S.C.A. No. 2754

NOVA SCOTIA COURT OF APPEAL

Cite as: Walwyn Stodgell Cochran Murray Ltd. v. Connolly, 1993 NSCA 141

Jones, Hallett and Roscoe, JJ.A.

BETWEEN:

WALWYN STODGELL COCHRAN MURRAY LIMITED Douglas A. Caldwell, Q.C. Appellant	Janet N. Chisholm for the Appellant
- and -	
DENNIS CONNOLLY and MICHAEL HIMMELMAN Respondents	W. Dale Dunlop D.A. Grant for the Respondents Appeal Heard: March 19, 1993 Judgment Delivered: May 19, 1993

THE COURT: Appeal allowed and cross-appeal dismissed with costs to the appellant in the amount of $16,250.00 plus disbursements and costs of $2,500.00 plus disbursements on the appeal per reasons for judgment of Jones, J.A.; Hallett and Roscoe, JJ.A. concurring by separate reasons.

JONES, J.A.:

This is an appeal and cross-appeal from a decision awarding the respondent, Dennis

Connolly, damages for breach of contract and negligence.

Mr. Connolly is a 53 year old life insurance salesman. He has sold life insurance for 32 years. He has invested in the stock market for over 20 years and has been involved in option trading. Mr. Connolly had an investment account with Goulding, Rose and Turner. The respondent, Michael Himmelman went to work for Goulding in 1981. Mr. Connolly had known Mr. Himmelman previously and when Himmelman switched to Goulding, Himmelman became his broker. He had four accounts, two Canadian and two American, including a U.S. options account. The appellant, Walwyn took over the Goulding firm in 1984. Walwyn's head office is in Toronto. Mr. Himmelman was branch manager and vice-president in charge of the Halifax office.

Mr. Connolly first noted unauthorized trades in one of his accounts in 1984. He testified on the trial as follows:

> "A. And there was once in a while he (Himmelman) would do a stock trade that hadn't been discussed.
>
> Q. And what would your reaction to that be?
>
> A. And as soon as I would get confirmation or in some cases before I got the confirmation, he'd say 'Look I did a deal such and such, I wasn't able, you know, to get a hold of you, I did a deal on such and such' and I'd say; well, you know, what's it all about and he'd explain it and some I said okay on - well, okay if you're sure it's all right. Oh yea, it will be fine. And then there was one or two incidents when he did a particular deal like that when I'd say, you are sure it's all right Mike because you know, if it's not, this is your responsibility and I only recall that

because at the end of '84, I believe that there was a small, between the buying and the selling, there was a small deficit of approximately $4300.00."

He discovered the unauthorized trades from discussions with Himmelman or through documents which he received confirming the trades. In 1985 these trades continued and got into the range of $8,000.00. Mr. Connolly admitted that he never ordered Mr. Himmelman to stop the unauthorized trades. His arrangement with Mr. Himmelman was that Himmelman would accept responsibility for the losses. He was prepared to let Himmelman continue trading so long as he accepted the responsibility for the losses. Mr. Connolly remained silent about the unauthorized trading.

In 1986 Mr. Connolly and Himmelman engaged in trading in Standard and Poor 100 Index options. In the period between March and December 1986 there was a monthly deficit in the U.S. account varying between twenty and sixty thousand dollars. In January, 1987 the deficit increased dramatically to $150,017.28 and by the end of March to $224,665.91. Mr. Connolly was advised of these purchase and sales through the confirmation slips which he received from Walwyn.

In his testimony he explained that he did not wish to get Himmelman in trouble as he knew Himmelman would be fired if the truth came out. Mr. Connolly also knew that his Canadian account which held substantial assets could be used to liquidate the debt in the American account. The trading in the U.S. account continued over two years and the losses mounted to $272,000.00 (U.S.).

The trading ceased in September, 1987. Following that Himmelman transferred 46,000 shares of his own Coxheath stock to Mr. Connolly's account which reduced the deficit to $162,000.00 (U.S.).

In December, 1987 Mr. Connolly went to Himmelman and they discussed the deficit. As a result, Himmelman gave Connolly a letter accepting responsibility for the deficit. The letter was not on Walwyn stationery and made no reference to that firm.

Nothing happened in the account for almost a year except that interest was accumulating. In October, 1988, Mr. Allibon of Walwyn's compliance department wrote to Mr. Connolly advising that Walwyn proposed to convert the Canadian account to liquidate the U.S. losses. Mr. Connolly took the letter to Himmelman. As a result, Himmelman, with the agreement of Mr. Connolly, wrote a memo to Allibon stating that Mr. Connolly did not want the Canadian account converted as the Canadian dollar was improving and to await further instructions. The memo was a fabrication. With regard to the trading between 1984 and 1987 Mr. Connolly testified as follows:

> "Q. Now you knew that these trades he was making, these discretionary trades without your consent were against the by-laws of the TSE, didn't you?

A. Yes, I did.

Q. Yes, And you knew that the application form restricted an RR from discretionary trading if indeed you had to be told that. Correct?

