1994S.H. No. 107381

IN THE SUPREME COURT OF NOVA SCOTIA
[Cite as: Fraser v. Westminer Canada Ltd., 2001 NSSC 176]

Between:

Sumner M. Fraser, William Kitchen, William Mundle, Dr. James Collins, Michael Bradshaw, Dr. Michael Cook, Gloria Coughlan, James Coughlan, Gerald Coyle, Allan Dand, Murray Edwards, James Hartling, Hector Jacques, Harry Kennedy, Doug McCallum, Gerald McCarvill, Roland MacDonald, John Panneton, Robert Peters, Andrew Saulnier, and Dr. Allistair Thomson, and Francis Hutt and Dennis Conolly in their capacities as the representatives of the Estate of Robert Dauphinee, Joyce Prest in her capacity as the representative of the Estate of Reg Prest and Bryman Enterprises Limited

Plaintiffs

- and -

Westminer Canada Limited, Westminer Holdings Limited, Western Mining Corporation Holdings Limited, James H. Lalor, Peter Maloney, William J. Braithwaite and Colin Wise

Defendants

DECISION

HEARD: at Halifax, Nova Scotia, before the Honourable Justice Gerald R.P. Moir on April 25, 26, 27 and 28, 2000; May 1, 2, 3, 8, 9, 10, 11, 12, 15, 16, 17, 18, 23, 24, 26, 29, 30 and 31, 2000; June 1, 5, 6, 7, 8, 9, 12, 13, 14, 15, 19, 20, 21, 22 and 23, 2000; July 5, 10, 11, 12, 13, 17, 18, 20 and 21, 2000; October 5, 6, 10, 11, 12, 16, 17, 18, 19, 20, 23, 24, 25, 26, 30 and 31, 2000; December 4, 5, 6, 7 and 8, 2000; April 25, 2001; with last submission received on May 1, 2001.

DECISION: November 9, 2001

COUNSEL: Douglas A. Caldwell, Q.C., Dennis J. James, Robert H. Pineo and Nancy M. Breen for the plaintiffs

Thomas P. Donovan, Q.C., Peter L. Roy, Richard Niedermeyer, Yvonne B. Chisholm and Michael J. Messenger for the defendants

Date: November 9, 2001
Docket: S.H. No. 107381

MOIR J.:

INTRODUCTION

[2] Early in 1988 WMC Acquisition (Canada) Corp., a wholly owned subsidiary of the large Australian mining and oil and gas concern, Western Mining Corporation Holdings Limited, acquired all shares of a small Nova Scotia gold mining company, Seabright Resources Inc., by way of an unfriendly take-over. Six months later, Westminer Canada Limited, into which Seabright had been amalgamated, and Westminer Canada Holdings Limited, once WMC Acquisition (Canada) Corp., sued the former directors of Seabright. The suit was brought in consort with the directions of the parent company. I shall refer to the parent, or the parent in combination with the subsidiaries, as "Westminer". The action was brought in Ontario. It alleged fraud, civil conspiracy, failure to disclose material changes and insider trading. At about the same time, Westminer approached the Ontario Securities Commission and there was discussion of prosecuting former Seabright directors for *Securities Act* violations.

[3] The suit was brought and the approach was made just when Cavalier Capital Corporation was about to make an initial public offering. Cavalier Capital had recently acquired a junior oil and gas company in Alberta, Cavalier Energy Limited. Numerous private investors, including plaintiffs in this suit, had backed a bank loan that financed a large part of the purchase price, and the plan had been to retire the loan, and thus the investors' liabilities, through funds raised in the public markets. The directors of Cavalier were some of the former Seabright directors. Mr. Terrence Coughlan, the former president of Seabright, was the president of Cavalier, and his efforts, abilities and integrity were essential to the success of the public offering. The plaintiffs say that the Westminer allegations caused underwriters to withdraw, caused the initial public offering to fail, precluded Cavalier from the public markets, and ultimately caused Cavalier to become insolvent.

[4] Not long after Westminer sued in Ontario, Mr. Coughlan and another former director brought two actions against Westminer in Nova Scotia. The rest of the former directors brought their own actions, and the actions were tried together before Justice Nunn over eight months in 1992. In a judgment released in March 1993, Justice Nunn made findings of fact adverse to Westminer and he found the Westminer companies liable to the former directors in civil

conspiracy, intentional interference with economic relations and breach of fiduciary duty: *Amirault and others* v. *Westminer Canada Limited and others* (1993), 120 N.S.R. (2d) 91 (S.C., T.D.). Justice Nunn made specific findings that Mr. Coughlan and the others had not engaged in fraud and had not failed to disclose material changes in Seabright. Rather, he found that Westminer had acted recklessly in its assessment of Seabright and had sought to cast the blame for its own recklessness upon the former directors by bringing the action in Ontario. The plaintiffs in the Nova Scotia actions recovered damages under some heads, but Justice Nunn refused to award damages on claims advanced concerning losses former directors had suffered on account of their own investments in Cavalier. The decision went on appeal and there was a cross-appeal on the Cavalier losses. The grounds of appeal included challenges to Justice Nunn's findings of fact. His decision was upheld except as regards the date at which pre-judgment interest was to be replaced by judgment interest: *Coughlan and others* v. *Westminer Canada Limited and others* (1994), 127 N.S.R. (2d) 241 (S.C., A.D.). Leave to appeal to the Supreme Court of Canada was refused.

[5] The present action was commenced in 1994. The plaintiffs were investors in Cavalier and they claim in civil conspiracy, unlawful interference with economic

relations and negligence. The plaintiffs contend that Westminer is precluded from seeking findings of fact inconsistent with those found against Westminer by Justice Nunn and as reviewed on appeal. They contend aternatively that the findings are evidence to be weighed against Westminer in the present case. The defendants deny liability in conspiracy, interference or negligence. They seek a finding that Westminer's investigations and actions leading to the Ontario suit and the approach to the OSC were reasonable and they say that a decision of the Supreme Court of Canada released after Justice Nunn made his findings necessitates a re-examination of the findings. The defendants also contend that the present plaintiffs are bound by Justice Nunn's findings on remoteness and causation against recovery for losses related to Cavalier. Alternatively, their position is that the past findings are generally inadmissible. Further, they have put in issue mitigation and some questions concerning calculation of loss.

[6] The parties were content to place before me much evidence that I might not have to consider or might not be able to consider if I accepted either or both contentions on the present effects of Justice Nunn's findings. So those issues must be dealt with in the beginning. As will be seen, my conclusions are that the past findings do not preclude either party from raising similar issues of fact in this case, but the findings fundamental to Justice Nunn's decision are

evidence to be weighed in making the findings now required. In respect of the Seabright aspect of this case, I have reached the same factual conclusions as Justice Nunn did. I have reached somewhat different factual findings respecting the Cavalier aspect of the case. However, I have reached the same conclusion, that the losses are not recoverable from the defendants.

[7] After dealing with the question of the effects of the past findings, I shall set out my findings of fact in detail. I shall then give the reasons for my conclusion that the plaintiffs have not made out the causes alleged against the defendants. In case I have erred in that regard, I shall provide alternative findings on causation, calculation of damages and mitigation.

EFFECTS OF PAST FINDINGS

Positions of the Parties.

