identifiable class of two or more persons. During the hearing, counsel for the plaintiffs revised the class definition to make clear that only the purchasers of MFC common shares would be included and that early sellers would be excluded. The revised definition now reads as follows:

> "Class" and "Class Members" means all persons and entities, wherever they may reside or be domiciled, who acquired MFC common shares over the TSX, or under a prospectus filed with a Canadian securities regulator at any time from April 1, 2004 to February 12, 2009, and continued to hold the common shares until February 12, 2009; but excluding: (1) the Defendants, members of the immediate families of the Individual Defendants, any officers or directors of MFC...and (2) all persons.. .who do not opt out of the proposed class action pending in the Quebec Superior Court and styled *Comité Syndical National de Retraite Bâtirente Inc. v. Société Financière Manuvie* (Court File No.: 200-06-000117-096).

90 I am satisfied that the revised definition properly identifies persons who have a potential claim for relief against the defendants, defines the parameters of the lawsuit so as to identify those persons who are bound by the result and describes who is entitled to notice of certification.[43] The second prerequisite for certification is cleared.

(iii) Common issues

91 Section 5(1)(c) of the *CPA* requires that the class proceeding raise common issues of fact or law. The common issues need not dispose of liability or predominate over individual issues.[44] They only have to move the litigation forward.[45]

92 As noted earlier, I am prepared to certify Proposed Common Issues 1, 2, 4, 5, 8, 9 and 10, albeit with some modifications. Each of these issues has some basis in fact in the evidence before me. They will help advance the litigation and avoid a duplication of factfinding and legal analysis. None of them require individual findings of fact or inquiry into the circumstances of individual claims.[46]

93 I will explain each of the certified Common Issues in turn. (I have attached the list of the Proposed Common Issues as Appendix A for ease of reference.) The following seven commons issues, as amended, are certified:

- Proposed Common Issue 1 is certified. However, the reference to "*the misrepresentations particularized in Schedule "A" to the Statement of Claim*" in the first sentence shall be deleted. As I have already noted,[47] nothing is gained by adding these 68 illustrations to what is already set out, in essence, in the defined Representation. Requiring the common issues trial judge to also deal with the examples listed in Schedule A will not advance the litigation. With this deletion, Proposed Common Issue 1 is certified.

- Proposed Common Issue 2 is certified. Liability under s. 138.3 of the OSA can be determined on a common basis and this determination will advance the litigation.

- Proposed Common Issue 4 is certified. Whether the defendants owed the class members a duty of care at common law can be determined on a common basis and this determination will advance the litigation.

• Proposed Common Issue 5 is certified (with a correction to the question number). Whether the defendants breached their duty of care at common law can be determined on a common basis and this determination will advance the litigation.

• Proposed Common Issue 8 is certified (deleting only the first seven words). The question asks whether "each Class Member's reliance" can be inferred from the fact that each Class Member acquired the MFC securities in an efficient market. Both the Court of Appeal and this court have held that individual reliance can indeed be inferred from the surrounding facts or circumstances. [48] Given that this Proposed Common Issue only asks whether buying securities in an efficient market can provide the surrounding circumstances for inferring individual reliance and does not require individual assessments, it is a legitimate query and one that, in my view, will help advance the litigation.

• Proposed Common Issue 9 is certified. Whether MFC is vicariously liable or otherwise responsible for the acts of the individual defendants is a legitimate question that can be determined on a common basis and this determination will advance the litigation.

• Proposed Common Issue 10 is certified. I question the rationale of pursuing this unjust enrichment claim given the statutory and common law claims and the fact that the litigation plan anticipates that any "unjust enrichment" recovery from Messers. D'Alessandro and Rubenovitch will be distributed on a pro rata basis to the eligible recipients. Nonetheless, I will certify this issue but flag it for the common issues trial judge as being one of questionable utility.

94 The list of the certified Common Issues is attached in Appendix B.

95 I will now turn to the five Proposed Common Issues that have not been certified. I am not prepared to certify proposed Common Issues 3, 6, 7, 11 and 12 for the following reasons.

• Proposed Common Issue 3 is not certified. As a rule, I believe that damages questions should generally be left to the common issues trial judge. Asking what "per share damages are payable" by which defendants if the statutory action succeeds is an obvious question that will be answered by the trial judge if and when that need arises. This is not a common issue that advances the litigation.

• Proposed Common Issue 6 is not certified. The Supreme Court has made it clear that proof of individual reliance remains an essential component of the claim for negligent misrepresentation. [49] Individual reliance may, depending on the facts, be inferred [50] or even presumed, [51] but it is always necessary. [52] The only possible answer to the Proposed Common Issue 6 regarding negligent misrepresentation is "yes." [53] There is no good reason to certify as a common issue a question whose answer is indisputably clear in the case law. It does not advance the litigation. It simply wastes time.

• Proposed Common Issue 7 is not certified. The question requires or depends upon a "no" answer to Proposed Common Issue 6. However, as just noted, the only possible answer to that question is "yes." Also, whether the class members sustained damage requires individual assessments and cannot be answered on a common basis. As for the damages "measure", this is an issue that is best left to the common issues trial judge as a self-evident question that will be answered as and when needed.

• Proposed Common Issue 11 is not certified. Here again, as in Proposed Common Issue 3, the plaintiffs are asking a question that will not only be obvious to the common issues trial judge if liability is established, it is not a common question that advances the litigation. I acknowledge that it is within my discretion to certify "aggregate damages" questions, but I decline to do so.

- Proposed Common Issue 12 is not certified. Whether the defendants should be required to pay for the costs of administering and distributing the recovery and if so how much should be paid, are not common issues that will advance this litigation. They are self-evident "ex post" questions that will be ably determined by the trial judge as and when needed. At this point, the questions are premature.

96 In sum, Proposed Common Issues 1, 2, 4, 5, 8, 9 and 10 are certified as set out in Appendix B.

(iv) Preferable procedure

97 Section 5(1)(d) of the CPA requires the motions judge to decide whether a class proceeding would be the preferable procedure for the resolution of the common issues.

98 To its credit, MFC did not seriously argue the preferability point. No other reasonable alternative was suggested. Also, in my view, it is self-evident that at least two of the three CPA objectives would be satisfied: judicial economy (better one class action than a multiplicity of proceedings, all of which would be based on essentially the same events) and behaviour modification (arguably achieved because certification would convey to the market that market participants will be held to account when they fail to make full and timely disclosure).

99 If liability is established at the common issues trial, individual damages trials will still be needed. This does not detract from the finding that a class proceeding is a preferable procedure for the liability phase. Indeed, s. 6 of the CPA makes clear that a court shall not refuse certification because the damages claims will require individual assessments.

(v) A suitable representative plaintiff

100 Finally, under s. 5(1)(e) of the CPA, the court must be satisfied that there is a representative plaintiff who (i) would fairly and adequately represent the interests of the class, (ii) has produced a workable litigation plan and (iii) does not have a conflict of interest.

101 There was no serious dispute about any of these sub-points. The proposed representative plaintiffs, in my view, would fairly and adequately represent the interests of the class; they have produced a workable litigation plan that will advance the proceeding through to completion; and there is no conflict of interest.

Conclusion

102 Leave is granted under s. 138.8 of the OSA allowing the plaintiffs to commence an action for damages against Manulife Financial Corporation and the company's former Chief Executive and Chief Financial Officers, Dominic D'Alessandro and Peter Rubenovitch. I am satisfied on the material before me that the action is being brought in good faith and there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiffs.