A. Would you say that - ask me again, please?

Q. We looked at Tab A3, which says specifically registered representatives may not accept authorization to exercise discretion -

A. Yes.

Q. You knew that registered representatives could not do an unauthorized trade.

A. Yes.

Q. You knew that Walwyn was a national firm with a head office?

A. Yes.

Q. In Toronto?

A. Yes.

Q. You knew that Mr. Himmelman was engaging in unauthorized trades, correct?

A. Yes.

Q. And you knew, or you had no reason to think that anyone in Walwyn knew besides Himmelman about these unauthorized trades, correct?

A. They didn't know from me.

Q. No. As far as you were aware, no one knew except you and Himmelman, correct?

A. That's correct.

Q. Now you - it was your view that Walwyn would have dealt with this situation immediately had it been aware of the unauthorized trade, is that correct?

A. That's right.

Q. And that was your concern, wasn't it?

A. That's right.

Q. Yes. You felt that Himmelman would have been

> finished because of the unauthorized trades if you had gone to Walwyn, right?
>
> A. That's correct.
>
> Q. And in not reporting these unauthorized trades to Walwyn, you were protecting Himmelman's career, correct?
>
> A. I think that's right.
>
> Q. Yea. So you purposefully refrained from contacting Walwyn at its head office in order to protect Himmelman's career.
>
> A. To give him an opportunity to make good and to be saved in his career, that's correct.
>
> Q. Yea. And if you had followed your agreement with Walwyn though, you would have reported these unauthorized trades to Walwyn head office in writing, correct?
>
> A. Well, I wouldn't have known that it was in writing at the time, but that was the procedure they probably would have told me to do and I would have done it.
>
> Q. Yes that's right. Had you read your agreement, you would have seen that that was the procedure that you could have followed, correct?
>
> A. Yes."

In June of 1989 Mr. Connolly became concerned that Himmelman was not going to cover the losses and contacted Mr. David Lager, Walwyn's Regional Sales Manager. As a result a meeting was held with Mr. Lager, Mr. Geraci of Walwyn's Toronto office and Mr. Connolly. Mr. Connolly wanted to negotiate a time frame for retiring the deficit. Mr. Geraci wanted to see the letter of guarantee from Himmelman. When Mr. Geraci eventually got a copy of the letter Walwyn fired Himmelman and advised Connolly that they had no obligation in the matter.

There was considerable evidence adduced on the trial regarding the obligation of Walwyn to supervise the account and the actions of Himmelman. This related to the various application forms filed by Mr. Connolly and the procedures followed by the Compliance Department in Toronto. Walwyn officials testified that the only reliable means of detecting unauthorized trading was from client complaints.

Mr. Connolly brought an action against Walwyn for breach of contract by allowing unauthorized trading in his account. The claim also alleged negligence including failure to supervise its employees. Walwyn denied liability and brought third party proceedings against Himmelman. The trial judge made the following findings of fact:

> "1. Although hardly necessary to be stated, Himmelman did participate in discretionary trading. That trading was unauthorized by the defendant and in any event, contrary to T.S.E. Regulations by which the defendant and Himmelman were bound. Initially, it was unauthorized by the plaintiff.
>
> 2. After the initial foray into such unauthorized trading by Himmelman, the plaintiff knew of it.
>
> 3. The plaintiff knew at all times he had the means and ability to stop Himmelman's unauthorized discretionary trading.
>
> 4. The defendant knew, or ought to have known, that Himmelman was participating in discretionary trading.
>
> 5. In relation to the defendant, the plaintiff acquiesced in this activity by his silence and failure to act.
>
> 6. The defendant failed to act decisively when it ought to have realized that trading for the plaintiff's account was inappropriate for the plaintiff's stated investment objectives.
>
> 7. The defendant was negligent in obtaining new statements of investment objectives to ratify retroactively inappropriate trading without obtaining verification of the validity of such statement from a person who did not have a conflict of interest arising from commissions.
>
> 8. The defendant failed to scrutinize carefully the plaintiff's application forms for consistency and accuracy. That is not to say the defendant was under any obligation to investigate the statements of the plaintiff. In this case, however, the defendant had at hand previous application forms of recent origin which demonstrated inconsistencies. Additionally, it had a blank, signed application form from the plaintiff which ought to have been sufficient to cause the defendant to inquire into it.
>
> 9. The plaintiff received monthly and other statements from the defendant. He did not protest these statements."

The trial judge also stated:

> "The plaintiff failed to dissent in a timely manner. His

> action of speaking to Himmelman did not amount to dissent. In fact, by speaking to him privately and permitting the activity to continue amounted to acquiescence accompanied by full knowledge of all the essential facts. That acquiescence continued throughout the period in question and was renewed on each occasion of receipt of a monthly statement; it ended when the plaintiff made his complaint to Lager and Geraci. Even if it may be said (with considerable justification) that the statements were difficult to understand, such an observation is not sustainable in view of the fact that the plaintiff had actual knowledge of the trading, had devised his own method of keeping track of his account and did not need or depend upon the notice of a statement.
>
> To the extent of ratification by acquiescence, this case is somewhat similar to **Grenkow v. Merrill Lynch Royal Securities Limited, MacFadden and Smith** (1983), 23 Man. R., (2d) 54. That case is dissimilar, however, from the instant case in the question of the knowledge, either actual or imputed, of the defendant of the impugned activity.
>
> It is clear from the facts as they were adduced before me that the plaintiff, by acquiescence, authorized Himmelman to act for him in the full knowledge that the defendant had not expressly authorized that activity.