[8] Counsel for the plaintiffs submitted that the defendants are precluded from raising defences which are inconsistent with findings made against them by Justice Nunn and confirmed by the Court of Appeal in the previous suit. This argument would apply the doctrine of abuse of process, but with a new feature. Counsel argue that in Canada abuse of process has borrowed a principle from the American law of collateral estoppel, which is the equivalent of the branch of res judicata we refer to as issue estoppel. In their pre-trial brief counsel characterize the applicable principles this way: "a party who has fully litigated an issue in a court of competent jurisdiction cannot later relitigate that same issue in another proceeding" and, subject to two exceptions, "the party is bound by the findings with respect to all material facts even where the subsequent proceeding involves a third party who was not present in the first proceeding." The first of these expresses, in a general way, the law of issue estoppel. The second expresses the American abolition or modification of one element of collateral estoppel, which is also a part of our issue estoppel: for res judicata to apply the parties in the new action must have been parties or privies of parties in the previous action. The requirement for mutuality has been largely abolished

in the United States. Some authorities have suggested its abolition from the law of issue estoppel in Great Britain and Canada. Here and in Great Britain parties who assert a position contrary to findings made against them in previous proceedings not involving the party presently opposite have sometimes been constrained by the court's authority to prevent an abuse of process. The argument on behalf of the plaintiffs suggests that the courts have brought some certainty to one application of abuse of process by incorporating a principle similar to issue estoppel but without the requirement for mutuality. In addition to the argument that the defendants are, in effect, bound by the findings in the Seabright action even though the present plaintiffs were not parties to that action, the plaintiffs refer to a "halfway house" by which they are entitled to produce and rely upon the previous findings as evidence in the present case. Plaintiffs' counsel referred extensively to authorities in the United States, the United Kingdom and Canada on abuse of process, issue estoppel and previous findings as evidence.

[9] Defendants' counsel argue that the claim advanced by the plaintiffs is an abuse of process. They say that the present plaintiffs were closely associated with the plaintiffs in the Seabright actions, who lost on a point essential to recovery in the present case. In the circumstances, to re-litigate that point is abusive or

gives rise to a conduct estoppel. In their pre-trial brief, the defendants assert, in language similar to that on behalf of the plaintiffs, that one application of "the broad doctrine of abuse" arises "when a party seeks to raise the same issue that has already been decided in a prior proceeding" and "that party will be estopped or precluded from re-litigating that issue." The defendants claim that an exception to this rule arises where the law applicable on the facts of the first case changes after the case was decided, and they assert that a decision of the Supreme Court of Canada fundamentally altered the law that guided Justice Nunn. Thus, the defendants are not prevented from re-litigating facts found against them. As regards the evidentiary value in this case of Justice Nunn's findings in the previous case, it is the defendants' position, based on a recent decision of the Privy Council, that no notice may be taken of past findings in formulating findings in a subsequent case.

[10] Counsel provided me with extensive authorities along with their pre-trial briefs. In light of the similar positions on the interrelationship of abuse of process and res judicata and also in light of some difficulties I had with that subject on an initial reading of the authorities, I suggested during trial that counsel may wish to consider providing even more extensive references in the end. I am grateful for the assistance of counsel in that regard, and particularly for a very thorough

and balanced presentation by Mr. Roy and Mr. Rollwagen. While I accept that an adverse finding in previous litigation not involving the party opposite may be significant of an abuse of process, I do not agree that re-litigating the issue is necessarily abusive or that it is necessarily abusive subject to the exceptions identified by the parties. In my opinion, res judicata precludes re-litigation according to principles that are rather precise, such that the application or otherwise of res judicata is usually predictable with a degree of certainty. The requirement of mutuality remains a part of the branch of res judicata known as issue estoppel. In my opinion, abuse of process involves a power of the court that cannot be exercised by any precise rule. I will discuss the three relevant branches of law separately: res judicata, issue estoppel and previous findings as evidence.

Res Judicata.

[11] Early in the last century, the Supreme Court of the United States regarded the requirement for mutuality in estoppel by judgment as “elementary law”: *Bigelow* v. *Old Dominion Cooper Co*. (1912), 225 U.S. 111 (S.C.) at p.127. The court revisited the issue in 1936. Mr. Lowell had sued for patent infringement and he had lost because his patent was found to be invalid.

Undeterred, he sued another person, Mr. Triplett, alleging infringement of the same patent. The Supreme Court decided Mr. Lowell could do this because the new suit involved a different defendant: *Triplett and others* v. *Lowell and others* (1936), 297 U.S. 638 (S.C.). The court said at p. 642, "While the earlier decision may by comity be given great weight in a later litigation and thus persuade the court to render a like decree, it is not res adjudicata and may not be pleaded as a defence." Thirty-five years after *Triplett* v. *Lowell*, the Supreme Court decided to abolish the requirement for mutuality, at least in cases where a suit is defended on the ground of a previous, adverse and fundamental finding against the present plaintiff: *Blonder-Tongue Laboratories* v. *University of Illinois Foundation and others* (1971), 402 U.S. 313 (S.C.). The University of Illinois Foundation held an assignment of a patent. It sued quite a few people in different states at various times for infringement of the same patent. It lost one of the earliest of these suits, which was brought against a company in Iowa. The Iowa court found the patent to be invalid. Another of the suits went to trial about a year later in Chicago against customers of Blonder-Tongue Laboratories, who defended for them. Blonder-Tongue did not even argue res judicata. Why would it? The facts were, for that purpose, identical to those in *Triplett* v. *Lowell*. The Illinois court disagreed with the Iowa court. The patent was found

to be valid. The case went to the Supreme Court of the United States, and it was the court, rather than Blonder-Tongue Laboratories, which raised the question of abolishing the requirement for mutuality. The court asked the parties to address this issue: "Should the holding of *Triplett* v. *Lowell*, 297 U.S. 638, that a determination of patent invalidity is not res judicata against the patentee in subsequent litigation against a different defendant, be adhered to?" Both the University Foundation and, against its particular interest, Blonder-Tongue, argued in favour of *Triplett* v. *Lowell*. However, the Court unanimously decided to overturn its previous holding. Justice White wrote the decision. He surveyed academic and judicial criticism going back as far as Jeremy Bentham. I summarize Justice White's reasons in two general propositions: 1) no unfairness results from estoppel which is not mutual where a party is reasserting an issue previously decided against the party after a full and fair opportunity to present evidence and be heard, and 2) requiring mutuality in such cases is uneconomic. His general discussion of economic policy is found at page 328, and his very detailed discussion of the economics of mutuality in patent litigation extends from page 330 to page 350. As regards fairness, the first general proposition seems to be treated as axiom in Justice White's discussion at pages 322 to 327. At page 329, he says that the American constitutional right to due process

precludes estoppel against a defendant who never appeared in the prior action, and he expresses some reservation about the "offensive use" of estoppel where it is asserted against a defendant. Otherwise, the absence of unfairness in estopping re-litigation of an issue by a previously unsuccessful plaintiff against a new defendant follows almost axiomatically from the original opportunity of full and fair hearing. He said,

> Although neither judges, the parties, nor the adversary system performs perfectly in all cases, the requirement of determining whether the party against whom an estoppel is asserted had a full and fair opportunity to litigate is a most significant safeguard. (page 329)

This seems to describe the safeguard provided through appellate review of fact finding in original proceedings, and a question that might deserve consideration is how the opportunity to litigate would have been exercised had the circumstances of the new defendant been in issue.