103 The action is also certified as a class proceeding. Each of the prerequisites set out in s. 5(1) of the CPA has been satisfied.

104 I repeat again that the certification of a class action is simply a procedural measure that allows matters to proceed to a trial where the certified common issues will be fully adjudicated. Whether or not the allegations against the defendants will actually prevail is a matter that will be decided at the common issues trial.

Disposition

105 The motions for leave and certification are granted.

106 Counsel shall prepare an Order in the form contemplated by s. 8 of the CPA. Please note that the plaintiffs' motion to amend the style of cause to remove the individual names of the Trustees is also granted.

107 If the parties are unable to agree on the costs, I would be pleased to receive brief written submissions from the plaintiffs within 14 days and from the defendants within 10 days thereafter. If an extension is needed, please advise.

108 My thanks to counsel for their co-operation and the quality of advocacy.

Applications granted.

Appendix A — The Proposed Common Issues (12)

(1) Was the Representation, or the Omission, or the misrepresentations particularized in Schedule "A" to the Statement of Claim, or any of them, a misrepresentation:

(A) within the meaning of the *Securities Act*, and/or

(B) at common law?

(2) If the answer to (1)(A) is yes, are the Defendants, or any of them, liable to Class Members pursuant to section 138.3 of the *Securities Act*?

(3) If the answer to (2) is yes, what per share damages are payable by the liable Defendant(s) in respect of that liability?

(4) If the answer to (1)(B) is yes, did the Defendants, or any of them, owe the Class Members a duty of care?

(5) If the answer to (4) is yes, did the Defendants, or any of them, breach their duty of care?

(6) Are the Class Members required to demonstrate individual reliance upon the Representation in order to have a right of action against the Defendants for common law negligence, or for negligent misrepresentation?

(7) If the answer to (6) is no, did the Defendants' negligence cause damage to the Class Members? If so, what is the appropriate measure of that damage?

(8) If the answer to (6) is yes, can each Class Member's reliance be inferred from the fact of the Class Member having acquired MFC's securities in an efficient market?

(9) Is MFC vicariously liable or otherwise responsible for the acts of the Individual Defendants?

(10) Were D'Alessandro and Rubenovitch unjustly enriched by their failure to perform their duties to the Class Members?

(11) If the answer to (10) is yes, can compensation to the Class Members be determined on an aggregate basis? If so, what is the amount of that compensation?

(12) Should the Defendants pay the costs of administering and distributing the recovery? If so, which Defendants should pay, and how much?

.....

Appendix B — The Certified Common Issues (7)

(1) Was the Representation or the Omission a misrepresentation:

(a) within the meaning of the *Securities Act* and/or

(b) at common law?

(2) If the answer to (1)(a) is yes, are the Defendants, or any of them, liable to Class Members pursuant to section 138.3 of the *Securities Act*?

(3) If the answer to (1)(b) is yes, did the Defendants, or any of them, owe the Class Members a duty of care?

(4) If the answer to (3) is yes, did the Defendants, or any of them, breach their duty of care?

(5) Can each Class Member's reliance be inferred from the fact of the Class Member having acquired MFC's securities in an efficient market?

(6) Is MFC vicariously liable or otherwise responsible for the acts of the Individual Defendants?

(7) Were Messrs. D'Alessandro and Rubenovitch unjustly enriched by their failure to perform their duties to the Class Members?

. . . . .

Footnotes

* Additional reasons at *Ironworkers Ontario Pension Fund (Trustee of) v. Manulife Financial Corp.* (2013), 2013 CarswellOnt 15419, 2013 ONSC 6354 (Ont. S.C.J.).

1 R.S.O. 1990, c. S.5.

2 The action against MFC directors Gail C.A. Cook-Bennett and Arthur R. Sawchuk has been discontinued.

3 S.O. 1992, c. 6.

4 The "guaranteed products" are equity-linked contracts such as variable annuities and segregated funds. MFC receives a premium from the policyholder. That premium, net of certain fees, is invested in a "segregated" fund, which is a portfolio of investments kept separate from the company's general fund and not available to satisfy the liabilities of the company's general fund. Some Guaranteed Product policyholders receive annuity payments for a defined period. In exchange for a fee and provided the annuity is held for a specified period of time, MFC guarantees a minimum level of benefits.

5 By year-end 2008, more than 95% of the guaranteed value associated with MFC's Guaranteed Products remained unhedged and uninsured.

6 As noted in the proposed class definition, Quebec residents are not included. There is a separate class action proceeding in Quebec. The Quebec action was authorized on July 8, 2011 and encompasses Quebec residents who purchased MFC securities between January 26, 2004 and February 12, 2009. Examinations for discovery are underway.

7 *Green v. Canadian Imperial Bank of Commerce*, 2012 ONSC 3637, [2012] O.J. No. 3072 (Ont. S.C.J.) at para. 356.

8 *Ibid* at para. 373.

9 *Ibid* at para. 361; *Drywall Acoustic Lathing and Insulation, Local 675 Pension Fund (Trustees) v. SNC-Lavalin Group Inc.*, 2012 ONSC 5288, [2012] O.J. No. 4389 (Ont. S.C.J.) at para. 41; *Dobbie v. Arctic Glacier Income Fund*, 2011 ONSC 25, [2011] O.J. No. 932 (Ont. S.C.J.) at para. 129.

10 *Silver v. Imax Corp.*, [2009] O.J. No. 5573 (Ont. S.C.J.) at para. 324.

11 Ontario Law Reform Commission, *Report on Class Actions (Ministry of the Attorney General, 1982)*.

12 *Ibid*, at 323.

13 *Round v. MacDonald, Dettwiler and Associates Ltd.*, 2011 BCSC 1416, [2011] B.C.J. No. 1980 (B.C. S.C.), aff'd 2012 BCCA 456 (B.C. C.A.).

14 *Ibid*, at para. 76.

15 In *Knight v. Imperial Tobacco Canada Ltd.*, 2011 SCC 42, [2011] 3 S.C.R. 45 (S.C.C.), the Supreme Court noted at para. 17 that under the strike-pleadings Rule one only has to show a "reasonable prospect of success" at trial. This amounts to the same thing as a "reasonable possibility of success." Thus, under s. 5(1)(a) of the CPA, which provides the same low hurdle as the strike-pleadings Rule, a reasonable cause of action will be made out if the plaintiff can show a reasonable possibility of success at trial. It therefore appears that the OLRC's more demanding interpretation of the "reasonable possibility of success" standard cannot be resuscitated and the s. 138.8 leave hurdle is doomed to be nothing more than a speed bump.

16 Canadian Institute of Actuaries (Working Group on Financial Statement Disclosure) Research Paper, *Financial Statement Policy Liability Sensitivity Disclosure for Life and Health Insurers* (December 2009) at 4 and 7.

17 The 2004 Annual Report defined "shareholders' economic value" as "the net present value of cash flows related to current assets, recurring premiums to be achieved and product obligations to be paid, discounted at market yields and adjusted for tax." The plaintiffs submit that the concept entails assumptions and net present value calculations that are not transparent to investors, and are thus poorly understood. Net income impact was disclosed after the Class Period and the difference was extreme. For example, the impact of a 10% decrease in markets in 2009 was minus $1.1 billion in net income terms but only minus $450 million (less than half) in "shareholders' economic value."

