C.A. No. 126716

NOVA SCOTIA COURT OF APPEAL

Chipman, Hart and Pugsley, JJ.A.

Cite as: Barrow v. 1874000 Nova Scotia Ltd., 1997 NSCA 66

BETWEEN:	)	
COLLINS BARROW	)	Steven Stieber and Michael J. Wood for the Appellant
Appellant	)	
- and -	)	
1874000 NOVA SCOTIA LIMITED and JOSEPH P. SHANNON	)	George W. MacDonald, Q.C. and Michelle C. Awad for the Respondents
Respondents	)	
	)	Appeal Heard: January 29, 1997
	)	Judgment Delivered: April 21, 1997

THE COURT: The appeal is allowed in part as per reasons for judgment of Chipman, J.A.; Hart and Pugsley, JJ.A., concurring.

CHIPMAN, J.A.:

This is an appeal from an assessment of damages flowing from the appellant's liability to the respondent in tort for negligently prepared financial statements upon which the respondent relied in deciding to purchase the shares of a business.

The appellant is a firm of chartered accountants. The respondent Shannon is a businessman living in Port Hawkesbury and the respondent numbered company is owned by him and was the vehicle used by him to acquire the shares of Action Business Machines Limited (ABM). I will use the name "Shannon" to refer to both or either of the respondents as the context requires.

ABM sold and serviced cash registers and point of sale equipment which includes a device used in many supermarkets and other businesses to scan the price code of an article. The company was incorporated in 1974 by Timothy Adams under the name Maritime Cash Register. It sold equipment and entered into maintenance contracts for such equipment. It required a large inventory of parts. As well, it carried out research into, and development of, market software packages for use in its machines.

ABM had done very well in the Atlantic Provinces but it fared poorly when it expanded its business into Ontario. By the late 1980's, it was experiencing severe cash flow problems.

Collins Barrow was engaged as auditor for ABM in 1987. It prepared audited statements for the years ending October 31, 1987 and 1988.

ABM's banker, Lloyds Bank, notified ABM that it must make other banking arrangements by the end of January, 1989, failing which the Bank was prepared to have a receiver appointed.

In late 1988 and early 1989, William Moore, a partner in Collins Barrow, made various unsuccessful attempts to secure new financing for ABM. On January 28, 1989, Moore approached Gordon Neal, a senior officer in Shannon's business organization in an effort to interest Shannon in the purchase of ABM. Shannon indicated to Neal that he was not interested and Neal relayed the information to Moore.

On January 30, 1989, Moore contacted Shannon directly and provided additional information about ABM. He faxed Shannon the 1988 audited year end financial statements of ABM, together with a business plan prepared by Collins Barrow. Moore expressed optimism for the future of ABM.

The pressure was on the parties to move quickly in view of the fact that Lloyd's Bank expected its outstanding loan of $947,000 to be paid by January 31,1989. Shannon knew this, and he also knew that ABM's venture in Ontario had been unsuccessful, resulting in large losses. In less than a week, Shannon concluded an agreement with Adams whereby Shannon's holding company would purchase the shares of ABM from Adams' holding company. In reaching his decision to buy, Shannon relied on the audited statements provided by ABM's auditor, Collins Barrow.

The closing took place on February 16, 1989. Prior to the closing, Shannon arranged to have Keith Eldridge carry out due diligence investigations. Eldridge was a registered industrial accountant. He was fully familiar with financial statements and auditor's reports. He reviewed ABM's financial statements and addressed his mind to whether the inventory that had been counted and audited on October 31, 1988, would be useful to Shannon. He was in contact with Shannon on a regular basis during his investigations. He prepared a checklist of items he reviewed as part of the due diligence process. Prior to closing the transaction, he was aware that the company was in some degree of financial difficulty and that about $80,000 was required for inventory purposes to complete various contracts.

Eldridge knew that there would be an expected cash shortfall of $250,000 or thereabouts which Shannon would have to make up shortly after he had acquired the company. However, the company had potential arising out of its customer list and the large amount of point of sale business it carried on in Atlantic Canada.

A lengthy meeting was held on February 15 and 16 between Adams' team and Shannon's team. Shannon kept in touch with his people. A provision was put into the purchase agreement that a physical count of inventory would be conducted on or about February 28, 1989 and October 31, 1990. The two counts would be compared and adjustment made to both saleable and serviceable inventory. This would have an impact upon the future payments of the purchase price to be made by Shannon during an earn out period provided for in the agreement.

The closing took place on February 16, 1989. Shannon acquired the shares of ABM for $700,000. Of this amount, $200,000 was paid on or before closing and the remaining $500,000 was to be paid out of future cash flow of ABM. No portion of the $500,000 has ever been paid.

In addition to the purchase price of the shares, Shannon was immediately obliged to make further payments so that the operation of ABM could continue. He paid out the Lloyd's Bank debt of approximately $947,000, and an overdraft of about $50,000, obtaining the funds by way of a loan for which he had to provide personal guarantees to the Bank of Nova Scotia and Roynat Limited, the institutions which had agreed to provide the financing. Shannon also provided an infusion of cash into ABM, obtained by way of a loan from the Bank of Nova Scotia.

Cash flow problems were experienced by Shannon and his team in the operation of ABM.

In Shannon's words the company "started to deteriorate" after he took it over. There were losses. On the plus side, Shannon and his team developed contacts with suppliers and customers. By October, 1989, he had put in far more money than he had planned. He said he could have considered cutting ABM off and "taking the hit and trying to recover from a financial point of view". While preparing the audit for the October 31, 1989 statements, Collins Barrow wanted to take a substantial write down in inventory. They also wanted to be paid before giving Shannon the financial statements. This concerned and irritated Shannon. By February of 1990 he consulted counsel with respect to Collins Barrow's work.