[12] American judges and scholars sometimes use the phrase "offensive collateral estoppel" when speaking of a plaintiff who seeks to preclude a defence on the ground that the defendant lost on an issue fundamental to the defence in previous litigation not involving the present plaintiff. That was the situation in

Parklane Hosiery Co. v. *Shore* (1979), 439 U.S. 322 (S.C.) when the Supreme Court of the United States last considered issue estoppel and the requirement for mutuality. Shore brought a class action for shareholders against Parklane, its directors and officers in connection with a proxy statement made in the course of a merger. The statement was alleged to have been materially false and misleading. Before that suit came to trial, the U.S. Securities and Exchange Commission sued Parklane on the same ground, proceeded to trial, and obtained a declatory judgment that the proxy statement was materially false and misleading. Shore moved for partial summary judgment in his suit. When the case reached the Supreme Court, Justice Stewart wrote for the majority. He said:

> Collateral estoppel, like the related doctrine of res judicata, has the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party or his privy and of promoting judicial economy by preventing needless litigation. (p. 326)

(It is clear from footnote 5 of the decision that, where we refer to issue estoppel and cause of action estoppel as the two parts of res judicata, collateral estoppel is the modern American equivalent of our issue estoppel and res judicata is the equivalent of our cause of action estoppel.) Justice Stewart discussed the requirement for mutuality,

criticism of it and the abrogation in 1971. He said the unabrogated requirement had been based “on the premise that it is somehow unfair to allow a party to use a prior judgment when he himself would not be so bound” (p. 327) and the requirement had failed “to recognize the obvious difference in position between a party who has never litigated an issue and one who has fully litigated and lost” (p. 327). After discussing *Blonder-Tongue Laboratories* v. *University of Illinois Foundation*, Justice Stewart noted that that case had involved "defensive use of collateral estoppel", and the case at hand concerned “offensive use of collateral estoppel” (p. 329). And he said, “the two situations should be treated differently” (p. 329). In explaining this, he began by pointing out that permitting collateral estoppel against a defendant does not serve judicial economy in the same way as does its use in defence. Defensive collateral estoppel gives “a plaintiff a strong incentive to join all potential defendants”, while with offensive collateral estoppel “the plaintiff has every incentive to adopt a ‘wait and see’ attitude”, and so a strict rule for the offensive variety would “increase rather than decrease the total amount of litigation” (p. 329-330). Justice Stewart then turned his attention to some concerns about fairness. Firstly, he noted that the defendant may have been sued originally for a small amount, and have chosen not to defend vigorously (p. 330). (It is difficult to see how this distinguishes the two kinds of collateral estoppel. What if the first patent infringement alleged by the University of

Illinois Foundation had been nominal, and the Blonder-Tongue case had been serious?) Secondly, he referred to the situation where "the judgment relied upon as a basis for the estoppel is itself inconsistent with one or more previous judgments in favour of the defendant" (p. 330). (Again, I have difficulty seeing how this distinguishes the once unsuccessful defendant from the once unsuccessful plaintiff. What if the University Foundation had succeeded in the first of its trials, and lost subsequently?) Finally, he referred to the situation "where the second action affords the defendant procedural opportunities unavailable in the first" (p. 330-331). (Again, the situation could be the same where estoppel is asserted defensively.) Although some of these concerns for fairness could arise in cases of collateral estoppel against a plaintiff, they justified a new approach where collateral estoppel is advanced against a defendant:

> We have concluded that the preferable approach for dealing with these problems in the federal courts is not to preclude the use of offensive collateral estoppel, but to grant to trial courts broad discretion to determine when it should be applied. The general rule should be that in cases where a plaintiff could easily have joined in the earlier action or where, either for the reasons discussed above or for other reasons, the application of offensive estoppel would be unfair to a defendant, a trial judge should not allow the use of offensive collateral estoppel. (p. 331-332)

[13] So, it appears that the Supreme Court of the United States abolished mutuality as a requisite of collateral estoppel. In that country, mutuality is not an issue where a defendant sets up collateral estoppel against a plaintiff, but where it is set up against a defendant and the plaintiff was not party to the original trial

there is a broad discretion to apply collateral estoppel or not. Generally speaking, the discretion should be exercised against estoppel where the plaintiff could easily have joined the earlier trial, where the earlier suit involved a small sum, where there are inconsistent judgments, where procedural opportunities were unavailable at first instance or where estoppel would be unfair for other reasons. I must note my respect for these high authorities because I have a very simple criticism of them. I fail to see how justice is served by a system which necessarily stops the once unsuccessful plaintiff but not necessarily the once unsuccessful defendant. The problem, as I see it, is that the Court in 1971 treated a full and fair opportunity to litigate an issue as ensuring the fairness of binding a party in any future suit, where in 1979 the Court began to explore the unfairness such a rigid approach could work in some particular cases. In the course of Justice White's remarks in 1971 he mentioned a number of developments analogous to the abrogation of mutuality and he said these developments "enhance the capabilities of the courts to deal with some issues swiftly but fairly" (para. 33). Among these he included the "expansion of the preclusive effects afforded criminal judgments [he could only have meant convictions] in civil litigation" (para. 33). On that note, I turn to the English experience.

[14] Originally res judicata referred only to cause of action estoppel. The term "issue estoppel" originated in a 1921 decision of the High Court of Australia: *Hogsted and others* v. *Federal Commissioner of Taxation* (1921), 29 C.L.R. 537 (A.H.C.) at p. 560. By 1964, Lord Diplock was able to describe issue estoppel as the second specie of res judicata: *Thoday* v. *Thoday*, [1964] 1 All E.R. 341 (C.A.) at p. 352. Two years later, Lord Guest identified three requirements for issue estoppel, mutuality being the third:

> ...(1) that the same question has been decided; (2) that the judicial decision which is said to create the estoppel was final; and, (3) that the parties to the judicial decision or their privies were the same persons as the parties to the proceedings in which the estoppel is raised or their privies. [*Carl Zeiss Stiftung* v. *Rayner & Keeler Ltd. (No. 2)*, [1966] 2 All E.R. 536 (H.L.) at p. 564.]

There is probably a fourth requirement in English law, that the question was fundamental to the decision made earlier: see the discussion of English authorities at pp. 555 and 556 in *Angle* v. *M.N.R.* (1974), 47 D.L.R. (3d) 544 (S.C.C.).

[15] In *Hollington* v. *Hewthorn*, [1943] 2 All E.R. 35 (C.A.), the plaintiff in an automobile case tried unsuccessfully to set up the defendant's conviction for careless driving, which came out of the same collision. Plaintiff's counsel was Mr. Denning, later of the Court of Appeal, the House of Lords, then returning to the Court of Appeal. Twice Lord Denning criticized the insistence upon

mutuality in *Hollington* v. *Hewthorn*: *Goody* v. *Odhams Press Ltd*., [1966] 3 All E.R. 369 (C.A.) at p. 371 and *Barclays Bank Ltd.* v. *Cole*, [1966] 3 All E.R. 948 (C.A.) at p. 949, and, on a third opportunity, he wrote for a majority of the Court of Appeal to abolish the requirement. The facts are infamous. IRA bombings killed twenty-one in Birmingham one night in November of 1975. Six Irishmen signed confessions. There was no question the Irishmen had been severely beaten. The question was whether false confessions had been beaten out of the men by the police or the beatings had been inflicted solely by prison guards afterwards. The trial judge decided the confessions had been given voluntarily. The jury returned guilty verdicts. Hoping evidence not led at trial would assist them, the six sued the police for the assaults. It was well known that the men continued to profess their innocence and hoped a civil trial might vindicate them: Fr. Denis Faul & Fr. Raymond Murray, *The Birmingham Framework* (Ireland, 1976). The police moved to strike the statements of claim on the grounds of issue estoppel and abuse of process. The motions were denied, and the police went to the Court of Appeal. Lord Denning referred to nineteenth century criticism of the requirement for mutuality including Bentham's criticism of it: *McIlkenny* v. *Chief Constable of West Midlands Police Force and others*, [1980] 2 All E.R. 227 (C.A.) at p. 235. He referred

to the American criticism as having been "just as scathing as Jeremy Bentham": *McIlkenny*, p. 235, and he stated the American position on mutuality as follows:

> They take a distinction between a decision *in favour* of a man and a decision *against* him. If a decision has been given *against* a man on the identical issue arising in previous proceedings and he had full and fair opportunity of defending himself in it, then he is estopped from contesting it again in subsequent proceedings. Not only is he estopped but so are those in privity with him. But there is no corresponding estoppel on the person in whose favour it operates. (*McIlkenny*, p. 235)