18 The Winokur opinion also noted that the company's Appointed Actuary confirmed in a press interview that the more negative scenarios were "always run" and were annually presented to the Board.

19 *YBM Magnex International Inc., Re*, 2003 LNONOSC 337, (2003), 26 O.S.C.B. 5285 (Ont. Securities Comm.); *Donnini, Re*, 2002 LNONOSC 570, (2002), 25 O.S.C.B. 6225 (Ont. Securities Comm.) at paras. 130-32.

20 OSA, *supra*, note 1, s. 138.1.

21 *Ibid*, s. 56.

22 *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23, [2011] 2 S.C.R. 175 (S.C.C.) at para. 61.

23 *Donnini*, *supra*, note 19, at paras. 130-34, citing *Basic Inc. v. Levinson*, 485 U.S. 224 (U.S. Ohio S.C. 1988) and *Securities & Exchange Commission v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (U.S. C.A. 2nd Cir. 1968).

24 *Massachusetts Retirement Systems v. CVS Caremark Corp.* [, Doc. 12-1900 (U.S. C.A. 5th Cir. May 24, 2013)], No. 12-1900, 2013 WL 2278599.

25 *Ibid* at 10.

26 *Ibid*

27 The CTE (conditional tail expectation) level is an actuarial measure that reflects the number of predicted adverse scenarios that are included when calculating reserves. All other things being equal, the higher the CTE level, the greater the reserves required. For Q3 2008, MFC employed a CTE of 80, its highest ever. According to MFC's Chief Actuary, it did so because of "the volatility." The CTE level was lowered by MFC to 65 for Q4 2008.

28 Under s. 1(1) of the OSA, a "material fact" is "a fact that would reasonably be expected to have a significant effect on the market price or value of the securities." In other words, information is material on a "move the market" or "market impact" standard. The market impact materiality standard is built into the definition of both "material fact" and "material change". A "misrepresentation" is tied directly to this standard, as well. Under s. 1(1) of the OSA, a misrepresentation is defined relative only to misstatements or omissions of material facts. Information that is not material on the market impact standard does not have to be disclosed and cannot give rise to statutory civil liability.

29 OSA, *supra*, note 1, s. 138.3(1)(b).

30 *Ibid*, s. 138.3(1)(c).

31 *Ibid.*

32 *Supra*, note 3.

33 *Sharma v. Timminco Ltd.*, 2012 ONCA 107, [2012] O.J. No. 719 (Ont. C.A.).

34 See e.g. *Millwright Regional Council of Ontario Pension Trust Fund (Trustees of) v. Celestica Inc.*, 2012 ONSC 6083, 113 O.R. (3d) 264 (Ont. S.C.J.) per Perell J. at para. 85: "Accepting that the plaintiffs' Part XXIII.1 claims are currently statute-barred, it is my argument that: (1) as a matter of statutory interpretation, the limitation period established by 138.8(1) of the Ontario *Securities Act* is subject to the special circumstances doctrine; (2) the special circumstances doctrine provides a limited jurisdiction to make orders *nunc pro tunc* that have the effect of reviving a still-borne and statute-barred cause of action; (3) the special circumstances doctrine could and should be applied in the circumstances of this case; and (4) in the case at bar, if the court grants leave under s. 138.8(1) of the Ontario *Securities Act* to commence an action under s. 138.3 of the Act, it would be appropriate for the court to exercise its special circumstances jurisdiction. Therefore, it is not plain and obvious that the plaintiffs' Part XXIII.1 claims are statute-barred."

35 *Hunt v. T & N plc*, [1990] 2 S.C.R. 959 (S.C.C.), at 980; *Cannon v. Funds for Canada Foundation*, 2012 ONSC 399, [2012] O.J. No. 168 (Ont. S.C.J.) at para. 138.

36 *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87 (S.C.C.).

37 *Silver*, *supra*, note 10 at para. 55.

38 *Ramdath v. George Brown College of Applied Arts and Technology*, 2012 ONSC 6173, 113 O.R. (3d) 531 (Ont. S.C.J.) at para. 62, aff'd 2013 ONCA 468 (Ont. C.A.).

39 I question why the plaintiffs have pleaded unjust enrichment as against MFC given the scope of the recovery under the other causes of action. I also question the rationale and utility of pleading unjust enrichment as against the two individual defendants. The plaintiffs' litigation plan anticipates that any recovery from Messrs. D'Alessandro and Rubenovitch will be distributed on a *pro rata* basis to the class members that can show they purchased MFC shares on the dates and stock exchanges on which the two individual defendants sold their shares. I'm not sure what is gained by seeking a recovery that is already covered by the statutory and negligent misrepresentation claims against MFC. Speaking of MFC, I also note that the claim in unjust enrichment against MFC is not mentioned in the plaintiffs' proposed common issues.

40 *Garland v. Consumers' Gas Co.*, 2004 SCC 25, [2004] 1 S.C.R. 629 (S.C.C.) at para. 30; *Metzler Investment GmbH v. Gildan Activewear Inc.*, [2009] O.J. No. 5695 (Ont. S.C.J.) at paras. 14-39; *McKenna v. Gammon Gold Inc.*, 2010 ONSC 1591, [2010] O.J. No. 1057 (Ont. S.C.J.) at para. 69.

41 *Limitations Act*, 2002, S.O. 2002, c. 24, Sched. B, ss. 4 and 5.

42 See e.g. *Ivany v. Financiere Telco Inc.*, 2011 ONSC 2785, [2011] O.J. No. 4162 (Ont. S.C.J.) at paras. 29-33.

43 *Bywater v. Toronto Transit Commission*, [1998] O.J. No. 4913 (Ont. Gen. Div.) at para. 10.

44 *Cloud v. Canada (Attorney General)* (2004), 73 O.R. (3d) 401 (Ont. C.A.) at paras 52-53 and 75.

45 *McCann v. CP Ships Ltd.*, [2009] O.J. No. 5182 (Ont. S.C.J.) at para. 96.

46 *McKenna*, *supra*, note 40, at para. 125(h) and 126.

47 *Supra*, para. 23.

48 *NBD Bank, Canada v. Dofasco Inc.* (1999), 46 O.R. (3d) 514 (Ont. C.A.) at para. 81; *CC&L Dedicated Enterprise Fund (Trustee of) v. Fisherman*, [2001] O.J. No. 4620 (Ont. S.C.J.) at para. 65; *McKenna*, *supra*, note 40, at para. 151.

49 *Sharbern Holding*, *supra*, note 22 at para. 129.

50 *Supra*, note 48.

51 *Ramdath v. George Brown College of Applied Arts & Technology*, 2010 ONSC 2019, [2010] O.J. No. 1411 (Ont. S.C.J.) at para. 103.

52 I agree with Perell J. in *Millwright*, *supra*, note 34, at paras. 171-72 and Strathy J. in *McKenna*, *supra*, note 40, at paras. 159-60, that individual reliance remains an essential element of negligent misrepresentation. I respectfully disagree with Rady J. in *McCann*, *supra*, note 45, at para. 59 that the case law is in "a state of evolution" and that in certain circumstances the courts are prepared to "relax the otherwise strict requirement to establish individual reliance", and that in some cases of negligent misrepresentation, individual reliance may not be necessary. The law may have evolved to recognize that individual reliance can be inferred from the surrounding circumstances or even presumed from the surrounding facts, but no case has eliminated the need to show individual reliance. Quite the contrary: see *Sharbern Holding*, *supra*, note 22. Also see *Mouhteros v. DeVry Canada Inc.* (1998), 41 O.R. (3d) 63 (Ont. Gen. Div.) per Winkler J., as he then was, at para. 30: "Reliance is an essential element of the tort. The question of reliance must be determined based on the experience of each individual student."