Collins Barrow continued as auditor for ABM and prepared the audited financial statements for the year ending October 31, 1989. These are dated January 23, 1990. Deloitte & Touche became the auditor for ABM for the year ending October 31, 1990. That firm was also retained to provide advice to Shannon about a potential claim against Collins Barrow. Deloitte & Touche wrote down inventory by $1,800,000 and determined that most of this should apply back to the October 31, 1987, audited financial statements. Deferred development costs which were also listed as an asset in those statements in the amount of $165,202 were also written off.

Rick MacCormick was dismissed by Shannon as General Manager in May of 1990. He was replaced by Brent Smith.

By the end of 1991 ABM, under Shannon's able management, had been turned around, and showed net earnings of $755,000. Loans made to ABM by Atlantic Corporation, Shannon's management company, will eventually be paid off, personal guarantees of Shannon and his company will not be called and the money borrowed by ABM from Roynat and the Bank of Nova Scotia which was guaranteed by Shannon is being repaid.

Shannon testified that the company is now profitable because it was capitalized and managed properly and the direction was changed. It does not operate as a single company but has been fragmented into three separate components, each of which is operated by a separate company. Gordon Neal attributes ABM's success to strategic decisions recognizing new markets, developing new products, taking risks, making investments, pumping in large amounts of time and energy. The introduction of the G.S.T. brought about new business opportunities. All of these things had been done by the Shannon organization and have brought about the turn around of the company.

Although Shannon was successful in turning ABM into a profitable operation under his new and restructured management, he claimed that as a result of his reliance on the audited statements of Collins Barrow, he suffered a loss because of their negligence in preparing the statements knowing that Shannon relied upon the information therein in deciding whether or not to purchase ABM.

Proceedings were brought by Shannon in the Supreme Court against Collins Barrow and Timothy Adams on January 10, 1992. They were continued against Collins Barrow only. The trial was held in Supreme Court for 12 days in October of 1995 and by decision dated January 31, 1996, the trial judge awarded the respondents:

Direct damages	$200,000
Consequential damages	$1,800,000
Damages for lost return on alternate investment of $2,000,000 at 10% per year for 7 years	$1,400,000
Prejudgment interest on $3,400,000 at 8% per year for 7 years	$1,904,000
Costs	$ 150,000
Total:	$5,454,000

Collins Barrow appeals to this Court claiming that the trial judge erred in a number of respects in arriving at his award of damages. Collins Barrow accepts the following findings of fact by the trial judge:

(a) The financial statements for the year ending October 31, 1988 were negligently prepared by Collins Barrow.

(b) Shannon relied upon the audited financial statements in making his decision to acquire the shares of ABM.

(c) Shannon would not have purchased the shares of ABM had he known the true state of affairs.

(d) It was reasonable for Shannon to rely upon the audited financial statements.

(e) Collins Barrow was aware that Shannon would be relying upon the audited financial statements.

Collins Barrow raises the following issues:

(1) Did the trial judge apply the correct test in assessing the direct damages?

(2) Did the respondents suffer any consequential loss and, if so, was it caused by the over valuation of the inventory of ABM?

(3) Were the respondents contributorily negligent?

(4) Did Shannon mitigate his damages with the result that Collins Barrow should get credit?

(5) Should the respondents be awarded prejudgment interest upon each of the three components of damages awarded, i.e. direct damages, consequential damages and return on lost investment opportunities for seven years?

1. CORRECT TEST IN ASSESSING DIRECT DAMAGES:

We must keep in mind the finding of the trial judge, stated by him more than once, that had Shannon known the true state of ABM's financial condition, he never would have bought the company.

As to "direct damages", the trial judge found that, "but for the misrepresentation by Collins Barrow, Shannon would never have entered into the contract which resulted in his damages". He therefore awarded, by way of direct damages, the amount of $200,000 which Shannon paid over to Adams at the closing.

The trial judge then addressed what he referred to as "consequential damages" suffered by Shannon as a result of the misstatement. He accepted the calculation by Deloitte & Touche as to the overstatement of the inventory and the deferred development costs. These totaled approximately $2,000,000. The trial judge then continued:

> Having approved those investigations and actions taken, I share Glen Williams' conclusion that while the exact amount of

> the misstatement at October 31, 1988 is not precisely determinable, it is perfectly reasonable to conclude that the financial statements were misstated by Collins Barrow and the amount of their misstatement was significant. On the witness stand he was prepared to say that it "approached $1.8 Million".
>
> The bases described by Williams in coming to that opinion were reasonable.

The trial judge then said that it would be impossible for Shannon to establish with precision the exact extent of his loss. Any measure of his damages is, he said, admittedly difficult. I agree fully with these observations. As Doherty, J.A. said in **Toronto Industrial Leaseholds Limited v. Posesorski et al.** (1994), 21 O.R. (3d) 1 (Ont. C.A.) at p. 21:

> The parties agreed at trial that had Mr. Solway told the clients about the option, they would not have purchased the property. Perfect restitution would therefore appear to require a notional undoing of the transaction some ten years after it was completed, coupled with an attempt to determine the net benefit or loss suffered by the clients as a result of entering into the transaction. Sometimes the evidence permits a relatively accurate reconstruction of events on the assumption that certain things would or would not have occurred had there been no breach (see, **e.g., Semelhago v. Paramadevan** (1994), 19 O.R. (3d) 479, 39 R.P.R. (2d) 215 (C.A.)). In this case, it is impossible to perform that reconstruction. There are too many variables, many of which were not addressed in the evidence, presumably because the parties were satisfied that an attempt to unravel the transaction and establish the clients' position on the assumption that the transaction had not occurred was so complicated as to defy performance.
>
> Absent the ability to make perfect restitution, a court, in assessing damages, must do the best it can . . .

The trial judge referred to the testimony of Brian E. Keough, whose report pegged Shannon's losses at between $1.6 and $1.8 million, excluding prejudgment interest and costs.

In addressing Shannon's loss, Mr. Keough adopted two approaches. The first was a measurement of his loss on the transaction date, February 16, 1989. By comparing the Collins Barrow financial statements with the adjusted statements prepared by Deloitte

& Touche he concluded that in the context of ABM as a going business, Shannon's loss was approximately $1.8 million. This, he said, was the amount that would have to be restored to ABM to put it (and therefore Shannon's investment) in the same financial position as it would have been, had no adjustments been required to the acquisition day balance sheet.