He also stated:

> "The plaintiff's knowledge of and acquiescence in Himmelman's unauthorized trading, in my view, vitiates the fiduciary duty owed by the defendant to the plaintiff."

He also found that the alleged guarantee was not binding on Walwyn as Mr. Connolly knew it was not authorized by Walwyn.

The trial judge held that Mr. Connolly having acquiesced in the trading was bound by Himmelman's actions and could not recover for the direct losses. Having found that Walwyn was negligent in not properly supervising the account in the result he held that both parties were in fact responsible for the losses. Based on the decision in **Varco v. Sterling** (1992) 7 O.R. (3d) 204 he found that it would be inequitable for Walwyn to recover commissions for the trading or interest on the overdue account. He awarded Mr. Connolly damages in excess of $285,000.00. Walwyn was granted full recovery against Himmelman for the judgment payable to Mr. Connolly.

Walwyn has appealed and Mr. Connolly has filed a cross-appeal. Walwyn claims that the action should have been dismissed because Mr. Connolly acquiesced in the trading and failed to mitigate his losses. The Company also denied that it was negligent.

The trial judge accepted Mr. Connolly's evidence. There can be no doubt from Mr. Connolly's evidence that he ratified the transactions. He relied on Himmelman to cover the losses in accordance with their agreement. He knew at all relevant times that Himmelman was not authorized to engage in discretionary trading. Himmelman was acting dishonestly and whether Mr. Connolly was aware of that fact he participated in deceiving Walwyn. Himmelman was putting the transactions through as legitimate and thereby putting Walwyn at substantial risk. Mr. Connolly trusted Himmelman and obviously believed that Himmelman could personally cover the losses. When he first discovered the unauthorized trading, his only option so far as Walwyn was concerned was to terminate the contract. The main issue on this appeal is the effect of the ratification of the unauthorized trading by Mr. Connolly. The following passage is from **Meyer** in the text **Law of Stockbrokers and Stock Exchanges**, 1931 at p. 408:

> "The general principle is that any wrongful act on the broker's part may at the election of the customer be either ratified or repudiated. He has the privilege or election, upon discovery of the facts, whether to adopt or to disavow the unauthorized act of his brokers'. This is in accordance with the simple doctrine of the law of agency, that an act performed by an agent on behalf of this principal which was in fact beyond the scope of the agent's powers may nevertheless after performance be ratified by the principal, and if so ratified will bind the principal to the same extent as if authorized in the first instance. Any wrong committed by a broker, no matter how serious and no matter what its nature, is susceptible of ratification. This applies to the improper execution or non-execution of an order to the wrongful sale of the customer's securities or the wrongful covering of short commitments, and to all kinds of miscellaneous breaches of duty of which the broker may become guilty during the course of his relations with his customer.
>
> . . .
>
> The first principle of ratification in stockbrokerage transactions is that a customer who wishes to take advantage of his broker's wrongful act must repudiate that

> act. If he does not he is deemed to have ratified it. He may not merely sit by and do nothing, but is bound at the risk of the loss of his claim affirmatively to indicate his repudiation:
>
> > 'Ratification can be proved, not only by an express assent, ***but also by implication from the principal's acquiescence or failure to dissent within a reasonable time after being informed by the agent of what he has done.'"

In this case the wrongful acts were not by the broker but by its employee.

Merrill Lynch Royal Securities Limited v. Norman Manning Limited, (1984), 52 B.C.L.R. 103, a decision of the British Columbia Court of Appeal is similar to the present case. In that case Merrill Lynch's employee engaged in discretionary trading with the approval of the client contrary to his company's internal rules. The trading was in the commodities market. The client suffered substantial losses. Merrill Lynch sued the client for payment of the losses. Hutcheon, J.A. in delivering the judgment of the British Columbia Court of Appeal stated at p. 108:

> "What were the positions in law of Holme, Merrill Lynch and Manning on Monday, 6th August 1979, when Holme made his first purchases that morning? Holme was an employee of Merrill Lynch with a limited agency to transmit orders to which a customer had assented. When Holme decided to purchase for the Manning account, filled in a trading slip for three lumber contracts and relayed the trading slip to the wire room with the indication that the order had been repeated to the customer, he was acting:
>
> > (1) on the express oral authority given to him the previous day by Manning to trade in the account without consulting Manning; and
> >
> > (2) so far as Holme was concerned, in accordance with the power of attorney given to him in June 1978.
>
> I think that Holme, beyond question was the agent of Manning on Monday, 6th August, when Holme decided to purchase the three lumber contracts and filled out the trading slip for that purpose. Immediately after the telephone conversation with Manning ('Great, keep up the good work'), Holme, when he decided what to buy or sell

and filled out the trading slips, was doing those things as the agent for Manning. It was not a part of his contract of employment with Merrill Lynch to make such decisions for Manning. With respect, I disagree with the trial judge's findings that 'Holme was acting as a friend of Manning, but primarily he was acting throughout as a representative of Merrill Lynch'.