53 I do not understand why the plaintiffs asked in Proposed Common Issue 6 whether individual reliance was required for negligence simpliciter. I assume they must be referring to the class members who were prospectus purchasers and who are suing MFC in negligence as well as negligent misrepresentation. However, reliance per se was not pleaded (and did not have to be pleaded) as an essential element this tort — only duty of care, breach, causation and damages.

End of Document

TAB 5

2003 CarswellOnt 3320
Ontario Superior Court of Justice

820823 Ontario Ltd. v. Kagan

2003 CarswellOnt 3320, [2003] O.J. No. 3425, [2003] O.T.C. 788, 125 A.C.W.S. (3d) 375

820823 ONTARIO LTD. and 96441 ONTARIO INC. (Plaintiff) and BRUCE KAGAN and MERRILL LYNCH CANADA INC. (Defendants)

Dambrot J.

Heard: April 14, 2003
Judgment: August 18, 2003
Docket: 01-CV-213776CM2

Counsel: Peter R. Greene, Kenneth A. Dekker for Plaintiffs
Edward Babin, Crawford Smith for Defendants

Subject: Evidence; Torts; Estates and Trusts

***Dambrot J.*:**

1 The plaintiffs bring this claim to recover stock market losses suffered by them allegedly as a result of the conduct of the defendants Merrill Lynch Canada Inc. and Bruce Kagan, an investment advisor employed by Merrill Lynch. The plaintiffs claim that their New Client Application Forms, which they executed when they became clients of the defendants, do not reflect their "true" investment objectives and experience, and that the securities subsequently held or purchased in their accounts with Merrill Lynch were unsuitable. The essence of the plaintiffs' claim is an allegation that Merrill Lynch and Mr. Kagan failed to act in accordance with the standard of care required of an investment advisor in the circumstances, and that such failure caused damage to the plaintiffs. The plaintiffs bring their claim in negligence, for breach of contract and for breach of fiduciary duty.

2 I propose to summarize only a part of the evidence at this time. The core of the plaintiffs' claim turns on what transpired between Mr. Lavergne, the principal of one of the plaintiffs, and the spouse of the principal of the second plaintiff at the relevant time, and Mr. Kagan, and to a small degree what transpired between Mr. Lavergne and Mr. Newton, who took over the plaintiffs' accounts when Mr. Kagan was promoted. I will outline the evidence of these three witnesses now, and make reference to other evidence only as necessary.

The Evidence of Brian Lavergne

3 Brian Lavergne is and at all material times was the sole officer and shareholder of the plaintiff 820823 Ontario Ltd. ("8"). Mr. Lavergne is a 45-year-old widower. He has a seven-year-old daughter. His wife Maureen passed away on June 1, 2000, leaving Mr. Lavergne to care for his then four-year-old daughter. Prior to her death, Maureen Lavergne was the sole officer and shareholder of the plaintiff 96441 Ontario Inc. ("9"). Mr. Lavergne inherited his wife's interest in the company in August 2000, and has been the sole officer and shareholder ever since.

4 Mr. Lavergne, operating through his company 8, has been in the business of building infill homes since 1988. Prior to that, he had been an employee of Sceptre Manufacturing for eleven years, rising to the position of maintenance coordinator, with ten employees reporting to him. He has a grade twelve education. He typically purchases residential properties, demolishes the existing homes, and builds new ones. On occasion, he contracts with the owner of an existing home to do the same. He has no employees, and engages sub-contractors to do the work.

5 Maureen Lavergne was a graduate of the Ontario College of Art. She also completed one year at York University. She worked for a year and a half doing administrative work in a family business, and ten years as an orthodontist's assistant. She left the work force when the Lavergne's daughter was born. Mrs. Lavergne had appeared to be in excellent health until 1998, when she learned that she had cystic fibrosis. She developed breathing problems and fatigue, but continued her daily routine until the fall of 1999. She spent considerable time in hospital in early 2000, and was severely restricted in her activities when she was at home. Mr. Lavergne was heavily burdened with responsibilities at home and at work throughout this period. He did go on a vacation to Belize for ten days in March or April.

6 Throughout the summer after the death of his wife, Mr. Lavergne only worked part time and devoted considerable time to the care of his daughter.

7 Prior to Feb 3, 1998, Mr. Lavergne had never invested directly in any particular stock. His only experience with the stock market was purchasing mutual funds. He first invested in a mutual fund in the early 1980s, which he purchased through an investment company. By early February 1998, his mutual funds had a value of between $50,000 and $60,000. He also owned some bonds and some term deposits. Maureen also had some mutual funds and term deposits at the time. Her mutual funds had a value of between $40,000 and $50,000.

8 In February 1998, Mr. Lavergne and his wife wanted to invest in a company called Royal Group Technologies, which was a competitor of his employer prior to 1988. As a result, he opened a cash account at Royal Bank Action Direct, a discount brokerage, in the name of 8. In 8's application form for this account, which was signed by Mr. Lavergne, the following information about Mr. Lavergne was recorded:

Investment Knowledge: Limited

Years Investing: 20

Approx. Present Portfolio Value: $500,000

Net Worth: $200,000 and over

Annual Income: $25,000 to $49,999

Investment Objective: Income

9 A similar document was prepared for 9 and signed by Mrs. Lavergne. The information about Mrs. Lavergne recorded on it was identical to the information for Mr. Lavergne, with the sole exception that her income was recorded as being $0 to $24,999.

10 Mr. Lavergne testified that from February 1998, to October 1999, he bought and sold shares in a number of Canadian and American companies. Some of his transactions involved significant dollar values. For example, on January 14, 1999, he bought 1000 shares of Amazon.com Inc. for $271,918.79. He sold these shares on January 26, 1999, losing about $115,000.

11 In late October 1999, Mr. Lavergne purchased 1700 shares of Xcelera.com Inc. (originally Scandinavia Co. Inc.) for $91,239 (U.S.). He had originally heard about this company on the Nightly Business Report on television in the spring of 1999. The company was in the hotel business, but had bought into an Internet business. On December 22, he purchased a further 1000 shares of Xcelera for $64,105 (U.S.) By the end of February 2000, his investment of $155,000 (U.S.) was worth close to $2,000,000 (U.S.).

12 In January 2000, Mr. Lavergne began actively trading in shares of USA Video Interactive Corp. At the end of February, his shares of this stock had a value of in excess of $500,000.

13 At that point in time, Mr. Lavergne testified, it was becoming apparent to him, given the growth in his account, that he needed some help with his investing. He said that he did not know a great deal about the companies he had invested in, and did not have the time to watch them. A friend of Mr. Lavergne's recommended that he meet Bruce Kagan, a Merrill Lynch broker that he was using. Mr. Lavergne first met Mr. Kagan in February 2000 at a restaurant. They were both attending a promotional function for a company that was marketing a new product. During dinner, Mr. Lavergne discussed his portfolio with Mr. Kagan. He told Mr. Kagan that it had a value of about three million dollars, and that it was invested almost entirely in two securities, Xcelera and USA Video, and that he was looking for help with his account. Mr. Kagan was unfamiliar with Xcelera, but told Mr. Lavergne that it was risky having that type of money in a discount brokerage house, especially in two stocks. His account needed to be managed properly.