The second approach was on the assumption that it was unlikely that Shannon could have recognized the extent of the difficulties with ABM's balance sheet at the transaction date. Therefore the same valuation analysis should be made at the first fiscal year end subsequent to the purchase. Based on a liquidation value at October 31, 1989, Keough determined Shannon's loss on the footing that he then decided to cut his losses and wind up the company. Viewed in the context of liquidation, Keough concluded that Shannon's losses would have been in the range of $1.6 to $1.8 million had he wound up ABM on October 31, 1989.

The trial judge did not adopt the second approach. He said:

> I am also satisfied that he did not become aware of the company's real financial situation until several months had elapsed. By that time he had undertaken significant personal obligations and had used substantial additional funds at considerable risk. Consequently he cannot be placed in his original position merely by returning the purchase price.

The trial judge concluded that the first approach was to be preferred, as it looked at the company as a going concern on the transaction date rather than assuming liquidation at a future date. Shannon did not, in fact, liquidate. The trial judge referred to the effort and money Shannon put into ABM. By October of 1989 he had injected $800,000 from his own company, Atlantic Corporation Limited, into ABM. He had made commitments to people. He had made contacts with key suppliers and customers of ABM. His reputation was exceedingly important to him, not only in terms of self-respect, but in his ability to raise funds. Over the years he had diversified in business and at first bankers were reluctant to support him when he entered a new field. However, they had acquired such confidence in him and in his management teams that he was able to obtain financing for new ventures. He simply could not walk away. He did not walk away, and after much effort he managed to turn ABM around. As at the end of 1991 the company showed net earnings of $755,000.

The trial judge concluded:

> Having found that the calculations determined by Deloitte & Touche in its adjusted balance sheet were accurate, and that the decisions taken by ABM's management in allocating those adjustments to 1990, 1989 and 1988 were appropriate, and after applying the evidence of both Williams and Keough, I find that the fairest and most accurate measure of the consequential damages suffered by the Plaintiff as a result of the Defendant's negligence is $1.8 Million. This takes into account all of the liabilities he was forced to incur in order to maintain the company's operations, the risks to his reputation, and the equity and time and energy devoted by him and the senior executives to maintain the company's existence.

The award of direct damages was $200,000 and that of consequential damages $1,800,000, for a total of $2,000,000.

Collins Barrow says that the trial judge's approach was erroneous. It was an approach designed to put Shannon in the position in which he would be had the financial statements correctly stated ABM's financial condition - the test for measuring damages for breach of a contractual warranty. The test to be applied for damages in tort is the amount of the overpayment, that is, the difference between the price paid and the market value of the shares at the time of the purchase.

G. H. Treitel, **The Law of Contract**, Ninth Edition, states the position:

> Liability for misrepresentation may arise in tort (where the representation is made fraudulently or negligently) or in contract (where the representation has contractual force). This distinction affects the assessment of damages in the most common case of misrepresentation: namely, where a seller represents that the subject-matter of a contract has a quality which in fact it lacks. The general principle is that in tort the plaintiff is entitled to such damages as will put him into the position in which he would have been if the tort had not been committed; while in contract he is entitled to be put into the position in which he would have been if the contract had been

> performed. It is thought to follow that in tort the plaintiff is entitled to be put into the position in which he would have been if the representation *had not been made,* while in contract he is entitled to be put into the position in which he would have been if the representation *had been true*. If the representation induces the plaintiff to buy something which, but for the misrepresentation, he would not have bought at all, it follows that the damages in tort are prima facie the amount by which the actual value of the thing bought is less than *the price* paid for it. In contract, on the other hand, the damages are prima facie the amount by which the actual value of the thing bought is less than *the value which it would have had if the representation had been true*.

Fleming on Torts, 8th Edition, concisely states at p. 649 the difference between damages in tort for negligent misrepresentation and damages in contract for breach of warranty:

> As in the case of deceit, damages for negligent misrepresentation are restricted to reliance losses and do not include expectation losses (loss of bargain) as could a claim for breach of warranty.

Specifically, Collins Barrow says that the approach taken by Keough was to arrive at the amount that would have to be restored to ABM to put it in the position it would have been had no adjustments been required to the acquisition day balance sheet.

Collins Barrow submits that the proper method of calculating the damages is the purchase price less the market value of the company at the date of acquisition. It says that Shannon failed to introduce evidence as to the value of the shares or the market value of the company at the time of the purchase.

I agree with Collins Barrow that the trial judge has measured the loss on the footing that Shannon should be put in the position he would be had the financial statements of ABM been correct. This, being the test for measuring damages for breach of a contractual warranty, is not the correct test.

The principle applicable to the award of damages here is clear. As the trial judge said, it is the application of it that is difficult.

The trial judge found that Shannon never would have purchased ABM had he known the true financial condition of the company. The exercise therefore is to fix the damages so as to put Shannon as far as possible in the position he would have been had he not invested in ABM. In particular, the damages are prima facie the amount by which the actual value of ABM was less than what Shannon paid for it.

In **Esso Petroleum Co. Ltd. v. Marden** (1976), 1 Q.B. 801, Denning M.R. in the Court of Appeal of England dealt with the assessment of damages by a businessman who, on the basis of negligent misrepresentations respecting potential volume of petroleum sales, purchased a service station business. At p. 820, he said:

> Mr. Mardon is not to be compensated here for "loss of a bargain." He was given no bargain that the throughput **would** amount to 200,000 gallons a year. He is only to be compensated for having been induced to enter into a contract which turned out to be disastrous for him. Whether it be called breach of warranty or negligent misrepresentation, its effect was **not** to warrant the throughput, but only to induce him to enter the contract. So the damages in either case are to be measured by the loss he suffered. Just as in **Doyle v. Olby (Ironmongers) Ltd.** [1969] 2 Q.B. 158, 167 he can say: ". . . I would not have entered into this contract at all but for your representation. Owing to it, I have lost all the capital I put into it. I also incurred a large overdraft. I have spent four years of my life in wasted endeavour without reward: and it will take me some time to re-establish myself."
>
> For all such loss he is entitled to recover damages. It is to be measured in a similar way as the loss due to a personal injury. You should look into the future so as to forecast what would have been likely to happen if he had never entered into this contract: and contrast it with his position as it is now as a result of entering into it. The future is necessarily problematical and can only be a rough-and-ready estimate. But it must be done in assessing the loss.