That finding is clearly wrong for the trading that took place on Monday, Tuesday and Wednesday. To use the language of Cardozo C.J. in **Bosak v. Parrish** (1929), 252 N.Y. 212, 169 N.E. 280 (C.A.), the limited agency of Holme, as a representative of Merrill Lynch to transmit orders to which a customer had assented, was replaced on those days by his general agency as the representative of Manning. When and how did the legal position change thereafter so that Holme, in deciding to buy or sell a contract, resumed his position as a representative of Merrill Lynch but without the limitation that required the assent of the customer? I have been unable to discover any principle of agency that would bring about such a change.

I think that the effect of the dual relationship is correctly stated in C.H. Meyer, **The Law of Stockbrokers and Stock Exchanges and of Commodity Brokers and Commodity Exchanges** (1931), at p. 483:

> 'An employee of the broker may in any particular matter be the agent of the customer, and if so may deal with the broker with respect to that matter in such a way as to bind the customer. The agency for the customer and that for the broker are not inconsistent. Authority to act for the customer may be conferred on the broker's employee expressly, as by written power of attorney, or may be inferred from the course of dealing, as where the employee has had complete charge and control of the customer's account...
>
> In the absence of any facts showing authority to act for the customer, the broker's employee will be considered the agent of the broker. In such a case if a loss is occasioned through the employee's misconduct, the broker and not the customer must sustain it. This principle applies to cases where the employee instructs his employers to execute orders for the customer which in fact the customer never gave ...

> However, if the employee has actually been authorized to act as the customer's agent, the loss arising from his misconduct will fall on the customer. This is true equally in the case of the transmission by the employee of orders which were in fact unauthorized, and of the conversion by the employee of securities entrusted to him by the broker for delivery to the customer or vice versa.
>
> To summarize, the question in each case is whether or not the employee of the broker has or has not been authorized by the customer to act for him. If he has not, his acts will be deemed to be on behalf of the broker. If he has, his acts will be binding on the customer.
>
> In this present case, Holme was authorized to act as Manning's agent and the loss arising from acting in excess of that authority must fall on Manning. If Holme was in breach of his general agency to make a trade in the Manning account without prior assent, Manning, as the person who put Holme in the position to make the trade, must bear the loss.
>
> I would allow the appeal of Holme and set aside the judgment against him, allow the appeal of Merrill Lynch and give judgment against Norman Manning Limited and the guarantor of the account, Norman Manning."

That reasoning applies in this case. Himmelman was acting as the agent of Connolly in all of these transactions and accordingly Mr. Connolly was liable to pay for the total losses as he authorized them. That was the effective cause of the loss. It ill behooves Mr. Connolly to complain that had Walwyn properly supervised the account that the unauthorized trading would have been terminated at an earlier date. That option was open to Mr. Connolly at any time. He was an experienced agent, although in the insurance field, who no doubt was fully aware of the effect of Himmelman's unauthorized actions.

It is unnecessary to consider the remaining issues. Walwyn has submitted that it was not negligent in the supervision of the account. It is certainly not clear from the trial judge's findings as to the specific acts of negligence on which he relied or the losses which resulted from such acts. Clearly a number of his findings on negligence were not supported by the evidence. In any event in my view the sole cause of the loss was due to Mr. Connolly's approval of the

actions of Mr. Himmelman.

I would allow the appeal and dismiss the cross-appeal. No appeal was entered by Himmelman. In the result the action against Walwyn should be dismissed.

Walwyn should have its costs of the trial in the amount of $16,250.00 plus disbursements and costs of $2,000.00 plus disbursements on the appeal.

J.A.

HALLETT, J.A. (Concurring by separate reasons)

I agree with Justice Jones that Walwyn's appeal should be allowed; Himmelman was, in reality, acting as Connolly's agent in making the option contracts and Connolly is therefore bound by the transactions including the obligation to pay commissions to Walwyn. However, there are several aspects of the appeal that warrant comment.

The primary issue raised by Connolly in his statement of claim was that the option transactions in his U.S. account were not authorized by Connolly; that Walwyn permitted discretionary trading in Connolly's U.S. option account and that Walwyn failed to properly supervise Himmelman to prevent him from carrying out unauthorized trades. There were no

allegations that Walwyn breached any statutory regulations or industry standards in the monitoring of Connolly's U.S. option account for "suitability" as that term is understood in the investment community. The statement of claim did not allege that the option trading was unsuitable for Connolly's investment objectives. A second issue raised by the statement of claim was whether Walwyn was bound by Himmelman's guarantee to Connolly that any losses would be looked after. The defence filed by Walwyn responded to these issues.

Connolly adduced no expert evidence that the option transactions were unsuitable. However, in the course of cross-examining certain of Walwyn's witnesses Connolly's counsel pursued a line of questioning suggesting that Walwyn had failed to properly monitor Connolly's trading for suitability. Some vague evidence was forthcoming from which it might be inferred that the extent of option trading was not suitable for Connolly's investment objectives as shown on his application to Walwyn to trade in options. No application was made to amend the statement of claim to plead unsuitability nor did Walwyn's counsel request an adjournment to adduce expert evidence that the trades were suitable and that Walwyn had met industry standards in its supervision of Connolly's trading in options.