Lord Denning believed there was some support for this position in an eighteenth century decision of the House of Lords: *McIlkenny*, p. 236, and he specifically adopted *Blonder-Tongue Laboratories Inc.*: *McIlkenny*, p. 238. He did not mention *Parklane*, which had been decided the year before Denning wrote his opinion. So, we see no mention of the broad discretion created by *Parklane*. However, Lord Denning did envisage instances where issue estoppel might work an injustice, and he proposed a solution. This came up in his discussion of the requirement for finality, rather than mutuality. In that context, he referred to "cases where it might be unjust to apply an issue estoppel": *McIlkenny*, p. 238 and he suggested this solution:

> ... when an issue has been decided by a competent court *against* a party in an earlier proceeding, it should only be regarded as final if he has had a full and fair opportunity of defending himself therein unless the circumstances are such that it would not be fair or just to allow him to re-open it in subsequent proceedings. (*McIlkenny*, p. 238)

So, I read Denning as having put forward something slightly different than the American approach. Where the Americans have a broad discretion to avoid issue estoppel only where it is advanced by a person who was not a party to the original decision and it is advanced against a defendant rather than a plaintiff, Denning suggested qualifying the whole of issue estoppel where "there are circumstances which make it fair or just to re-open the issue": *McIlkenny*, p. 240.

[16] Mr. McIlkenny was one of the six convicted Irishmen. Mr. Hunter was another. The case went on to the House of Lords where Mr. Hunter's name is reported in the style: *Hunter* v. *Chief Constable of the West Midlands Police*, [1981] 3 All E.R. 727 (H.L.). The requirement for mutuality was re-affirmed. Issue estoppel was "... restricted to that species of estoppel per res judicata that may arise in civil actions between the same parties or their privies ...": *Hunter*, p. 733. However, the House reached the same conclusion as did the Court of Appeal. Agreeing with the decision of Goff LJ., the House of Lords dismissed the appeal on the ground that the suits were an abuse of process. Incidentally, this was not the last word on Mr. McIlkenny, Mr. Hunter and the others. Lord Denning referred to the convicted Irishmen as "the Birmingham bombers": *McIlkenny*, p. 231. So did Lord Diplock: *Hunter*, p.730. However, the convictions were set aside by the Court of Appeal in 1991 after the men had

been in prison for sixteen years: *R.* v. *McIlkenny and others*, [1992] 2 All E.R. 417 (C.A.).

[17] Counsel for both parties referred me to decisions in other Commonwealth countries. In a reference to the full court, a majority of the Australian Federal Court (General Division) rejected an argument that non-mutual estoppel was part of the law of Australia: *Saffron* v. *Federal Commissioner of Taxation* (1991), 102 A.L.R. 19 (F.C., G.D.). The dissenting judge was of the view that the American position was analogous to the application of abuse of process in *Hunter*, a subject I will discuss in reference to abuse of process. It appears equally clear that the requirement for mutuality remains part of the law of New Zealand: *Hamed Abdul Khaliq Al Ghandi Company* v. *New Zealand Dairy Board* (1999), CA110/98 (N.Z.C.A.).

[18] There are Canadian decisions which may suggest that abuse of process operates in much the same way as would issue estoppel if issue estoppel did not include the requirement for mutuality. Abuse of process is the next subject, and I shall refer to those decisions then. For me, the law governing issue estoppel is stated conclusively by *Angle* v. *M.N.R.* (1974), 47 D.L.R. (3d) 544 (S.C.C.). At p. 555, after referring to a decision of the High Court of Australia in *Hoysted* where the name "issue estoppel" was coined to distinguish this branch of res judicata from

cause of action estoppel, Justice Dickson, as he then was, accepted Lord Guest's statement in *Carl Zeiss Stiftung* of three requirements for issue estoppel:

> ...(1) that the same question has been decided; (2) that the judicial decision which is said to create the estoppel was final; and, (3) that the parties to the judicial decision or their privies were the same persons as the parties to the proceedings in which the estoppel is raised or their privies.

Dickson J. recognized a fourth requirement: "The question out of which the estoppel is said to arise must have been 'fundamental to the decision arrived at' in the earlier proceedings" (p. 555-556). This statement of the four requirements of issue estoppel was repeated in *Grandview* v. *Doering*, [1976] 2 S.C.R. 621 and was referred to by our court of appeal as recently as *Fickes* v. *Lamey et al.* (1997), 165 N.S.R. (2d) 184. As far as I am aware, only one Canadian authority has gone so far as to embrace the positions of Lord Denning and the United States Supreme Court: *Bjarnarson et al.* v. *Manitoba* (1987), 21 C.P.C. (2d) 304 (M.Q.B.) affirmed on different grounds (1987), 21 C.P.C. (2d) 312 (M.C.A.). After reviewing English and American decisions and immediately before the passage in which Chief Justice Hewak accepted "both the direction and reasoning found in the decisions of Lord Denning and the United States Supreme Court, and the principles there applied", he said:

> In Canada, it appears that insofar as the development of the doctrine of issue estoppel is concerned, Courts have moved rather slowly toward adopting the logic and reasoning of Lord Denning, have relied on the principle of abuse of process although they have on occasion accepted, subject to rebuttal, prior determinations as prima facie evidence of a fact. [p. 311]

Some Canadian decisions do seem to suggest that a Canadian case that could be met by issue estoppel as Lord Denning would have recast it or by collateral estoppel in the American view, will be met on the same terms in Canada by exercise of the power to prevent abuse of the court's process. Does Canada have issue estoppel without a requirement for mutuality, but under the guise of abuse of process?

Abuse of Process.

[19] The decision which comes the closest to affirmatively answering the question just posed is that of Chief Justice McEachern in *Saskatoon Credit Union Ltd.* v. *Central Park Enterprises Ltd. et al.* (1988), 47 D.L.R. (4th) 431 (B.C.S.C.). A creditor sued to set aside certain transfers as fraudulent. The creditor succeeded at trial, the defendant appealed, the parties settled before the appeal was heard and the appeal was dealt with by consent. Another creditor sued to set aside the same transactions, and the same defences were raised. The court allowed a motion to strike parts of the defence. The Chief Justice said, "no doubt the

traditional approach to estoppel per rem judicatum operates only between the same parties or their privies" (p. 437), but more recent authorities "particularly Lord Denning, have suggested that the principle of abuse of process prevents a party from relitigating a question which has been fairly decided against him" (p. 437). Note the distinction between estoppel and abuse of process. He suggested that the requirement for mutuality recognized in *Angle* had not been applied strictly in Canada (p. 437). The Chief Justice concluded that "no one can relitigate ... an issue that has previously been decided against him ... where he has or could have participated in the previous proceedings unless some overriding question of fairness requires" (p. 438). Chief Justice McEachern declined "to decide whether the foregoing conclusion represents the application of a species of estoppel by res judicata or abuse of process." For present purposes, they would appear one and the same.

[20] *Bomac Construction Ltd. and others* v. *Stevenson and others*, [1986] 5 W.W.L. 21 (S.C.A.) also seems to go far in equating issue estoppel without mutuality and abuse of process. Two passengers were injured in a plane crash. One sued successfully. The other brought an action against the same defendants, who sought to defend on similar grounds. The defences were set aside. The defendants appealed. As to issue estoppel, the Saskatchewan Court of Appeal

said at p. 25, "The problem in the application of that doctrine is that it has only been applied in situations where the same issue is being raised by the original parties or their privies." However, the subject could be considered "under the broad heading of the concept of abuse of process" (p. 26). The court referred to *Hunter* (p. 26), commented on the identity of issues in the two cases (p. 27), and expressed the view at page 28 that any injustice resulting from the defendant not having a trial on the present plaintiff's claim was "less than the potential injustice perpetuated both on the parties and the judicial system by having the same basic issues dealt with in two or perhaps three separate trials."