It was only in the fall of 1989 that Shannon began to become aware of the extent of the difficulties with ABM and the role played by the financial statements in drawing him into this unwanted bargain. It was at this time or soon thereafter that his losses became measurable, and he could have cut them and left. He did not choose to do so. Keeping in mind, however, what Denning M.R. said in **Marden, supra**, the best way to assess Shannon's direct loss is to ascertain how much he was out of pocket if he had cut his losses and walked away in late 1989. He had a duty to mitigate, to prevent the snowball from rolling further down hill. See **Haida Inn Partnership v. Touche Ross and Company** (1989), 64 D.L.R. (4th) 305 (B.C.S.C.) at pp. 310-311, 314-316.

Mr. Keough's second approach therefore offers a better basis on which to assess the loss. He assessed it at a figure of between $1,600,000 and $1,800,000 by calculating what Shannon had put into the business, plus the cost of liquidation, less what would have been salvaged on liquidation. He produced Table 7 to this report:

LOSS OF INVESTMENT IF ABM WOUND UP ON OCTOBER 31, 1989
(Using Figures from Table 6)

	Net Book Value	**Liquidation Value**	
		Low	**High**
Assets:			
Accounts receivable trade	$ 502,636	$ 402,100	$ 452,400
Accounts receivable re: future period maintenance agreements	393,000		
Inventory	521,302	173,800	260,700
Prepaids	11,802	5,900	8,900
Goodwill and investment	1		
Receivable from associated companies	548,814	548,800	548,800
Deferred development costs	70		
Equipment and leaseholds	106,381	53,200	79,800
	2,084,006	1,183,800	1,350,600
Less Payout to Secured Creditors:			
Bank indebtedness	1,046,267	1,046,300	1,046,300
Prime +1% note payable to ICL	106,875	106,900	106,900
15.2% debenture payable to Roynat	734,000	734,000	734,000
Wind up costs	100,000	100,000	100,000
	1,987,142	1,987,200	1,987,200
Residual (Shortfall) to secured creditors, guaranteed by Shannon	**96,864**	**(803,400)**	**(636,600)**
Add: Other non-recoverable investment by Shannon:			

Note payable to Atlantic Corporation	793,934	793,900	793,900
Original purchase price of shares		190,000	190,000
Loss of Investment, if ABM Liquidated at October 31, 1989		$(1,787,300)	$(1,620,500)
	Say	**$(1,800,000)**	**$(1,600,000)**

It will be seen that Keough has allowed a substantial amount for wind up costs. He has calculated Shannon's contribution to the business as of October 31, 1989, at $2,681,100, and he has allowed all but $10,000 of the purchase price of $200,000. By this time, Shannon was clearly aware that there were serious problems with the business and he should have, as he did, consider "pulling the plug".

Keough's second calculation and the evidence on which it is based furnishes a basis for assessment of damages by the application of tort principles. Within reasonable limits, it establishes how much Shannon paid to acquire the business on the one hand and how much it was really worth on the other. The difference is the loss of investment had ABM been liquidated on October 31, 1989. Although this approach is not perfect, I am prepared to accept it as establishing on a balance of probabilities the loss sustained as a result of the misrepresentations which led Shannon to purchase ABM. It was impossible to undo the bargain and this liquidation approach comes closest to measuring the loss.

At this point, I would observe that counsel for the respondent put the position succinctly in his factum when he said:

> Further, and perhaps more simply, a comparison of the price which Shannon paid for ABM and the company's actual negative value results in an award similar to that given by the learned trial judge.

The burden is on Shannon to establish his loss. In view of the fact that Keough is only able to provide a range with a $200,000 spread, it is reasonable to peg that loss in the middle of a range and arrive at a figure of $1,700,000 to which should be added the balance of the purchase price of $10,000, making an award of $1,710,000 for direct damages. I would propose this figure in lieu of the amounts of $200,000 and $1,800,000 respectively fixed by the trial judge.

The trial judge said that his assessment of $1,800,000 took into account what he referred to as all of the liabilities the respondent was forced to incur in order to maintain the company's operations, the risks to his reputation and the equity, time and energy devoted by him and his senior executives to maintain the company's existence. On the approach I have taken, the award of $1,710,000 does not. It is true that as it turned out, these efforts on the part of Shannon were not lost. Having done all these things, he had a company that soon became a money maker for him. This has to be addressed as well under the heading of mitigation of damages. Nevertheless, consideration must be given to what, if anything, should be awarded for the additional time, risk and expenditure incurred by Shannon as a result of the negligence of Collins Barrow. I will deal with this in connection with consequential loss.

2. <u>CONSEQUENTIAL LOSS</u>:

This issue deals with the trial judge's award of $1,400,000 representing lost return on alternative investment of $2,000,000 at 10% per annum for seven years.

The trial judge recited Shannon's claim that had he not purchased ABM, he would have invested his capital, used available credit and applied his business skills and resources in other profitable ventures. Given his successful track record, it was urged that Shannon would have earned a reasonable return on such other ventures.