14 Within a couple of days of this meeting, Mr. Lavergne called Mr. Kagan to make an appointment to see him. They met in Mr. Kagan's office on February 23 2000 in the late afternoon and discussed the opening of an account for 8 at Merrill Lynch. At Mr. Kagan's request, Mr. Lavergne brought his January Action Direct monthly account statements. Mr. Lavergne testified that Mr. Kagan did not ask about his past trading practices, when he first traded in the stock market, past stocks that he owned other than what was in the January statement, how much money he had made over the preceding two years, his present salary, whether he owned Canadian Savings Bonds, how much money he had in his bank account, how much money 8 had, whether he had any RRSP's, whether he had any pension benefits. He did ask what he did for a living, what his wife did for a living, whether he had children and what their ages were and what areas he had invested in.

15 Mr. Lavergne said that Mr. Kagan showed him some literature on the stock market and securities, and about different areas of the market. He showed him some charts showing the average gain per year in the market starting around 1991. Mr. Kagan did not make any specific recommendations about what Mr. Lavergne should be investing in, but he did speak generally about risk in relation to Mr. Lavergne's account. He told Mr. Lavergne that he needed to get more diversified across the market. Mr. Lavergne understood what Mr. Kagan meant by diversification.

16 According to Mr. Lavergne, Mr. Kagan mentioned mutual funds to him in a general sense, as one of the areas of the market. He did not discuss the idea of Mr. Lavergne investing in mutual funds or in "consults."

17 Mr. Kagan specifically asked Mr. Lavergne if he knew anything about a stock called Surefire. Mr. Kagan had mentioned it at the restaurant. Mr. Kagan said that it was a good company, and he liked it. Mr. Lavergne asked if Mr. Kagan would recommend it to him, and he said that he would. In fact, Mr. Lavergne testified that only once did he ever not accept Mr. Kagan's advice.

18 Mr. Lavergne said that Mr. Kagan did not discuss margin accounts with him. He didn't explain what a margin account was and did not ask Mr. Lavergne if he wanted one. Mr. Kagan did explain how a Merrill Lynch Asset Partnership Account works. If he opened such an account, Mr. Kagan told Mr. Lavergne that he would pay the broker one percent of the dollar value of his account monthly rather than a commission for each transaction. He also told Mr. Lavergne that he had to have a minimum of $100,000 in this account.

19 During this meeting, Mr. Lavergne decided to hire Mr. Kagan and open an account with him. He and Mr. Kagan completed a new account agreement for a Merrill Lynch Asset Partnership Account, and Mr. Lavergne signed it that day. Mr. Kagan filled out the form. According to Mr. Lavergne, Mr. Kagan did not discuss the items in the form as he filled it out. He did not discuss Mr. Lavergne's investment objectives with him. Mr. Lavergne did not say that he wanted 100% of his money invested in speculative securities. He did not say that his investment knowledge was sophisticated. He did not say that he had a three million dollar net worth; he said that his stock portfolio was worth approximately three million dollars. He did not say that he wanted a margin account opened.

20 After the form was completed, Mr. Kagan passed it to Mr. Lavergne. Mr. Lavergne looked at the top of the document, and briefly scanned it. He said that he did not read it.

21 At the time that he signed the document, Mr. Lavergne did not consider himself to be a sophisticated investor. When asked if he wanted to invest 100% in speculative positions, he said, "I was very open to investing whatever was put in front of me." When asked the question a second time in examination-in-chief, he said, "At this point when my account was moved over there my - was I willing to - that's not how I was - perceived this was going to be invested."

22 At the same time as he completed the New Account Application Form, Mr. Lavergne signed a Merrill Lynch Asset Partner Application. Mr. Kagan also filled out this form. He did not explain it to Mr. Lavergne. Mr. Lavergne signed it without reading it.

23 Mrs. Lavergne opened an account with Mr. Kagan a short time later. Mr. Lavergne recommended the move to her because of her health. Mrs. Lavergne did not meet with Mr. Kagan in his office because of her precarious medical condition. Instead, Mr. Lavergne went to Mr. Kagan's office and picked up blank account agreement forms from Mr. Kagan. Mr. Lavergne told Mr. Kagan that his wife had cystic fibrosis and had been in and out of the hospital, and that she wanted to move her account from Action Direct to someplace where it would be more looked after. Mrs. Lavergne signed the documents in blank on March 14, 2000.

24 In the next few paragraphs, I will outline some of Mr. Lavergne's investment history with M. Kagan. I do not propose to outline all of it, but some review of this nature is necessary to achieve an appreciation of the plaintiffs' claim.

25 On February 24, 2000, Mr. Lavergne gave instructions to Mr. Kagan to purchase 10,000 shares of Surefire Commerce, based on Mr. Kagan's recommendation. He deposited $130,000 into his account that same day to pay for the shares.

26 Between March 2 and March 7, 2000, the securities held in Mr. Lavergne's Action Direct account were transferred to his Merrill Lynch account. At the end of March, the value of Mr. Lavergne's Merrill Lynch account was $3,372,699.95.

27 During the month of March, on Mr. Kagan's recommendation, Mr. Lavergne sold all of his shares in USA Video, Dejour Mines and Royal Group Technologies, and purchased additional shares of Surefire, and shares in Vasogin, Interactive Telesis, Exodus Communications, EMC Corp. and American Express, all at Mr. Kagan's recommendation. According to Mr. Lavergne, on March 27 he asked Mr. Kagan if he should sell his shares in Xcelera. Mr. Kagan replied, "Absolutely not."

28 By the end of April, the value of Mr. Lavergne's account had fallen to $2,418,443.09.

29 By the end of May, the value of Mr. Lavergne's account had fallen to $1,484,974.74.

30 By the end of October, the value of Mr. Lavergne's account was $1,720,056.34. This amount included $620,000 in cash the Mr. Lavergne had acquired from the sale of a house and deposited into the account.

31 By end of December, the account has a value of $716,000, down from the original value of $3.4 million, and despite the deposit of $600,000. The principle cause of the decline in value was the precipitous drop in the share price of Xcelera.

32 Although half of Mr. Lavergne's portfolio remained in Xcelera at the end of April, and he was losing money, he did not speak to Mr. Kagan about his concerns. He testified that he was consumed with his wife's health at that time, and was not paying a lot of attention to his holdings.

33 In June, while in Mr. Kagan's office, Mr. Lavergne asked Mr. Kagan if it was time to get out of Xcelera. Mr. Kagan turned his computer screen to Mr. Lavergne and showed Mr. Lavergne his own account. Mr. Kagan said, "I own 80,000 shares. We're in this together. This is a good company. Exodus did not pay $650,000 to them for nothing. Just sit tight."

34 At the end of December, Mr. Lavergne went to Mexico with his daughter for three months. Before leaving, he told Mr. Kagan that, on the advice of his accountant, he needed to sell some stock at a loss to offset some gains he had made in 2000. Some stock was sold in December for this purpose.