[21] *Nigro* v. *Agnew-Surpass Shoe Stores Ltd. et al.* (1978), 82 D.L.R. (3d) 302 (O.H.C.) may be an early example of a case in this category. Twelve actions were brought because of a fire in a shopping centre. There was no order for consolidation or for trial together. Each raised issues of whom among several defendants had caused the fire. One of these actions proceeded to trial and the judge found Agnew-Surpass caused the fire and was liable to a fellow tenant in negligence. Agnew-Surpass was prevented from re-litigating that issue in the other actions. The Ontario High Court expressed the view at p. 304 that "An estoppel, based on a prior judgment, is not limited to cases where there is an identity of the subject-matter of the litigation and of the parties." Rather, the

court referred to the "inherent jurisdiction to prevent an abuse of process" in saying that the court should take "a rather broader view of the matter than by simply applying the doctrine of *res judicata* in its narrow sense" (p. 305). The court expressed opinions that the issue had been decided for all defendants "among themselves" and that the present plaintiffs had so identified themselves with the first plaintiff that they could not plead that any defendant other than Agnew-Surpass had caused the fire. For those reasons, pleadings inconsistent with the findings in the first action were struck.

[22] While *Nigro*, *Bomac* and *Saskatoon Credit Union* suggest that cases involving the elements of issue estoppel except mutuality may almost axiomatically give rise to abuse of process, other authorities clearly indicate that abuse of process entails a more particular inquiry into the circumstances of each case and a less predictable outcome. *Solomon* v. *Smith et al.* (1987), 45 D.L.R. (4th) 266 (M.C.A.) involved claims in negligent and fraudulent misrepresentation against a house agent. The plaintiff had been the defendant in a related action not involving the agent. The claim was at odds with the findings of the previous action. The action was struck by the Manitoba Queen's Bench. Three members of a panel of the Manitoba Court of Appeal each wrote their own reasons, two of whom concluded the appeal should be dismissed. All three agreed that issue

estoppel was not applicable because of lack of mutuality. O'Sullivan J.A. was of the opinion that the action did not amount to an abuse, and he commented upon differences in the issues raised by the two actions. Philp J.A. and Lyon J.A. agreed with each other's reasons. Justice Philp provided the reasons for their conclusion that issue estoppel was inapplicable. He concluded that mutuality remained a requirement in issue estoppel as stated in *Angle* (p. 271). Justice Lyon provided reasons on abuse of process, and he held that re-litigation of the issues determined in the earlier action was abusive in the circumstances. He distinguished the approach to be taken where abuse of process is alleged from the approach taken in assessing issue estoppel:

> I agree with Philp J.A. that a plea of issue estoppel is not available. However, to permit the statement of claim to proceed would be an abuse of process and that is the principle applicable. In considering this doctrine, it seems to me prudent to avoid hard and fast, institutionalized rules such as those which attach to the plea of issue estoppel. By encouraging the determination of each case on its own facts against the general priniciple of the plea of abuse, serious prejudice to either party as well as to the proper administration of justice can best be avoided. Maintaining open and ready access to the courts by all legitimate suitors is fundamental to our system o f justice. However, to achieve this worthy purpose, we must be vigilant to ensure that the system does not become unnecessarily clogged with repetitious litigation of the kind here attempted. There should be an end to this litigation. To allow the plaintiff to retry the issue of misrepresentation would be a classic example of abuse of process – a waist of the time and resources of the litigants and the court and an erosion of the principle of finality so crucial to the proper administration of justice. [p. 275]

One month after releasing the decision in *Solomon*, the Manitoba Court of Appeal released its decision *Bjarnarson*, which I have already cited. Although the court dismissed the appeal from Chief Justice Hewak's decision, the court of appeal did not adopt his reasoning, which had embraced the approach of Lord Denning to mutuality in issue estoppel and the American approach in respect of collateral estoppel. Rather, the Manitoba Court of Appeal referred to *Solomon* and it found abuse in the circumstances of the case before it.

[23] Similarly, one of the earlier decisions of the Ontario Court of Appeal on this subject indicates that to establish abuse of process requires something more than proof of issue estoppel without mutuality. The appellant in *Demeter* v. *British Pacific Life Insurance Co.* (1984), 48 O.R. (2d) 266 (C.A.) had been convicted of murdering his wife. He sued on a policy that had insured her life. The record before the motions judge included Mr. Demeter's statement that "I am not here for the money, I am here to reopen my case." The Ontario Court of Appeal, at p. 268, said, "... the use of a civil action to initiate a collateral attack on a final decision of a criminal court of competent jurisdiction in an attempt to relitigate an issue already tried, is an abuse of the process of the court." This is identical to the position of the House of Lords in *Hunter*. Let us take a brief look at

Hunter and the cases which followed it, before returning to Canadian authorities on this subject.

[24] The basis for the finding of abuse in *Hunter* was expressed by Lord Diplock at p. 733:

> The abuse of process which the instant case exemplifies is the initiation of proceedings in a court of justice for the purpose of mounting a collateral attack on a final decision against the intending plaintiff which has been made by another court of competent jurisdiction in previous proceedings in which the intending plaintiff had a full opportunity of contesting the decision in the court by which it was made.

More was required to establish abuse of process than the mere fact that the plaintiffs were seeking findings inconsistent with those found against them in the earlier proceeding. The plaintiffs' motivation was the additional component which made the civil action abusive. This point about *Hunter* was discussed in decisions of the Court of Appeal where that court has made it clear that circumstances which would, but for one requirement of mutuality, give rise to an issue estoppel do not necessarily give rise to an abuse of process: *Bragg* v. *Oceanus Mutual Underwriting Association (Bermuda)*, [1982] 2 Lloyd's L.R. 132 (C.A.); *Ashmore* v. *British Coal Corporation*, [1990] 2 All E.R. 981 (C.A.); *Bradford & Bingley Building Society* v. *Seddon*, [1999] 4 All E.R. 217 (C.A.); and, *Sweetman* v. *Shephard* (2000), 144 S.J.L.B. 159 (C.A.). In *Bradford & Bingley Building Society*, for example, Auld L.J. said at p. 225, "it is

important to distinguish clearly between res judicata and abuse of process not qualifying as res judicata." He explained:

> The former [res judicata], in its cause of action estoppel form, is an absolute bar to relitigation, and in its issue estoppel form also, save in "special cases" or "special circumstances" .... The latter [abuse], which may arise where there is no cause of action or issue estoppel, is not subject to the same test, the task of the court being to draw the balance between the competing claims of one party to put his case before the court and of the other not to be unjustly hounded given the earlier history of the matter.

A similar point is made in some Canadian authorities. In *Re Del Core and Ontario College of Pharmacists* (1985), 19 D.L.R. (4th) 68 (O.C.A.), Houlden J. A. wrote the majority opinion. He pointed out at p. 85 the "ulterior motive for bringing the proceedings is important in the abuse of process cases" and he referred to the importance of ulterior motive in both the *Hunter* and the *Demeter* decisions. In the circumstances of *Taylor* v. *Baribeau* (1985), 51 O.R. (2d) 541 (O. Div. Ct.), the plaintiff's "real interest" (p. 547) in his claim was significant for a finding that his action was not abusive although he was alleging negligence in a motor vehicle collision in respect of which he had been convicted of dangerous driving. In *Q.andQ.* v. *Minto Management Ltd.* (1984), 46 O.R. (2d) 756 (H.C.) it was said at p. 760 that it may be abusive for a convicted criminal to bring action that requires findings in contradiction

of the conviction, but that is not the case where the victim sues and the defence alleges "that he did not do it".