Consequential damages may be awarded to a plaintiff who has relied upon the defendant's negligent misrepresentation. I repeat and expand upon **Fleming, supra**, at p. 649:

> As in the case of deceit, damages for negligent misrepresentation are restricted to reliance losses and do not

> include expectation losses (loss of bargain) as could a claim for breach of warranty. Thus a plaintiff who had been misled into buying an insurance in the belief that it contained a certain cover in the event of injury, recovered nothing because the policy he purchased was worth (even without that cover) what he paid for it. The court allowed, however, that he would have prevailed if he could have proved that he forwent an opportunity to purchase elsewhere a policy containing the extra cover. Similarly, when a mistaken certificate from a local authority led a prospective purchaser to believe that the land was zoned for subdivision, his damages were assessed on the basis of its lesser value (plus conveyancing costs) but not including profits from any subdivision. <u>These would have been recoverable only on proof that he lost an opportunity of buying another property which would have earned profits</u>. While the possibility of recovering opportunity costs moves the tort measure closer to the expectancy measure of contracts, it is not identical with it. In case of a promise by a seller that the property yielded a certain return, the promisee's recovery (in contract) will be measured by the expected gains, whereas in tort for misrepresentation it would by the (usually lesser) return of an alternative investment.

(emphasis added)

In testifying, Shannon described his approach to business acquisition. He said that he looks for a 20% return on his investment. When he analyzed the financial information he had received from Collins Barrow and prepared his own calculations, Shannon was satisfied that ABM would give him this type of a return.

In addressing what would have been likely to happen had Shannon not purchased ABM, the trial judge accepted Shannon's proposition that he looked for a 20% return on his investment in purchasing a business. Keeping in mind what Denning M.R. said in **Marden, supra**, the trial judge said that looking into the future from February 1, 1989 onward was "necessarily problematical" and could only be done by a rough-and-ready estimate. He thought a contingency factor should be applied to reduce Shannon's expectation in as much as in acquiring ABM he was entering into a new field of business about which he knew little. The trial judge continued:

> The best consideration I can give to the evidence suggests that a 15 percent per year return would be a reasonable yield on the Plaintiff's investment. There should also be a discount in

> that the Plaintiff will be entitled to prejudgment interest. It would be, in effect, double compensation to award Shannon the full amount of his lost investment opportunity plus prejudgment interest. In the result I make a further reduction of five percent thus leaving the Plaintiff a ten percent per year return on his investment.

Shannon did not establish that he lost an opportunity to buy another profitable business venture because of the purchase of ABM. True, such damages are "necessarily problematical" and involve, as the trial judge said, a rough-and-ready estimate. However, it is not realistic to award damages for lost opportunity absent any evidence showing that because of the purchase of ABM and the time spent in turning it around, Shannon was disabled from entering into other more profitable acquisitions. There was no evidence of any acquisition available which he would otherwise have considered but for the purchase of ABM. There was no evidence that the effort spent in dealing with ABM deprived him of financial or other resources which would enable him to seize an opportunity. The discovery evidence of Shannon tendered on behalf of Collins Barrow at the trial sheds considerable light on this:

> Q. So, really, when we're talking about the non-financial burden on Joe Shannon and his companies, what we're talking about is primarily the devotion of people time to sort out the problems at ABM?
>
> A. Well, it was a sacrifice to our group of companies. It was - -
>
> Q. I'm not saying it isn't.
>
> A. It was a freebie for ABM but it was certainly, in our group of companies and me, you know, at the end and on the bottom of the pile, it was a - - it was more of an investment for me because while those people were committing their time to this exercise in trying to get this thing sorted out, I mean, we weren't doing something else. We were losing opportunities, you know, of doing something else.
>
> Q. Were there any specific opportunities that you were losing that you can think of, or is it just generally the fact that they were spending their time at ABM that, almost by definition, there were opportunities out there - -

A. Yes.

Q. - - that you were missing?

A. Yes, of course.

Q. So it's not a specific? You're not saying here was a specific thing we wanted to do that we couldn't do? Are you?

A. Again, I can't give you a time and a date but there would have been investment decisions that would have been postponed in our companies as a result of this exercise.

Q. When you say "investment decisions", you mean new businesses that you would have - -

A. Well, either new business or expansions, you know, because we were very deeply, heavily committed to this company and trying to get it sorted out as a result of the - - of the - - of what we discovered.

Q. Are you in a position to quantify at all those lost opportunities that you say you weren't able to pursue?

A. As I just told you, I said I can't give you a time and a date on it, but there was, you know, I mean, if you look at the history of our companies, they, you know, were always on the acquisition - - looking for acquisitions, and if we hadn't spent four gruelling years or five years, whatever in the hell it was, on this thing, we would have been doing other things. And there is - - but I can't give you a specific company or an opportunity. No, I can't give you that.

Q. But do you have in your mind a value, an amount that you - -

A. No.

Q. - - that you missed out on?

A. No, sir, I can't give you that.

Q. Is there anyone else that could give us - -

A. No.

Q. - - that?

A. No.

These extracts from the discovery examination were tendered at the conclusion of the defendant's case.

Shannon's counsel urged the trial judge to disregard this evidence. He referred to the so-called rule in **Browne v. Dunn**, [1893] R. 67 and Sopinka, Lederman and Byrant, **The Law of Evidence in Canada** (Butterworths: Toronto (1992) at pp. 876-7). He urged that it would be unfair to discredit the plaintiff by the answers he gave at discovery. The trial judge said:

> I agree . . . Shannon was not confronted with this discovery evidence. "The apparent contradiction" went unchallenged and unexplained. If the defendant intended to impeach the plaintiff by virtue of this "apparent" contradiction, Shannon ought to have been given the opportunity, of testifying, of making any explanation which was open to him. Not having been given that opportunity, it is unfair to ask me to disbelieve what the plaintiff said under oath at trial. I therefore accept his evidence that he planned to achieve a 20% yield on his investment annually.

I do not consider that the discovery evidence was a contradiction of any evidence given by Shannon. Shannon stated his objective of making acquisitions and getting returns of 20%. The discovery evidence simply establishes that he was unable to point to any specific company or opportunity that he lost.