35 In January 2001, Mr. Lavergne telephoned Mr. Kagan from Mexico. Mr. Kagan told him for the first time that he was taking a management position in Merrill Lynch, and that Michael Newton would be taking over his account.

36 A few days later, Mr. Lavergne called Mr. Newton for the first time. Mr. Lavergne testified that Mr. Newton told him that his account was a mess, that he was "all in one area", and that his way of investing and Mr. Kagan's way were different. He said that he was more of a family man, while Mr. Kagan was only concerned with his running, his car and his career. He was not as aggressive as Mr. Kagan, and would provide a diversified spread. He wanted Mr. Lavergne to buy some "boring" stock outside of the technology area. He promised to e-mail a list of stocks for Mr. Lavergne to look at. Mr. Lavergne also told Mr. Newton that he still needed to sell some stock at a loss for tax reasons, and provided him a dollar amount.

37 On February 7, 2001, Mr. Lavergne received an e-mail from Mr. Newton containing a number of investment recommendations. After reviewing the e-mail, Mr. Lavergne discussed these with Mr. Newton and accepted his advice.

38 Mr. Lavergne testified that on February 7, 2001, 11 shares of McData Corp. appeared in 9's account. He didn't know where these shares came from, and asked Mr. Newton about them. Mr. Newton said to him, "It's something I bought for you. We're kind of trading this around the office, and I thought maybe you'd like to have some."

39 Mr. Lavergne returned to Canada on March 28, 2001. In early April he met with Mr. Newton. Mr. Newton urged him to sell his stock and invest in managed money funds. He said that the reason was that the brokers didn't have time to do the research and trade in individual stocks any more. He provided Mr. Lavergne with a written portfolio and analysis and proposal. Mr. Lavergne viewed this as a complete change and was confused. He was upset about this change in advice, as well as his losses, what Mr. Newton had said about Mr. Kagan, the way his account had been transferred to M. Newton. He told Mr. Newton, "You know, somebody's got to be responsible for these losses." He said that Mr. Newton replied "Brian, there is nothing I can say. He is my boss." Mr. Lavergne asked for a letter outlining Mr. Newton's proposal for his investments.

40 Mr. Newton wrote a letter to Mr. Lavergne on May 1, 2001. In it, he noted that Mr. Lavergne had agreed with his proposal to use private portfolio managers to handle his equity investments, but resisted the move with the hope of making up previous losses by remaining in his previous investments. Mr. Newton reemphasized the importance of his proposal. In cross-examination, Mr. Lavergne denied resisting Mr. Newton's proposal. In any event, Mr. Lavergne telephoned Mr. Newton shortly after receiving the letter. He testified that he told Mr. Newton that he agreed with his strategies, but would like to see how the funds had performed in the last couple of months. Mr. Newton sent him this material in late June.

41 Mr. Newton did not follow up with Mr. Newton. He commenced this lawsuit on July 5, 2001. He subsequently moved his account to Scotia McLeod.

The Evidence of Bruce Kagan

42 I turn next to the evidence of Mr. Kagan. Bruce Kagan is 36 year of age, married and the father of thee children. During the period of time when Mr. Lavergne was Mr. Kagan's client, Mr. Kagan was a branch manager and vice president of Merrill Lynch.

43 Mr. Kagan testified that he first met Mr. Lavergne at Centro, a Toronto restaurant, at a presentation made by a bioethical company attempting to raise money from a group of investors. Both Mr. Lavergne and Mr. Kagan were invited to the presentation by a mutual friend, who wanted Mr. Kagan to assess the investment for him. He had told Mr.

Kagan that Mr. Lavergne had made a lot of money on a couple of tech stocks, one of which was Xcelera, in a discount trading account. Lavergne and Kagan met briefly at the end of the presentation. Kagan found it incredible that Lavergne had made so much money on the stock without selling a share. Lavergne told him that he had learned of the stock on the Nightly Business Report on PBS, did some research, and hit a home run. Mr. Kagan told Mr. Lavergne that he helped people with their business affairs, and that if he was thinking of diversifying, he should come in and chat. Lavergne asked him if there were other tech stocks he was interested in and Kagan replied that Surefire looked pretty good for a junior tech stock. He did not recommend that Mr. Lavergne buy it.

44 Mr. Lavergne subsequently called to set up a meeting with Mr. Kagan, which took place on February 23, 2000. During this meeting, Mr. Kagan discussed Mr. Lavergne's concentration in tech stocks, specifically Xcelera, and recommended that Mr. Lavergne diversify into different sectors. He discussed all of the different areas that he thought that Mr. Lavergne should be investing in, including mutual funds, specifically "consults", which are high end, diversified and professionally managed mutual funds. He suggested that Mr. Lavergne eliminate his position in Xcelera and USA Video, pay the tax, and invest in diversified stocks, preferably consults.

45 Mr. Lavergne was not excited by this proposal, which would not result in more than 10 to 12% returns. He described this as low, said that he was making substantially more, and wanted to continue to do so by owning stocks. He did not even want to diversify in terms of sectors. He was content to focus on tech stocks. In addition, Mr. Lavergne was concerned that because his cost base for his stock was so low, he would have to pay a huge capital gain if he sold, and reduce his net worth. He did not want to do this. Mr. Kagan did not endorse Mr. Lavergne's approach. He never changed his advice that Mr. Lavergne should diversify out of tech stocks.

46 In his first meeting with Mr. Lavergne, Mr. Kagan followed his standard practice with new clients. He had three working documents with him. The first was a personal profile, which was a standard form that directed him to particular questions to enable him to get to know his client, and on which he made notes. They discussed Mr. Lavergne's family, his income, his business, his trading, the source of his investment funds and his understanding of risk. Mr. Lavergne explained how he came to buy Xcelera, and the research he had done

47 The second document was a standard presentation booklet that he went through with Mr. Lavergne. The booklet was an educational tool that introduced Mr. Kagan's team and their services, discussed market perspectives, asset allocation, growth, investment value, selection and management, and portfolio review, and that also enabled Mr. Kagan to assess what his client knew about investing. Mr. Kagan and Mr. Lavergne spoke a great deal about market perspectives, and Mr. Kagan's philosophy of investing for the long run and being patient. They also discussed diversification and rates of return. Mr. Lavergne told Mr. Kagan that he was not looking for fixed income investments at this point; his objective was to grow his capital. He wanted to continue to concentrate in technology stocks.

48 The third document was the new account application form. Mr. Kagan reviewed this form with Mr. Lavergne and obtained his signature. In particular, he had no doubt that Mr. Lavergne understood the operation of a margin account. They discussed Mr. Lavergne's experience and objectives. Mr. Lavergne clearly understood that Mr. Lavergne's only interest was to grow his capital. It was clear that Mr. Lavergne was prepared to have 100% speculative investments in his portfolio. He knew the type of account he was opening, and he knew the risks.