[25] I follow the decision of the Manitoba Court of Appeal, the decision of Houlden J.A. in *Del Core* and the decisions of the English Court of Appeal I have cited. In my opinion, a clear distinction must be maintained between issue estoppel and abuse of process, the former serving to stop re-litigation of issues by the application of rather precise principles and the latter serving to stop any litigation where it is shown that the process which is to serve justice is being abused to work an injustice. The latter involves diffuse considerations that cannot be contained within a precisely stated rule with precisely stated exceptions. Thus, the fact that a party pleads inconsistently with findings made in other proceedings may be a relevant fact going to abuse of process but it can never be determinative. Rather, all relevant circumstances are to be considered in settling the balance indicated by Lyon J.A. in *Solomon* and referred to by Auld L.J. in *Bradford* v. *Bingley Building Society.*

Evidentiary Value of Past Findings.

[26] In the sixty years since it was decided *Hollington* v. *F. Hewthorn & Co. Ltd.* travelled full circle in England, but it does not appear to have travelled to

Canada. As discussed in reference to issue estoppel, in that case the English Court of Appeal decided that a conviction for dangerous driving could not be introduced in a civil trial towards proving negligence of the convicted driver. The decision has been criticized as unjust by law reform commissions, judges and academics: John Sopinka, Sydney N. Lederman & Alan W. Brant, *The Law of Evidence in Canada*, 2nd ed. (Butterworths, 1999), p. 1119-1120. It has been the subject of legislative attention in England, Ontario, Alberta and British Columbia. It was the butt of Lord Denning's dramatic criticism in the cases to which I referred. And, in *Hunter*, Lord Diplock said that *Hollington* was "generally considered to have been wrongly decided" (p. 734). However, in *R.* v. *Hui Chi-Ming*, [1992] 1 A.C. 34 (P.C.), a capital case involving conspiracy to murder, the Privy Council upheld conviction and rejected an argument for Mr. Hui that he ought to have been permitted to introduce the certificate of conviction of an alleged co-conspirator who had been convicted of the lesser charge of manslaughter, tending to show there had been no conspiracy to murder. The Privy Council referred to *Hollington* and applied the principle decided by it. *Hollington* and *Hui Chi-Ming* were followed in *Land Securities plc* v. *Westminster City Council*, [1993] 4 All E.R. 124 (Ch.D.), where an

arbitrator's determination of market rent was held to be inadmissible in subsequent proceedings where the market rent was a fact in issue.

[27] In *Taylor*, to which I referred in discussing abuse of process, the Divisional Court in Ontario held that a certificate of conviction for dangerous driving was admissible to prove civil negligence "subject to rebuttal" (p. 545) but detailed findings were inadmissible. The judge who had decided the dangerous driving case had, in his decision, made findings that would touch upon causation and contributory negligence. Writing for the Divisional Court, Craig J. said the judge "was not required to decide those issues". (I emphasize the words "not required".) In light of the volume of *Highway Traffic Act* convictions "being registered on a regular basis by justices of the peace in provincial offences courts", Craig J. said "in the absence of the clearest authority I would hold that the reasons for conviction or findings of fact in support of the conviction are not admissible". This passage and the subsequent discussion of abuse of process seem to have been considered to the exclusion of the earlier passages indicating the certificate of conviction itself was admissible to prove negligence when *Taylor* was considered in *Edwards* v. *Law Society of Upper Canada* (1995), 40 C.P.C. (3d) 316 (O. Gen. Div.), which was followed by *876502 Ontario Limited* v. *I. F. Propco Holdings*, [1998] O.J. No. 3277 (O. Div. Ct.). With respect, I

think that the conclusion in those cases, that the reasons for conviction and the findings are inadmissible unless the parties are identical, takes *Taylor* as more restrictive than it was meant to be.

[28] There is a remark in *Fullowka* v. *Whitford* (1996), 147 D.L.R. (4th) 531 (N.W.T.C.A.) at p. 546 that suggests *Hollington* applies in Canada. After referring to "the rule in *Hollington*" the court said, "In jurisdictions which have not repealed that rule, such other judgments are not ever admissible at trial." While some Canadian jurisdictions have enacted legislation following the amendments to the *Civil Evidence Act* (1968) that were designed to negative the effects of *Hollington* in England, the question remained whether *Hollington* would be adopted in Canada. With respect, the comment in *Fullowka* would have been more accurate if it had also been qualified by a condition that the rule does apply here. The weight of authority is that *Hollington* was never good law in Canada. This was the specific holding for Ontario in *Demeter*. And it is implicit in *Del Core*. As Sopinka, Lederman & Bryant put it, those provinces which enacted legislation "ensured" (p. 112) that the rule is not a part of their law. In my opinion, *Hollington* is not good law in Nova Scotia. Facts necessarily indicated by a criminal conviction may be proved in a civil case by admission of a certificate of the conviction for whatever weight the past finding

may have among all of the evidence going to the fact-in-issue. Is the situation any different for essential findings in an earlier civil proceeding?

[29] There is little authority to guide the answer to that question. It may be helpful to recall what the Supreme Court of the United States said in 1936 when mutuality was still a requirement of res judicata in American law: "... the earlier decision may by comity be given great weight in a later litigation and thus persuade the court to render a like decree ...": *Triplett* v. *Lowell*, p. 642. Perhaps a system of law which takes a restrictive approach to the preclusion of re-litigation ought to take a liberal approach to admitting past findings. In any case, I think it illogical to admit findings from a criminal case and exclude findings from a civil case. This is the point made in Sopinka, Lederman & Bryant at p. 1123:

> If the rule in *Hollington* v. *Hewthorn* is not to be recognized so far as it relates to a previous criminal conviction, then logically it also should not apply so far as it relates to a previous civil judgment. The fact that it is a civil judgment only would be significant in terms of weight. The party against whom the judgment was rendered would have a greater opportunity to explain it or suggest mitigating circumstances.

In my opinion this is the logical result of *Demeter*, and I would admit Justice Nunn's decision and consider the findings that were fundamental to his decision.

Conclusions.

[30] It was submitted on behalf of the defendants that the present plaintiffs were privies of Mr. Coughlan and other plaintiffs in the Seabright actions. If so, the element of mutuality was established going to issue estoppel. There is no suggestion of agency or of privity of contract or of estate, and the argument can only succeed if the plaintiffs were privies within a broader and ordinary meaning of that word. "Privy" derives from the same source as "private" and, when used as a noun it may have the sense of "one who participates in the knowledge of something private or secret; a confidant ...": Oxford English Dictionary, 2ed (Oxford, 1989), v. XII, p. 525, and for derivation see p. 515 and p. 524. The meaning of privity is discussed in *Hamed Abdul Khaliq Al Ghandi Company* v. *New Zealand Dairy Board* starting at para. 8. After referring to English authorities, the New Zealand Court of Appeal concluded, at para. 11: "One looks in particular to the identity in interests pursued, and degree of common control. That process is an intensely fact-dependent one, in which precedents may be of limited value." I cannot find that mutuality has been established against the present plaintiffs. The evidence establishes and I find

that they were not taken into the confidence of the earlier plaintiffs in connection with either the defence of the Ontario action or the prosecution of the Nova Scotia actions. They may have received some information concerning those cases and they certainly had an interest in them, but they were not privy to the defences or cases of the Seabright directors. There was no element of common control. Nor was there a significant identity of issues. Two of the plaintiffs in Seabright had no claim for any loss on account of Cavalier. As will be discussed, those five who advanced such a claim, it was bound up with many interests at stake in the litigation and of no direct interest to the present plaintiffs. If the element of common interest was strong and the element of common control or confidence was weak, or *vice versa*, a finding of privity might be appropriate in this case. But the claims are far from identical and there was no common control or confidence. In conclusion, the element of mutuality in issue estoppel has not been made out against the plaintiffs and they are not stopped from advancing their claims for damages on the ground that Justice Nunn may have made findings inconsistent with those claims. The plaintiffs made alternative arguments, including reference to Westminer's failure to disclose relevant documents in the Seabright suit. In view of my findings on mutuality, I do not need to decide upon the alternative arguments and, in view

of the fact that similar points may be made in reference to costs, I should say no more.