I do not take the view that the discovery evidence was only to impeach or discredit Shannon in any event. Collins Barrow had a right to tender this discovery evidence at the trial without first having put it to Shannon on cross-examination. **Civil Procedure Rule** 18.14(1) is clear:

> 18.14 (1) At a trial or upon a hearing of an application, any part or all of a deposition, so far as admissible under the rules of evidence, may be used against any party who was present or represented at an examination for discovery, or who received due notice thereof, for any of the following purposes,
>
> > (a) to contradict or impeach the testimony of the deponent as a witness;
> >
> > (b) <u>where the deponent was a party</u>, or an officer, director or manager of a party that is a corporation, partnership or association, <u>for any purpose by an adverse party</u>;

. . .

(emphasis added)

Collins Barrow tendered this discovery pursuant to Rule 18.14(1)(b). Indeed, at the time counsel tendered it, he stated that he had added certain portions of Shannon's discovery at the request of Shannon's counsel, presumably in response to Rule 18.14(2):

> 18.14 (2) If only part of a deposition is offered in evidence by a party, an adverse party may require the introduction of any other part which is relevant to the part introduced, and the other party may introduce any further part.

The failure to put this discovery evidence to Shannon on cross-examination may well be criticized from a tactical point of view. At the very least, such failure would clearly give Shannon's counsel an opportunity to deal with the subject on rebuttal. He did not do so.

I am satisfied that the trial judge erred in not giving effect to this discovery evidence which confirms that however ambitious Mr. Shannon may have been and however willing he was to take advantage of any and all opportunities, he was unable to show that any specific opportunity was lost as a result of the purchase of ABM.

The case is clearly distinguishable from **V. K. Mason Construction Limited v. Bank of Nova Scotia**, [1985] 1 S.C.R. 271 on which the respondent relied. There, on the facts of that case, the court was prepared to assume that a contractor induced by the defendant's negligence to enter into a contract which turned out to be unprofitable would, but for such negligent inducement, have found a profitable means of otherwise employing itself. That case is fact specific in that in its judgment the Supreme Court of Canada referred to a finding of the trial judge that but for the misrepresentation, the plaintiff would have ceased work on the project, recovered its expenses for work already done and found another construction project to work on. See [1985], 1 S.C.R. pp. 279-280, 285. Here the evidence fails to disclose anything to support the conclusion that Shannon, would, but for this particular investment, have made other profitable investments.

Applying the test laid down by **Fleming**, Shannon has not shown that as a result of buying ABM he "forwent an opportunity to purchase elsewhere" a lucrative business.

Another concern with the trial judge's award is that it compensates for supposed loss of opportunities over a seven year period. Shannon himself spoke of "four gruelling years or five years, whatever the hell it was". Within two years, Shannon was making money with ABM. There is no evidence that if any opportunity was lost, that it was lost over such a long period of time as seven years. I am satisfied that this award must be disallowed.

The question remains what if any general damages should be awarded to Shannon for extra wasted effort which would not have been wasted had ABM not been acquired. Bearing in mind that it is necessarily problematical and can only be a "rough-and-ready" estimate it still must, as Denning M.R. has said, be made in assessing the loss. In the case of **Marden, supra**, the court awarded damages for capital loss representing cash put into the business and overdraft incurred in running the business. Loss of earnings were to be discussed and further argument was called for. We are thus unable to find any guidance there as to what might have been awarded in that case in making the rough-and-ready estimate.

Because I have concluded that it would have been reasonable for Shannon to cut his losses in the fall of 1989, the amount to be awarded should reflect compensation for wasted efforts prior to that time only.

I am prepared to accept the challenge thrown out by Lord Denning of making an estimate "in a similar way as the loss due to a personal injury". The trial judge found that Shannon was forced to incur greater liabilities than he anticipated in order to maintain the company. His reputation was at risk. He devoted more time and energy, both of himself and his senior executives, to maintain the company's existence than would have been the case had he not purchased it. The trial judge said:

> Fortunately, the banks "kept the faith" and although Shannon said he "spit a lot of blood", he managed to turn ABM around, part of that was undoubtedly due to the efforts of Brent Smith.
>
> Fortunately, the agonies had a happy outcome, but nevertheless they are not to be ignored. There was not only effort and exertion, but money tied up for varying periods of time for which I have not yet accounted. It is extremely difficult to estimate. Giving the matter the best consideration I can, an award of $50,000 general damages for disruption and inconvenience would be appropriate.

3. **<u>CONTRIBUTORY NEGLIGENCE</u>**:

Collins Barrow submits that contributory negligence and apportionment may be utilized in negligent misrepresentation cases and cites various authorities for this proposition. It submits that there is a distinction between reasonable reliance as a necessary prerequisite to a finding of liability and reliance in the context of contributory negligence as a factor going to the extent of damages suffered. It is said that reliance that was unreasonable simply goes to reducing damages recoverable by a plaintiff. It does not go to cancelling the **prima facie** liability of the defendant.

Collins Barrow submits here that the reliance was unreasonable because, "the plaintiff himself was a person who had some degree of expert knowledge or perhaps knows as much as the defendant". Collins Barrow submits that Eldridge, a qualified accountant, was the person primarily responsible for the due diligence investigation of ABM on behalf of Shannon. It is submitted that he was negligent in failing to discover the inventory overstatement and consequently the respondents own conduct contributed to any losses suffered. It is said that if Eldridge did not possess the requisite skill to carry out a due diligence investigation, it was in Shannon's economic interest to retain someone who did.

Collins Barrow also submits that the respondents were, in fact, aware of circumstances that should have alerted them to the economic risks of a transaction. Shannon's people knew that ABM was in some degree of difficulty in view of the requirement of Lloyd's Bank that it be paid out by the end of January and in view of their knowledge that some $80,000 in inventory purchases were required in order to complete contracts, that the serviceable equipment had no value and that the amount of inventory write-down on a monthly basis was not adequate and that there would be a cash shortfall of $250,000 to be made up in the immediate future. It submits that the trial judge erred in failing to find that Shannon was contributorily negligent in these respects.