49 I do not consider it useful to summarize Mr. Kagan's account of the many discussions he subsequently had with Mr. Lavergne, or for that matter the evidence concerning the setting up of Mrs. Lavergne's account. The discussions with Mr. Lavergne deal in large measure with the purchase and sale of various stocks, and are accordingly tedious and repetitive. It is sufficient to say that Mr. Kagan testified that he never changed his advice to Mr. Lavergne. He wanted Mr. Lavergne to sell his position in Xcelera and diversify. Mr. Lavergne did not accept this advice. In response to Mr. Kagan's advice to eliminate his position in Xcelera, Mr. Lavergne did sell some shares, but after doing so, he called Mr. Kagan regularly to ask if it was time to buy them back. Mr. Kagan wanted him to buy consults. When Mr. Lavergne resisted, Mr. Kagan recommended that he at least diversify into different sectors. Mr. Lavergne resisted this as well, although he did buy shares in a few companies that were not in the tech sector. For example, he bought some shares in

Amex on one occasion. He sold them soon after, however, against Mr. Kagan's advice, because Amex was "too slow." In the face of Mr. Lavergne's determination to remain in tech stocks, Mr. Kagan recommended that he at least purchase stock in some very large blue chip techs. Mr. Lavergne accepted this advice, but only to a small degree.

50 Mr. Kagan did testify that he did own shares of Xcelera from time to time, but that he never had 80,000 shares at one time, and never showed Mr. Lavergne a computer screen with his ownership of Xcelera on it.

51 Mr. Kagan acknowledged that after Mr. Lavergne's wife's death, and despite the fact that Mr. Lavergne's account had suffered some serious losses, he never changed the entries on the New Account Application forms, because Mr. Lavergne's level of knowledge never changed, and his objectives never deviated from 100% capital gains. He agreed that Mrs. Lavergne's account should have been updated, but was not.

The Evidence of Michael Newton

52 In December of 2001, it became known that Mr. Kagan was going to be promoted, and Mr. Newton would take over his book of business. Mr. Newton reviewed the account of each of Mr. Kagan's clients, and discussed them with Mr. Kagan. When he discussed Mr. Lavergne, Mr. Kagan explained how he had transferred in his holdings in Xcelera, which was his baby. Mr. Newton said that Mr. Lavergne looked like a good candidate for consults. Mr. Kagan told him, "Good luck. I tried."

53 Mr. Newton testified that he tried to contact Mr. Lavergne in January, when he actually took over Mr. Kagan's book, but was unable to reach him. Ultimately, Mr. Lavergne got in touch with him from Mexico. They discussed Mr. Lavergne's portfolio, and the need for diversification. Mr. Lavergne told him that he was not really focused on this, that they could discuss it when he returned, and asked why he would want to sell his stocks when they were this low. Mr. Newton denied saying that he was a less aggressive investor than Mr. Kagan, or otherwise denigrating him.

54 When Mr. Newton urged Mr. Lavergne to diversify, Mr. Lavergne asked him to e-mail some ideas, which he did. Mr. Lavergne took some of his advice.

55 Mr. Lavergne returned to Canada in April 2001, and soon after met with Mr. Newton. He told Mr. Newton that he was not happy, and that someone was going to have to be responsible for this, whether it was Merrill Lynch or Bruce Kagan. Mr. Newton said that whatever happened with others before him should be taken up with them. He said that he could not talk about it, but not because Mr. Kagan was his boss. Mr. Newton then discussed several consults with Mr. Lavergne. Mr. Lavergne said that it would take him a long time to get back to where he was with those kinds of rates, but did ask for data for the last couple of months. When Mr. Newton wrote to Mr. Lavergne, he got no response.

56 Mr. Newton was specifically asked about the eleven shares of McData that appeared in Mr. Lavergne's account. He explained that these shares were a dividend from a stock called EMC that Mr. Lavergne owned. This is consistent with the entry in Mr. Lavergne's account, which identifies these eleven shares as a stock dividend. Mr. Newton denied telling Mr. Lavergne that he had purchased the stock for him because people were passing it around the office.

Other Evidence

57 The plaintiff also led the evidence of Samuel Hirsch, Justin Vaz, and Anthony Davidson. Mr. Hirsch was another client of Mr. Kagan's, who also had brought a claim against him (the only other claim ever brought against Mr. Kagan). His testimony was led as similar fact evidence, but I found it to border on irrelevance. Mr. Vaz was a business associate of Mr. Lavergne who was called to corroborate a small piece of Mr. Lavergne's evidence. I found his evidence to be unhelpful. Mr. Davidson was called as an expert witness. I found his evidence to be most unimpressive. He was far too partisan to attract the court's confidence in his expertise. He was argumentative and arrogant. His opinions were conclusory. He had no notes or calculations to justify his conclusions. In the view I take of the case, however, as will be seen, it is unnecessary to say more about him.

Theory of the Plaintiffs' Case

58 The plaintiff's case concerns the loss of $3.8 million in stock brokerage accounts, primarily as a result of the precipitous decline in the value of Xcelera. Xcelera had been purchased by the plaintiffs in late 1999, toward the end of the so-called dot-com boom, for about $220,000. Over a short period of time, this $220,000 investment grew to $3.7million. After moving their accounts to the defendants, sadly, but not uncommonly at the time, the plaintiffs lost their spectacular gain. The plaintiffs argue that the defendants are responsible for this loss. They claim that Mr. Kagan, on behalf of Merrill Lynch, failed to meet the standard required of a broker, and was responsible for a breach of fiduciary relationship, breach of contract and negligence in the giving of advice to the plaintiffs, resulting in the loss. Specifically, first, his advice fell short of the standard required of him, and secondly, his conduct otherwise fell short of the mark.

59 The plaintiffs concede that there is a major credibility issue in this case affecting the first aspect of their claim. According to Mr. Lavergne, during the ten-month period that he dealt with Mr. Kagan, from late February 2000, to mid-January, 2001, he followed virtually every recommendation made by Mr. Kagan relating to the choice and amount of securities to be purchased. On the other hand, according to Mr. Kagan, Mr. Lavergne made every decision concerning his account, and generally refused to follow his advice. Instead, he insisted on an unsuitable investment strategy, keeping his entire account invested in high tech stock. The collapse of the high tech sector resulted in the collapse of the plaintiffs' accounts.

60 It is obvious that were I to accept the plaintiffs' version of the facts, their action would succeed. But the plaintiffs contend that even if I accept Mr. Kagan's version of events, they should succeed in their claim. Merrill Lynch and Mr. Kagan had regulatory obligations that created a duty on their part to stop Mr. Lavergne from a path of destruction, and to refuse to accept orders that they strongly recommended against. Mr. Kagan' failure to know his clients as required, to complete the new client forms accurately and update them appropriately, his failure to record in even one letter or memorandum that Mr. Lavergne was not following his recommendations, or to warn him in writing of the perils of not diversifying his account are breaches of his and Merrill Lynch's regulatory obligations and the standard of care required of them, entitling the plaintiffs to succeed in this action. Merrill Lynch is also liable, so the argument goes, for failing to adequately supervise Mr. Kagan.

My Analysis

61 I will state immediately that I prefer the evidence of Mr. Kagan and Mr. Newton to the evidence of Mr. Lavergne. It is most difficult in cases such as this one to discern the truth. The plaintiffs' claim for the most part is dependant on what transpired between Mr. Lavergne and Mr. Kagan. In order to come to a conclusion about these crucial events, I am forced to rely almost exclusively on the evidence of Mr. Lavergne and Mr. Kagan. There is some documentary evidence and a bit of oral evidence from Mr. Newton and Mr. Hirsch that is capable of providing assistance in this exercise, but not much. Mr. Lavergne and Mr. Kagan have given evidence, largely from memory, about events that took place several years ago. Neither of them had any reason, at the time, to think that they would ever have to recall these discussions in detail, or at all. Subsequent events have given each of them a reason to recall those events through a prism of self-interest. Nonetheless, I am required to do my best to find facts based on their evidence.