The learned trial judge found that Connolly had, in effect, authorized Himmelman to trade in options at his discretion. He found that Connolly, by his acquiescence and failure to advise Walwyn's head office that he did not accept the option transactions affirmed the same. He found Connolly and Himmelman had a private arrangement which was not disclosed to Walwyn whereby Himmelman could use Connolly's account for option transactions and the losses would be covered by Himmelman. He rejected Connolly's position that Walwyn was bound by Himmelman's commitment to Connolly.

Justice Gruchy, however, found that Walwyn was at fault as set out in his findings Nos. 6, 7 and 8 quoted in the decision of Mr. Justice Jones. After finding that Connolly was bound by the transactions the learned trial judge stated that for reasons which he would set forth that Connolly was not liable for the total loss claimed to have been sustained. He found that at a certain point in time Walwyn knew or ought to have known that Himmelman was participating in unauthorized trading; he does not state at what point that was. He dealt with Connolly's

allegation that Walwyn breached a fiduciary duty owed to him and concluded that Connolly's knowledge of and acquiescence in Himmelman's trading in his account vitiated the fiduciary duty owed by the defendant to the plaintiff.

He considered the decision of Keenan J. in **Varcoe v. Sterling, Dean Witter Reynolds (Canada) Inc. and Dean Witter Reynolds Inc.** (1992), 7 O.R. (3d) 204 and concluded that the case he was dealing with was similar to **Varcoe**. He stated (at p. 39) that "the combination of fault by all parties in my view must be best addressed by the fashioning of an appropriate remedy". The learned trial judge then quoted from Keenan J. in the **Varcoe** case who, after reviewing the Supreme Court of Canada decision in **Canson Enterprises Ltd. et al. v. Boughton & Co. et al.** (1992), 85 D.L.R. (4th) 129 (S.C.C.) dealing with the fusion of law and equity stated "concerns about any rigid restriction on the right of the court to fashion a just and equitable award of damages are relieved and a suitable award may be crafted whether the breach be in law or in equity". Justice Gruchy then went on to state at p. 41:

> " I have concluded that it would be unjust to allow the defendant to profit to the extent of the commissions and interest charged as a result of the trading which, by virtue of its own actions, or lack thereof, was largely unregulated. Against that, it is necessary to balance the plaintiff's acquiesence amounting to a failure to mitigate. It is necessary to fashion a just and equitable award.
>
> While most of the plaintiff's losses occurred in S. & P. trading, it is clear that the defendant's negligence was not restricted to one account. As between the plaintiff and defendant, therefore, I order that the plaintiff is entitled to recover from the defendant the total of all commissions charged to all his accounts from November 1985. He is further entitled to the recovery of all interest charges against those accounts. As I do not have sufficient information before me to permit an accurate calculation of those amounts, I will hear counsel if that is necessary.
>
> The defendant shall be entitled to full recovery from the third party, Michael Himmelman, of the total amount to be paid to the plaintiff, including costs as hereafter ordered.
>
> The plaintiff's loss has undoubtedly had a catastrophic effect on him. The trial was not especially long, but I am aware that a great deal of pre-trial work was done by the parties. While the success of the action

> may be said to be divided, I exercise my discretion and order that the plaintiff shall be entitled to his costs. I will hear the parties, if necessary, to determine the "amount involved" for the purpose of quantifying costs."

There is no indication in this passage of what negligence the learned trial judge was alluding to other than a vague reference to "unregulated" trading. Nor why he ordered repayment of the commissions that had been paid on trades in the Canadian account - when the allegations of improper management by Walwyn related solely to the U.S. option account nor why the learned trial judge disallowed commissions on all transactions as far back as November, 1985 when the only area of dispute related to option transactions in the U.S. account in 1986 and 1987.

Following the submission of further material by counsel for the parties the learned trial judge, by a supplementary decision, calculated that the commissions charged and interest on overdue commissions to be returned to Connolly was approximately $285,000.00 plus pre-judgment interest at 7% from November 22, 1990, the date Walwyn had liquidated Connolly's securities to pay off the balance in Connolly's U.S. options account.

On this appeal Walwyn says the learned trial erred:

" (1) In awarding damages to the Plaintiff, Connolly after finding that the Plaintiff, Connolly acquiesced in all the impugned trading in his brokerage accounts with the Defendant;

(2) In finding that the Defendant was negligent or that such negligence as was found by the learned Trial Judge caused a loss to the Plaintiff, Connolly;

(3) In failing to properly apply the principles or doctrine of mitigation after having found that the Plaintiff, Connolly failed to mitigate his losses;

(4) In finding the Plaintiff, Connolly was entitled to relief in the nature of an equitable award where there was found to be no breach of a fiduciary or equitable duty to the Plaintiff, Connolly;

(5) In awarding the Plaintiff, Connolly

> recovery of all commissions and interest charged on all his accounts with the Defendant from November, 1985 where no or few impugned trades took place in any account other than the S & P U.S. options account, and no claim was made by the Plaintiff, Connolly for damages or any other relief respecting any account but the S. & P. U.S. option account;
>
> (6) In failing to reduce the amount of the damage award by the amount of the tax credit obtained by the Plaintiff, Connolly."