The trial judge addressed the issue of contributory negligence. He found:

> Eldridge impressed me as being astute, reliable, assiduous and fair. I accept all of his evidence. I am satisfied that every step taken by Eldridge and his people was thorough and appropriate and his due diligence investigation was in no way deficient.

This is a very strong finding. It must be remembered that in testing the conduct of Collins Barrow and that of Eldridge respectively, the former had great advantages in determining what was the true picture of ABM. It was engaged by ABM and had the necessary opportunity it required to satisfy itself of the financial condition before certifying the statements. On the other hand, Eldridge's team had only a matter of days in which to carry out the due diligence. In my opinion, Collins Barrow has failed to show the trial judge made any palpable or overriding error in his finding which I have set out, and in the following finding:

> While theoretically intriguing, I find the defendant's submission to be circular and impractical, when applied to the circumstances of this case. One cannot assess contributory negligence in a vacuum. The defendant has failed to demonstrate any negligence on the part of the plaintiff which might be seen to be contributory. If the defendant Collins Barrow failed to recognize their own negligence and breach of professional conduct in the years they served as auditors, how could the plaintiff be expected to detect such negligence in its two weeks work of diligence investigations? . . .

I would reject Collins Barrow's submissions on the issue of contributory negligence.

4. MITIGATION:

In the course of the argument, counsel for Collins Barrow referred to the finding that Shannon would not have purchased ABM had he known the true picture. The argument was that since he did not cut his losses, but continued his effort to save the business, he had embarked upon a program of mitigation. That program was successful. Collins Barrow therefore claims to have the benefits of the successful set off against the loss sustained by Shannon.

With respect to mitigation of damages, **McGregor on Damages**, Fifteenth Edition, refers to, in Ch. 7, para 273, et. seq. to three rules concerning avoiding the consequences of a wrong:

(a) The plaintiff must take all reasonable steps to mitigate the loss to him resulting from the defendant's wrong and cannot recover for loss that could have been avoided by taking such steps.

(b) A corollary of the first rule is that where a plaintiff does take reasonable steps to mitigate the loss, he can recover for loss sustained in so doing.

(c) Where a plaintiff does take steps to mitigate the loss, the defendant is entitled to the benefit accruing from such action and is liable only for the loss as lessened.

In addressing Collins Barrow's argument on mitigation, we are concerned with the application of the third rule.

McGregor, supra, at para 325 said:

> . . . But the plaintiff may have gone further and by sound action have avoided more consequences than the dictates of the law required of him. In such circumstances the position has been definitively stated by Viscount Haldane L.C. in the leading case

> of **British Westinghouse Co. v. Underground Ry**, [1912] A.C. 673. He put the rule thus: "When in the course of his business he [the plaintiff] has taken action arising out of the transaction, which action has diminished his loss, the effect in actual diminution of the loss he has suffered may be taken into account even though there was no duty on him to act." Later in his speech he said similarly: "Provided the course taken to protect himself by the plaintiff in such an action was one which a reasonable and prudent person might in the ordinary conduct of business properly have taken, and in fact did take whether bound to or not, a jury or an arbitrator may properly look at the whole of the facts and ascertain the result in estimating the quantum of damage." He emphasised however that "the subsequent transaction, if to be taken into account, must be one arising out of the consequences of the breach and in the ordinary course of business," and the important practical question is therefore what steps taken by the plaintiff satisfy this definition.

As McGregor points out, **British Westinghouse, supra**, was a case of breach of contract. He states that a wider formulation, which more readily includes tort, is that a subsequent event "completely collateral and merely **res inter alios acta**" cannot be used in mitigation of damage. He continues (para 326):

> . . . This has the great merit of stating the rule at once concisely and completely: but it gives no indication of how the rule operates and of what solutions would be reached when applying it to particular circumstances. Indeed the line between those avoided consequences which are collateral and those which are not is an exceedingly difficult one to draw. It is thought that, in considering the relevant decided cases which are widely dispersed over many fields, Viscount Haldane's formulation is of value, and that assistance is also derived from a division into actions taken before breach and actions taken after breach, and from a subdivision of the latter group into actions taken by third parties and actions taken by the plaintiff.

The author states, referring to **The World Beauty** (1970), P. 144 that the onus is on the defendant to prove that the steps taken by the plaintiff were not completely collateral to the wrong, and the extent to which the loss has thereby been avoided.

In that case, a ship was damaged. In assessing damages against the wrongdoer, the latter got credit for increased profit the ship owner made on a charter party by reason of being able to find a substitute ship. Denning M.R. said at p. 152:

> . . . The 7-year time charter with Mobil Oil was advanced by three months. The *Andros Springs* started on the 7-year charter (at a high rate) 100 days earlier than she would have done if there had been no collision. She was delivered to Mobil Oil on July 11, whereas if there had been no collision, she would have been on October 19.

McGregor states in paragraph 335 with respect to action taken by a plaintiff:

> The matter is not well worked out in the authorities and all that can be done is to sketch what the law probably is.

The author discusses a number of contract cases. In addition to **The World Beauty, supra**, the author refers to **Bellingham v. Dhillon**, [1973] Q.B. 304. There, the plaintiff sustained injuries as a result of the defendant's negligence. The plaintiff owned and ran a driving school and as a result of the injuries, lost the opportunity of buying on hire purchase an expensive driving simulator. Some three and one-half years later, however, he was able to buy the same equipment as liquidated stock for a fraction of the original price. In his claim for loss of profits that he would have made with the simulator over three and one-half years it was held that there must also be brought into account the profits in fact earned by the substitute simulator.