[31] The defendants argue that it is an abuse of process for the plaintiffs to seek findings in this case inconsistent with the findings in the Seabright case on remoteness and causation, which precluded claims of some plaintiffs in the Seabright case for losses related to investments in Cavalier. The defendants submit for a finding that, long before the beginning of the Seabright trial, the plaintiffs decided to await the outcome of that trial and to sue for themselves if the outcome indicated. That is not my finding. Without doubt, since 1988 members of the core group believed that the suit for fraud brought by Westminer against the former Seabright directors damaged investments in Cavalier. Further, starting in the fall of 1990 or earlier, there were serious discussions of Cavalier suing Westminer and, two of the plaintiffs, Sumner Fraser and William Mundle, were party to those discussions as Cavalier board members. About the same time, discussion began between Mr. Coughlan and his counsel concerning Mr. Coughlan amending the statement of claim in his action against Westminer to include a claim for the diminished value of his own investment in Cavalier, a suggestion he opposed until Cavalier actually failed. Furthermore, it is likely that many members of the core group considered the possibility of suing

Westminer for the diminished value of their own shares and one plaintiff, Mr. Peters, went so far as to consult a lawyer about participating in actions against Westminer. However, I find the plaintiffs did not seriously turn their minds to that question until an event drew the question acutely to their attention. That event was the failure of Cavalier and the realization that their shares were worthless and the debts owed to them by Cavalier were uncollectible. In February 1992, investors met to discuss a plan of arrangement under the *Companies Creditor's Arrangement Act,* and towards the end of the meeting the question of suing Westminer was raised by the plaintiff, Mr. Jacques. Notes of Cavalier's counsel suggest that Mr. Coughlan said in effect that if the former directors got justice in the Seabright suit, a suit might be brought again "on behalf of Cavalier". His brother, Mr. James Coughlan, and Dr. James Collins were witnesses with fairly precise memories of Cavalier meetings. Mr. Coughlan's recollection is that his brother had too much on his plate to engage in yet another claim and that many of the issues in the Seabright action did not concern Cavalier. He suggests his brother said he had to get his own suit over with first. Dr. Collins recalls a comment to the effect that if the former directors were successful, some other group might go ahead. The discussion was very brief. The subject at hand was National Bank demands for cash injections into

Cavalier as the price of its supporting a plan of arrangement under the *Companies' Creditors Arrangements Act*. Three weeks later, after the *CCAA* effort had failed and Cavalier had been liquidated through receivership, investors met again. There was a discussion about suing Westminer and the indication was that a decision should be put off until the outcome of the Seabright trial was known. If these events had occurred well before the Seabright trial then they might have indicated an abusive "wait and see" attitude. However, that coincided with trial. The Seabright trial commenced only six days after the *CCAA* meeting, and the trial was going into its twelfth week by the time of the meeting about the receivership. Mr. Geoffrey Machum testified for the plaintiffs. I accept his testimony. Mr. Machum and his colleague, Mr. Jonathan Stobie, worked with the late Ronald Pugsley as counsel for Coughlan and Garnett in the Seabright case. Based on Mr. Machum's testimony and the documentary exhibits to which he referred, I find it would have been unreasonable for the present plaintiffs to have sought to join in the Seabright suit when the question of Westminer's liability to them was acutely raised. For one thing, the case was extremely complicated, especially as regards sorting out the facts, and, on such short notice, the present plaintiffs could not have been served by independent counsel's independent assessment of the evidence and

independent judgments concerning framing their claims, presenting evidence and advocating their causes. Further, the present plaintiffs remained loyal to Mr. Coughlan and the other former directors and it would have been fair for the present plaintiffs to have considered the interests of the then plaintiffs. Records of meetings between Cavalier's solicitors and Mr. Pugsley indicate he was cool towards Cavalier becoming involved in the suit at the late stages. No wonder. Such would add to the complexity and length of a trial that was already to be extremely complex and so long it was record-setting for Nova Scotia. Further, the stance of the plaintiffs in Seabright was largely defensive. That was true of their specific claims relating to indemnification under Seabright by-laws and also on account of Westminer's deliberate decision to let lapse the Seabright director's and officer's insurance. However, the suit was also generally defensive. It responded to the suit brought by Westminer in Ontario and, as Mr. Machum said, counsel for the former directors were far more focused upon findings of liability under the economic torts than upon any damages that would be assessed if liability was established. The former directors had a strong interest in avoiding adjournment and in concentrating their efforts for a finding of liability.

[32] The defendants characterize the plaintiff's failure to join in the Seabright suit as taking a "wait and see" attitude. This is the attitude that was of concern in *Parklane* and proof of such an attitude would go a long way towards a finding of abuse. Aside from the fact that a wait and see attitude might be justified where the possibility of a claim was brought acutely to the attention of the new plaintiffs only on the eve of a long and complex trial, the attitude of the present plaintiffs was different than that which gave rise to concern in *Parklane*. Abuse of process may well control the party who has a claim on the same set of facts as a plaintiff and who lets the plaintiff do all the labour with a view to advancing an easy claim against the same defendant if the plaintiff is successful and advancing no claim if the plaintiff is unsuccessful. I accept the evidence of so many of the Cavalier investors who said they did not know what to make of the claims between Seabright and Westminer or that they saw many of the issues as irrelevant to their losses. Their choice not to advance claims until after the Seabright trial is distinguished from the behaviour described in *Parklane* and their attitude does not support a finding of abuse. The factual underpinnings of the defendants' argument on abuse of process have not been made out. I cannot find the plaintiffs' claims are abusive of the court's process. For the same reasons, I do not find conduct estoppel.

[33] However, the opportunity the present plaintiffs may have had to raise their present claims before Seabright came to trial tells against the plaintiffs' position that the present defence is abusive. In the circumstances, it would be unfair to bind Westminer to those of Justice Nunn's findings as may assist the present plaintiffs' claims while precluding Westminer from relying upon his findings against claims for damages identical to those now advanced. Contrary to indications in *Blonder-Tongue Laboratories* and *McIlkenny*, I conceive that the natures of the parties opposite and their counsel, their various interests and stances, influence the many decisions an opponent makes through the course of a difficult suit. Things always would be done differently if the other parties were different or were differently represented. I think there is substance rather than mere formal symmetry to the proposition that it is "somehow" unfair to bind a party to findings when the other party is not so bound. At least it is a factor going against a finding of abuse in the circumstances of a case like this. Also, the plaintiffs chose to join individuals as defendants, thus distancing themselves further from Justice Nunn's findings. In addition, the defendants argued that a decision of the Supreme Court of Canada released after Justice Nunn made his findings changed the governing law in such a way as to call his findings into question. As will be seen, I do not accept that argument.

However, a substantial argument that the law had changed indicates something against a finding of abuse. It adds weight in favour of allowing the parties their day in court and against limiting re-litigation in the balancing to which the authorities refer. Further, the issues of liability raised by the plaintiffs in this case are not identical to those raised by the plaintiffs in the Seabright case. Although many of Justice Nunn's findings are relevant to the present issues, the success of the present claims requires the court to take a step beyond what Justice Nunn found because he dealt with liability towards those who were most directly the objects of Westminer's actions. Finally, Westminer's motives in defending itself in this case are not subject to the same censure as were the motives of the plaintiffs in *Demeter* and in *Hunter*. Westminer's motives in bringing the Ontario suit and in taking other steps at that time were censured, but the present motive is proper. In the circumstances of this case, re-litigation of some questions answered in the Seabright case is not abusive. The balance is with Westminer's claim to put its defences fully before the court rather than with the interest of the plaintiffs or the justice system in avoiding re-litigation of an issue of fact. Of course, where Westminer fails to establish findings significantly different than in the past litigation, the re-litigation is relevant to costs.