Connolly's position, of course, is that the trial judge's decision should be affirmed subject to the points he raises in his cross-appeal.

With respect to the first and second grounds of appeal, I am of the opinion, having reviewed the evidence, that it was open to the learned trial judge to find as he did that Walwyn was somewhat at fault in monitoring the U.S. option account; that is not to say I would have come to the same conclusion. However, the trial judge did not make any clear finding that any fault was causative of the loss. I have asked myself if one could infer that in finding that there was shared fault the learned trial judge, in fact, was finding that Walwyn's negligence was in part causative of the loss. However, he did not assess damages on the basis that Walwyn's negligence was a contributing cause of the loss in that he did not connect the loss or part of it to any specific negligence. The fact that Connolly acquiesced in the trades, in my opinion, is not a bar to assessing damages caused by Walwyn's negligence, if any, in monitoring the option transactions for suitability. However, I am not satisfied that any failure by Walwyn in monitoring the account (whatever it was) was a contributing cause of the loss. I will address this issue later.

With respect to appeal ground no. 3, the learned trial judge did consider the issue of mitigation. In my opinion the principles of mitigation should not be applied in this case to any damages that would flow from Walwyn's negligence in not properly supervising trades in Connolly's account for suitability because Connolly would not have known whether or not the account was not being properly supervised by head office and therefore there was no basis upon which he could mitigate any damages arising from any fault of Walwyn's in monitoring the

account that might have been causative of his loss. With respect to the issue of the trades being unauthorized, the learned trial judge quite properly found on the evidence that Connolly had accepted the trades and therefore on this issue he had failed to mitigate any loss arising from unauthorized trades. He ought not to have assessed damages for that breach of duty if that was in fact the basis of his damage award.

With respect to ground no. 4, I agree with the appellant's counsel that the learned trial judge erred in finding that Connolly was entitled to relief in the nature of an equitable award where there was no breach of a fiduciary or equitable duty to Connolly. Damages ought to have been assessed applying the usual criteria respecting the assessment of damages arising out of negligent performance of contractual obligations; to do so a trial judge must determine what damages were caused or contributed to by a lack of reasonable care in the performance of contractual duties.

I agree with the submissions of Walwyn in ground no. 5. In view of my conclusions it is not necessary to deal with ground no. 6.

In my opinion, the learned trial judge, having apparently found a breach of duty by Walwyn, erred in that he did not properly consider the issue of causation and as a consequence did not properly assess damages. Insofar as the learned trial judge did not make a clear finding that Walwyn's faults in the administration of Connolly's account or the supervision of Himmelman were a contributing cause of the loss it is necessary to deal with that issue.

A review of Connolly's option trading account shows that there was heavy trading in the U.S. account starting in April 1986. However, it was not until March 16, 1987, that the substantial losses in the account were incurred when the debit in the U.S. options account went up to $193,769.00, apparently as a result of Walwyn, on Connolly's behalf, having to settle options contracts that had been exercised. Three days later, on March 19th, the debit balance increased to $242,973.00. Up until March 16 the highest debit balance in the account was $138,377.00 on February 24, 1987. By February 27th, the debit balance had been reduced to $82,134.00. The adverse turn of events in March would have resulted from option contracts entered into in the preceding month or two. In 1987 Walwyn held securities of Connolly with

a market value of $500,000.00. The value of securities held was relevant in assessing the extent of trading that would be suitable for Connolly at any particular time.

From March 16, 1987, until trading in the U.S. option account was stopped in August of 1987, the trading was a mere fraction of the trading in the period of May, 1986 to March 16, 1987. After March 16th the balance owing remained more or less constant except for monthly increases in Connolly's debt due to interest charges on the outstanding balance.

All through the period May, 1986, to March 31, 1987, Connolly received confirmation slips of every option transaction and received monthly statements showing the extent of the trading and the month end balance in his U.S. options account. He never advised Walwyn's head office that he did not accept the transactions.

The learned trial judge's finding #6 that Walwyn did not act decisively when it ought to have realized the trading was inappropriate for Connolly's stated investment objectives, appears to have applied a standard of review for managed accounts in which discretionary trading is a method of trading that is authorized by the client as he quoted Regulation 8.31(8) of the TSE Regulations which spells out the review required with respect to a managed account. Such an account must be reviewed four times a year to ensure that the investment objectives of the client are being diligently pursued as the trading is discretionary. In Connolly's U.S. option account discretionary trading was not permitted. Although the trial judge appears to have incorrectly considered the review requirement respecting managed accounts there is no question that Walwyn's head office did have a supervisory role respecting Connolly's U.S. option account. However, the principle mechanism a brokerage firm's head office has to detect whether a registered representative (Himmelman) of that firm is involved in unauthorized trades is the practice of sending confirmation slips to the client. Connolly never advised Walwyn's head office that he did not accept the transactions as described in the confirmation slips. Therefore, there was no reason why Walwyn's head office would have reason to suspect the option transactions were unauthorized as opposed to inappropriate. With respect to the trail judge's finding that trading in Connolly's accounts was either "inappropriate" or "unregulated" there are several points that warrant comment. First, there was no allegation that the trading in the