62 While I considered Mr. Kagan's evidence with a jaundiced eye, and a full appreciation of the motivation he might have to colour the events in his favour, I nonetheless have concluded that he has done his best to tell the truth, and that his recollections are, for the most part, not far off the mark. I reach this conclusion without any reliance on the notes that he made on his computer, the authenticity of which has been impugned. I am inclined to the view that his notes are authentic, and therefore draw no negative inference from them, but since I choose not to rely on them, I need not rehearse them or their frailties. As I say, for a variety of reasons, even without reference to the notes, I prefer his evidence to that of Mr. Lavergne.

63 I found Mr. Kagan to be an honest witness, who did his best to recall events as accurately as he could. He was thoughtful about his answers in cross-examination, he was prepared to admit that he did not recall a matter when it would have been easy for him to say that he did, and he was quick to admit shortcomings on his part that were not helpful to his case.

64 I found Mr. Lavergne, on the other hand, to be partisan, and contentious under cross-examination. It was apparent that he honestly felt wronged by the defendants, and believed, as he himself testified, that "somebody's got to be responsible for these losses," by which he meant somebody other than himself. His determination that the defendants had to bear responsibility for his losses led him to consistently recall events in a manner that favoured his position, even in the face of strong evidence to the contrary. The best, but far from the only example of this was his evidence about the eleven shares of McData Corp. that appeared in one of his accounts.

65 As I noted previously, Mr. Lavergne testified that on February 7, 2001, eleven shares of McData Corp. appeared in 9's account. He didn't know where these shares came from, and asked Mr. Newton about them. Mr. Newton said to him, "It's something I bought for you. We're kind of trading this around the office, and I thought maybe you'd like to have some." Mr. Newton, however, testified that the eleven shares of McData were a dividend from a stock called EMC that Mr. Lavergne owned. Mr. Newton denied telling Mr. Lavergne that he had purchased the stock for him because people were passing it around the office.

66 It is plain that Mr. Newton's account of this matter is correct. First, Mr. Newton had no authority to purchase stock for Mr. Lavergne without his instructions. More importantly, as I noted, the acquisition of these shares is identified in Mr. Lavergne's account as a stock dividend. It does not concern me that Mr. Lavergne misunderstood how his stock came to be in his account. It concerns me a great deal that, however, that when faced with the obvious truth that the shares were not purchased for him by Mr. Newton, rather than admitting an error on his part, he took the position that Mr. Newton had lied to him about their acquisition for some unfathomable reason. In his zeal to support his own case, he was prepared to put words in Mr. Newton's mouth that could never have been spoken. I am not prepared to say, even in these circumstances, that Mr. Lavergne was lying. I do say that his self-interest has so coloured his recollection of events as to make his evidence unreliable, and unquestionably less reliable than the evidence of Mr. Kagan and Mr. Newton.

67 Given that I view Mr. Kagan's evidence as reliable and Mr. Lavergne's evidence as not reliable, it is apparent that I accept the position of the defendants that Mr. Kagan consistently and from the beginning of their relationship advised Mr. Laverne to sell his shares in Xcelera and to diversify his holdings, preferably by buying consults, alternatively by balancing his account and buying stock in other sectors, or at the very by purchasing blue chip tech stocks. For the most part Mr. Lavergne ignored this advice, and pursued his own strategy of owning risky tech stocks for the purpose of making a lot of money quickly, and later, for the purpose of making up his losses quickly. He was the author of his own misfortune. The defendants did not provide him with bad advice, and cannot be liable to him for his losses on this basis.

68 The legal theory underlying the plaintiffs' second argument is more complex. With admirable skill, Mr. Greene took me through the regulatory obligations placed on brokers and brokerages in the investing of clients' money, and the standard of care that they owe their clients. Based on this excursion, I have no doubt that Mr. Kagan and Merrill Lynch did not comply with all of their duties and responsibilities in the handling of the plaintiffs' accounts. Accepting as I do Mr. Kagan's evidence, I cannot find that the plaintiffs have established all of the breaches that they allege. Whatever shortcomings there may be in the paperwork completed by Mr. Kagan, I do believe that he knew his client well. He knew his business, he knew his tolerance for risk, and he knew his investing objectives. He gave Mr. Lavergne the benefit of his sound advice, communicated the risks inherent in Mr. Lavergne's investment strategy to him, and in the end accepted Mr. Lavergne's instructions when he resisted that advice. The only question is whether liability attaches to the defendants for non-compliance with other duties and responsibilities, or for failing to save Mr. Lavergne from himself. In my view, it does not.

69 In reaching this conclusion, I begin with a finding that there was no fiduciary relationship between the plaintiffs and the defendants. The relationship of a client and broker is primarily one of principal and agent. The terms of the relationship are governed by the contract between them, In general, in exchange for the payment of fees or commissions, a broker is required to execute trades on behalf of the client in accordance with the client's instructions and within the parameters of the client's stated investment objectives, and to provide investment advice if requested. (See *875121 Ontario Ltd. v. Nesbitt Burns Inc.* (1999), 50 B.L.R. (2d) 137 (Ont. S.C.J.), at 155.) While a fiduciary relationship can arise between the broker and client, it will only do so where the client is vulnerable to the broker and does not make his or her own investment decisions. (See for example *Parks v. Midland Walwyn Capital Inc.*, [1998] O.J. No. 1038 (Ont. C.A.).) Here Mr. Lavergne was not vulnerable to the broker, and most emphatically made his own investment decisions. The relationship was not fiduciary.

70 The fact that the defendants did not have a fiduciary duty to the plaintiffs does not relieve them of their contractual obligations, or of their duty of care owed to the plaintiffs, a duty which sounds in negligence. Undoubtedly their duty of care is informed by the statutes, regulations, by-laws and internal manuals applicable to them. (See *Varcoe v. Sterling* (1992), 7 O.R. (3d) 204 (Ont. Gen. Div.), at 238-240.) In this case, however, there is no need to review the applicable obligations and identify the defendants' breaches. Causation is an essential component of any claim for breach of contract or negligence. To be recoverable, a loss must be caused by the contractual breach or the breach of duty in question. (See *Parks v. Midland Walwyn Capital Inc.* , *supra.*) The simple fact is that no breach of contract or duty of care in this case could conceivably have caused the plaintiffs' losses. Mr. Lavergne's determination to pursue a risky investment strategy in the face of strong advice to the contrary in the hopes of continuing to benefit from his initial amazing good fortune was the sole cause of his losses. He cannot now lay the blame for his own stubbornness and greed at the feet of his broker.

Conclusion

71 This claim is dismissed. The defendants may make submissions in writing about interest and costs within fifteen days of the release of this judgment, and the plaintiffs may make submissions within fifteen days of receipt of the defendants' submissions.

End of Document

THE CATALYST CAPITAL GROUP INC. et al.
Plaintiffs

-and-

VERITAS INVESTMENT RESEARCH CORPORATION et al.
Defendants

Court File No. CV-15-530726

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SUPERIOR COURT OF JUSTICE

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TORONTO

BOOK OF AUTHORITIES OF THE RESPONDING PARTY THE CATALYST CAPITAL GROUP INC. and CALLIDUS CAPITAL CORPORATION

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