Waddams on Damages, loose leaf edition, Canada Law Book Inc., has a discussion on the subject of avoided loss at Ch. 15 at para. 15.670. He states with respect to the third rule that the simple statement of it conceals a very difficult proposition. He says:

> After the defendant's wrong, the plaintiff continues to engage in the ordinary transactions of business; some of these will turn out to be profitable. The difficulty is to determine when such profits should be taken into account for the benefit of the wrongdoer. The problem is akin to some of the intractable problems of legal causation. After the wrong has been done the plaintiff finds a state of affairs that includes the alteration caused by the wrong. In that altered state of affairs, the plaintiff enters into a profitable transaction which could not have been entered into in exactly the same form if events had been unaltered by the defendant's wrong. In one sense it can be said that all such profits are attributable to the wrong, for in the absence of the wrong they would not have been made. But this rule would plainly be too generous to the defendant. In

> another sense it might be said that all such profits are due to the plaintiff's enterprise, not to the defendant's wrong, but this would be too generous to the plaintiff, for where a profit is very closely linked with the defendant's wrong, common sense requires the conclusion that the effect of the profit is to reduce the loss caused by the wrong.

Waddams points out that at best phrases such as "collateral" or "**res inter alios acta**" state the court's conclusion in a particular case rather than provide guidance in the application of the principle. In discussing the case of **Apeco of Canada Limited v. Windmill Place**, [1978] 2 S.C.R. 385, to which we were referred, **Waddams** says at para 15.750:

> . . . The Supreme Court of Canada quoted from Viscount Haldane's speech in **British Westinghouse**: "The subsequent transaction, if to be taken into account, must be one arising out of the consequences of the breach and in the ordinary course of business." The Supreme Court of Canada held that the rent from the second transaction need not be taken into account, describing it as: "an independent transaction which in no way arose out of the consequences of the breach by the appellant".

Waddams then concludes, paragraph 15.800:

> These considerations suggest what seems to be a test often applied, that is, whether the plaintiff could, even in the absence of the wrong, have made the disputed profit. If so, it is treated as collateral. If not, it goes to reduce the plaintiff's loss. A profitable purchase of shares or goods would usually be treated as collateral because usually it could have been made even if the wrong had not been done . . .

It is clear from these passages that while the rule is easy to state and difficult to apply, it is left to a court in making the judgment call whether subsequent profit earned by a plaintiff is "completely collateral" to the defendant's wrongdoing.

In **Scott Group Limited v. McFarlane and others** (1977), 1 N.Z.L.R. 553 (N.Z.C.A.), Cooke, J. at p. 587 expressed the position this way:

> . . . In principle it must be so, because the tort measure is the plaintiff's loss, which cannot be ascertained without taking into account the benefit that the transaction has in fact brought him.

I do not view Shannon's subsequent turn-around of the company as being analogous to situations such as that dealt with in **Bellingham v. Dhillon, supra**, and **The World Beauty, supra**. It is hard to view the subsequent successful operation of the business as being attributable to the negligence of Collins Barrow.

In my view, Shannon's decision to stay with the company and attempt to turn it around was an intervening event which put an end to the chain of causation connecting the negligence of Collins Barrow with the losses suffered by Shannon. The misrepresentation of Collins Barrow was but a **sine qua non** and not a **causa causans** of Shannon's subsequent successful reorganization. I have already measured Shannon's direct loss on the basis of what he would have suffered had he wound up the company at the end of the fiscal period ending October 31, 1989. It was at that time that the direct damages arising from Collins Barrow's negligence were capable of some degree of measurement. I believe it would have been reasonable for Shannon to cut his losses. He could have done that. Instead, largely for reasons of pride and the maintenance of his reputation, Shannon chose to go on with the company. From there on, it was Shannon's game to win or lose. The subsequent steps taken by Shannon and his resulting success were intervening or collateral events which should not be credited to Collins Barrow by way of mitigation. Underlying the success was the complete reorganization and recapitalization of ABM, the development of new products, injection of very large amounts of cash and the advent of the G.S.T. which presented new opportunities.

Had Shannon gone on to incur more extensive losses in his attempt to turn the company around, it is unlikely that the expenses so incurred could fall within the second rule of mitigation. Collins Barrow could probably be heard to say that he should have cut his losses when he saw the situation shortly after October 31, 1989. See **Haida Inn Partnership, supra**, pp. 314, 316.

I am not satisfied that Collins Barrow has established (as it must), that

Shannon would not have made these profits "even in the absence of the wrong".

Collins Barrow is not entitled to an offset against the damages for the subsequent success attained by Shannon after he had channeled the company into an entirely new operation.

5. PREJUDGMENT INTEREST:

Collins Barrow submits that the trial judge erred in awarding prejudgment interest upon each of the three components of damages awarded - direct damages, consequential damages and return on lost investment opportunity for seven years.

I have recalculated the award. On the basis I have adopted, I am satisfied that prejudgment interest at the rate of 8% should be applied to the sum of $1,760,000 over a period of seven years. Collins Barrow submitted that the trial judge failed to consider that loans were being repaid thereby reducing the amount upon which prejudgment interest should be awarded. I have taken these uncertainties into account in fixing the sum for consequential damages at $50,000 and for that reason see no need to further reduce prejudgment interest.

As I have not awarded damages for loss of investment opportunity, the submissions of Collins Barrow respecting that need not be considered.

Accordingly, prejudgment interest should be allowed at 8% for seven years for an amount of $985,600.

SUMMARY:

I would allow the appeal in part by varying the award of damages and substituting the following in place of that awarded by the trial judge:

Direct Damages	$1,710,000
Consequential Damages	$ 50,000
Prejudgment Interest	$ 985,600
TOTAL:	**$2,745,600**

The prejudgment interest is calculated to the date of the trial judge's order, March 6, 1996. In addition, Shannon should recover interest from that date to the date of the order of this Court at the rate of 6% per annum: **Civil Procedure Rule** 62.10(4). Shannon should also recover his costs at trial fixed by the application of Scale 5 of the Tariffs to the amount involved which I fix at $1,760,000. This amounts to $93,325, plus disbursements to be taxed. As Collins Barrow has, in the main, succeeded on this appeal, I would allow it costs of $37,330, being 40% of the trial costs, plus disbursements, to be off set against Shannon's recovery of costs.

I would delay issuing the order in this matter for two weeks in the event that there are circumstances relevant to the issue of costs of which this Court is not aware.

Chipman, J.A.

Concurred in:

Hart, J.A.

Pugsley, J.A.