Canadian accounts was inappropriate yet the learned trial judge ordered repayment of the commissions earned on the Canadian accounts; the issue at trial related to the trading in the U.S. option account. Secondly, the issue raised by Connolly's statement of claim was that the transactions were unauthorized, not unsuitable as that term is understood in the investment industry. The question of unsuitability apparently arose from cross-examination of Walwyn's compliance officer. There was no evidence before the learned trial judge from any expert that Walwyn's option department or compliance department did not measure up to an acceptable standard in the monitoring of transactions in Connolly's option account. However, the learned trial judge decided having considered the wrong provisions of the Toronto Stock Exchange Regulations (those relating to managed accounts) that the option trading was "inappropriate". The learned trial judge does not state why the trading was inappropriate. Connolly owned cash and marketable securities valued at $500,000.00 as shown on his option account application form signed in October, 1986. The application showed that Connolly was prepared to invest 20% in risk transactions and that until mid March of 1987 the debit in his account was generally within this guideline and clearly was so at the end of each month prior to March 31, 1987. However, I recognize that heavy trading in index options can result in high risk if the trader has failed to correctly forecast the direction of the stock market.

A review of Connolly's monthly account for the period May, 1986 to March, 1987 indicates that the U.S. option account was not showing obvious signs of difficulty until the option contracts had to be honoured on March 16, 1987. At that time the head office of Walwyn took immediate steps to deal with the situation. A letter was prepared to be sent to Connolly advising him that trading in options would be restricted. However, Himmelman talked the head office out of sending the letter of March 27, 1987. It is of paramount significance that even if that letter had been sent the loss which gave rise to Connolly's claim against Walwyn had already been incurred. The latter, had it been sent, would have changed nothing. The trial judge's reference in his findings to Walwyn having failed to act decisively when it ought to have realized the trading for Connolly's account was inappropriate is likely a reference to this incident although he does not specify what he is referring to.

On the other hand, he may have been referring to heavy trading in options generally in 1986 prior to October as in finding #7 he makes reference to Walwyn obtaining an updated application form in October, 1986, to "ratify retro-actively inappropriate trading"; the learned trial judge does not articulate just what was inappropriate. I would assume the learned trial judge was considering the fact that Connolly's earlier application to Walwyn to trade in options did not state that he wished to trade in short term risk. However, prior to October, 1986, the trading in options never resulted in Connolly's U.S. account having a debit balance in excess of $20,000.00. It is obvious that Walwyn head office was keeping an eye on the account as in October, 1986, Connolly, at the request of Walwyn's head office, signed a new option trading agreement in which he stated that his investment objective was to have 20% in short term risk. His prior application had shown a net worth in cash and marketable securities of $300,000.00 but it did not show that he wished to trade in short term risk. His October, 1986, application showed a realizable cash net worth of $500,000.00 and that he was prepared to invest 20% in short term risk. The debit in the U.S. options account did not exceed $100,000.00 except for a day or two at any given time. His updated application, signed in October, 1986, which was approved by head office, included his right to trade in uncovered options. This would include trading index options.

The learned trial judge made no analysis of just what it was that Walwyn failed to do that constituted the negligence that warranted the award he fashioned. Apart from the discretionary trading which Connolly authorized there is no indication of what specific duties were breached by Walwyn nor any indication of what T.S.E. Regulations were breached other than the regulations respecting managed accounts. The learned trial judge did not indicate at what level of trading or at what point in time he found that the trading was not properly regulated. There was no independent opinion evidence before the trial judge that the option transactions were unsuitable for Connolly. There just does not appear to be a satisfactory evidentiary basis for such a finding if that is what the trial judge intended when he indicated the trading was largely unregulated. Unsuitability was not pleaded so there was no reason for Walwyn at trial to adduce evidence that the trades were suitable for Connolly. It is clear that

head office was monitoring the account, as when the large loss occurred on March 16, 1987, immediate action was initiated to restrict trading but was not finalized. The learned trial judge's finding that Walwyn did not act decisively (in March of 1987) is supported by the facts but, as noted, the loss was already incurred before officials at Walwyn's head office allowed themselves to be talked out of sending the March 27th letter to Connolly.

In summary, the learned trial judge did not make any finding that the Walwyn conduct which he found was negligent caused Connolly's loss. The learned trial judge erred in his assessment of damages in that he did not assess damages in accordance with acceptable principles relating to the assessment of damages flowing from negligent conduct. A review of the evidence does not support a finding that any fault by Walwyn with respect to the monitoring of Connolly's account was a contributing cause of his loss. I agree with Mr. Justice Jones that the sole cause of the loss was Connolly's private arrangement with Himmelman.

Insofar as the trial judge put such reliance on the similarity between the **Varcoe** case and the case he had under consideration I think a word about that case is warranted. The cases are similar in that an investor lost money in option trading but that is where the similarity ends. The essential issue in the cases were substantially different. In **Varcoe** the issue was the suitability of the trading for the investor. In Connolly the issue was whether the trades were authorized or not. Secondly, in **Varcoe** expert evidence respecting statutory requirements and standards in the industry was called by the plaintiff. No such evidence was adduced in the Connolly case. Thirdly, in **Varcoe** clear findings of breaches of statutory duties were made and that such breaches were causative of the loss; in the Connolly case the trial judge made no clear findings of negligence or any finding that the negligence was causative of the loss.

Furthermore, insofar as considerable reliance has been placed by Connolly's counsel on the trial judge's decision in the **Varcoe** and the fact that the appeal in that case by the brokerage firm to the Ontario Court of Appeal was dismissed it should be noted that both decisions focused on the findings of breach of statutory duties; there were no breaches of statutory duties in the case we have under consideration. Secondly, the Ontario Court of Appeal

did not give wholehearted support to the method of assessment of damages employed by the learned trial judge in that case. On these points the Court of Appeal stated:

> " . . . we see no error in the approach taken by the trial judge on the general issue of the appellants' breaches of their statutory duties.
>
> The assessment of damages (and their reduction on account of the respondent's contributory negligence) was difficult in this case. Although we might have approached the assessment of the damages to which the respondent was entitled somewhat differently, we are satisfied that the trial judge fairly and reasonably determined the respondent's financial losses which were caused by the appellants' negligence, and the extent to which those losses should be reduced by the respondent's contributory negligence."

Obviously, the Ontario Court of Appeal concluded that the trial judge was correct to have found that the damages suffered by the investor were caused by the brokerage firm's negligence. We have no such finding by the trial judge in this case. No attempt was made by the learned trial judge to determine what portion of the loss was caused by Walwyn's negligence. He merely stated that the combination of fault by all parties may be addressed by fashioning an appropriate remedy. The learned trial judge then arbitrarily decided to deprive Walwyn of its commissions on all transactions going back to 1985. The learned trial judge did not do the sort of analysis that was done by Keenan J. in assessing damages in **Varcoe**.

There is a substantial body of case law that if there are serious breaches of duties to a principal, the agent is not entitled to be remunerated (**Bowstead on Agency**, 14th Edition, Article 65). Having found that Walwyn was at fault but having failed to find the fault was causative of Connolly's loss, was the learned trial judge nevertheless correct in deciding that Walwyn should not be allowed to retain the commissions and interest on overdue balances.

There are situations where an agent does something not disclosed to the client that will result in the agent being deprived of the commission on the transactions. For instance, if an agent who is employed to sell real property sells it to a company in which he is a director and a major shareholder, he is not entitled to commission upon the sale even if the sale is adopted

and confirmed by the principal (**Salomens v. Pender** (1865) 3 H. & C. 639.) Similarly, if an agent fraudulently takes a secret commission from the purchaser he is not only accountable to his principal, the vendor, for the secret commission but he is not entitled to remuneration from the vendor and if the vendor pays him a commission in ignorance of the true facts he is entitled to recover it. **(Andrews v. Ramsey & Co.** [1903] 2 K.B. 635). These are examples of serious breaches of duty to the principal. As Bowstead points out, it is in these cases that the principal is not liable to pay the agent. The rules that disentitle an agent to a commission where he is in breach of duty are penal in operation and it is on this basis that they are justified in the cases. (Bowstead, supra, Article 65). However, where the principal knows the true facts the agent is generally entitled to a commission. For instance, in **Harrods Ltd. v. Lemon** [1931] 2 K.B. 157:

> " the estate department of a company acting for the vendor of a house introduced a purchaser and, in ignorance of the agency, the building department of the company acted for the purchaser and made a report on the house which had the effect of reducing the price. Subsequently the company discovered that they had been acting in this way and made an offer to the vendor to invite the purchaser to obtain an independent report on the house. The vendor refused and completed the sale at a reduction of the agreed price, the reduction being due to the work required to be done as a result of the report. Held, that although the company had committed a breach of their duty as agents, since the principal with full knowledge of this breach had completed the sale at the reduced price, the principal had affirmed the transaction."

In this case Connolly, with full knowledge that Himmelman was acting outside the scope of his authority with Walwyn and in reality acting as Connolly's agent, authorized the transactions and participated with Himmelman in covering up Himmelman's actions in accordance with their private arrangement. The learned trial judge, in granting equitable relief, failed to consider Connolly's complicity in the dealings by Himmelman in his U.S. options account. Under the circumstances, there is no equitable basis to disallow Walwyn their commissions on the transactions entered into by Connolly through Walwyn.

In summary, Connolly affirmed the transactions which included an affirmation that Walwyn was entitled to commissions on the transactions. The contract between Connolly and

Walwyn permitted the broker to charge interest on overdue accounts. The evidence does not support a finding that a breach of duty by Walwyn in the supervision of the account for suitability was causative of the loss. There was no legal or equitable basis for the trial judge to have ordered the refund of commissions and interest.

I would allow the appeal and the disposition of the other issues raised on the appeal and cross-appeal as proposed by Mr. Justice Jones.

Hallett, J.A.

Concurred in:

Roscoe J.A.

ENDFIELD

S.C.CLAVIER(A. No.CLAVIER(2754

NOVA SCOTIA COURT OF APPEAL

BETWEEN:

CLAVIER(WALWYN STODGELL COCHRAN MURRAY LIMITED	)	
Appellant	)	
- and -	)	REASONS FOR
	)	JUDGMENT
BY: CLAVIER(DENNIS CONNOLLY and MICHAEL HIMMELMAN	)	JONES, J.A.

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