[34] As I said, I am considering relevant and fundamental findings of Justice Nunn as part of the evidence in this case. Sopinka, Lederman & Bryant suggest that more weight should be given to past findings established under the criminal burden than to those established on a balance of probabilities. That notwithstanding, I am giving much weight to Justice Nunn's findings relevant to the Seabright aspect of this case. Justice Nunn was presented with a massive volume of evidence on that aspect of the case and, as one counsel observed, the evidence presented to me on that subject was "synoptic". As regards the Cavalier aspect of this case, the reverse is true.

WESTMINER AND SEABRIGHT

Westminer's Strategy for North American Acquisitions.

[35] Gold discovery and extraction is the industry upon which Westminer was founded in 1933. By the 1980s, it was one of the world's largest producers of gold and it was a prominent producer of other minerals and of oil and gas. Westminer reported annual operating revenues of more than $1 billion, and shareholder's equity in excess of $2 billion. It employed more than seven thousand people. Its shares were listed on all the Australian exchanges and on five major exchanges outside its home country. The lawyers in its legal department and senior management were well familiar with regimes of securities regulation requiring full, plain and true disclosure. Westminer relied on this cornerstone of modern securities law when it decided to acquire gold mining operations in North America, where the corporation had some experience but little presence.

[36] By 1987, Westminer determined to spend about half a billion dollars to acquire publicly traded gold mining companies in North America. It put together a team of experienced employees to work on what was called the North American Acquisition Program. As the project progressed, the team expanded. The team

was led by Mr. James Lalor, a geologist who had devoted his career to serving the corporation and who lately had been the Exploration Manager, and the team included personnel expert in geology, engineering, finance and law. Mr. Lalor reported directly to Mr. Donald Morley, the Director of Finance and Administration, and he also reported frequently to the Managing Director himself, Mr. Hugh Morgan. The project was followed closely by the chairman of the board, Sir Arvi Parbo. Westminer was interested in junior mining companies, which, as Mr. Lalor agreed during his cross-examination, are promotional by necessity, are sometimes overly promotional and must be assessed with care. At that, Westminer was not interested in established junior mining companies. It was looking for ventures that were just emerging, those with gold reserves in very early production or apparently on the verge of production. This strategic decision involved taking greater risk for greater chance of gain.

[37] Initial studies were carried out in Westminer's own library at head office in Melbourne. Library holdings included publications of the Metal Economics Group, a business which gathered and summarized information on mining operations and published the information. For a price, companies like Westminer could get advance copies. At this early stage, the team was looking

at two ratios that could be calculated for hundreds of public North American mining companies. Market capitalization is the total of issued and outstanding shares times the current share price. Westminer was concerned to know two ratios: market capitalization divided by ounces of gold produced annually and market capitalization divided by the ounces of gold in stated reserves. This study led to another strategic decision. The team saw that the ratios were less favourable with larger emerging producers. As compared with production and reported reserves, the shares of larger companies were 25% to 50% more expensive than those of small ventures. Obviously, the markets saw the small ventures as involving substantially greater risk and, as Mr. Lalor agreed during his cross-examination, they are inherently high risk. Westminer decided to acquire a number of small gold mining ventures, rather than one or two larger emerging producers. Again, a strategic decision was made in favour of risk. Having narrowed the candidates to companies with no established production and to ventures holding small, potential operations, the risk undertaken by Westminer was compounded by its choice for mode of acquisition: sudden, speedy and unfriendly take-overs. Westminer also chose utmost secrecy. Mr. Lalor explained that if the markets became aware of Westminer's interest in a small venture, the price of the shares would increase. I refer to the evidence of

one of the defendant's experts, Mr. H. Garfield Emerson, Q.C., and I find that this choice involved even greater risk. The decision to proceed in secrecy limited Westminer to information on the public record and information it could gather clandestinely. A reporting issuer is required by law to continuously disclose information to the standard provided for a prospectus, such that at all times the public files should disclose information substantially equivalent to that provided in a current prospectus as regards quantity, quality, currency and accessibility: Milton H. Cohen, *Truth in Securities Revisited* (1966), 70 Harv. L. Rev. 1340 at 1368, as referred to by Mr. Emerson. That being so, Mr. Emerson and other leaders in his field strongly recommend performing one's own diligent study of a company, sometimes referred to as "doing due diligence", when one is considering an acquisition. The requirement for full, plain and true disclosure may assure that the public record reflects a company's understanding of its assets, but it cannot assure the quality of that understanding. To forego due diligence for secrecy places a very high price on secrecy. Westminer took the price to an astonishing extreme. Not only did it forego due diligence where there would be some likelihood of Westminer's interest becoming known, it forbade due diligence when there was little or no risk to secrecy. It specifically instructed counsel, who have a fundamental obligation

to guard client confidentiality, not to carry out corporate due diligence because of "the risk of a leak". Further, Westminer deliberately decided against technical due diligence even after the take-over bids, when its interest would be public. In cross-examination, Mr. Lalor said that was an "unwise" decision. Astonishing, I say. In addition to secrecy, Westminer chose speed, a choice also made to keep share prices down, according to Mr. Morgan when he was cross-examined. Westminer would proceed from bids to closings in about a month and without terms permitting due diligence, and, in the case of Seabright, Westminer was not even interested when a sale of assets with an opportunity for due diligence was proposed as an alternative to take-over. No due diligence, speedy closings, small ventures only, none proven by established production. I find Westminer deliberately chose a strategy of great risk for its 1987 North American Acquisition Program.

Westminer's Investigation of Seabright: The Public Record.

[38] The acquisition team set up in Toronto. Westminer retained the brokerage firm First Marathon Securities Limited as financial adviser. The firm was relatively small and Westminer chose it because smallness would reduce the risk of inadvertent leaks. First Marathon provided office space to the acquisition team,

and the team had access to the firm's library, as well as its services. The team was diverted to another project, which did not bear fruit, but that exercise led to Westminer's retention of Canadian counsel, the well known commercial firm of Stikeman, Elliott, primarily Mr. William Braithwaite. During latter 1987, the team had over 130 companies under consideration. It appears about thirty-five were seen as serious contenders. By early November, they were down to eleven. One of these was Seabright Resources Inc., which, as a reporting issuer with the Ontario Securities Commission, was under a duty of continuous disclosure. Westminer studied documents obtained from the OSC in analyzing Seabright, selecting it for the short list and making a bid. Let us look closely at what those records disclosed.

[39] We begin with a prospectus dated April 23, 1986 under which deposit receipts for flow-through shares, class A common shares and warrants were offered to raise funds for exploration. From this document we learn that Seabright was incorporated under the *Canada Business Corporations Act* in 1980 to do mineral exploration in Nova Scotia and to process some tailings from old gold mines that operated many years ago when gold mining was an active industry in Nova Scotia and when less gold was extracted from ore than is possible today. We learn that the company had been "obtaining properties for early production of

gold ores" and that it had been "delineating its own gold deposits for early production." Also, "the Corporation significantly increased exploration activities in the past year." We learn that the company recently bought a zinc mill and planned to renovate it to process gold. Despite the references to early production and the acquisition of a mill, we are warned in the beginning: "The securities offered hereby should be regarded as speculative and are subject to a number of risk factors. Mineral exploration involves significant risks. The Corporation presently has no producing properties." The prospectus provides descriptions of each of Seabright's main properties, the most important of which are Beaver Dam and Forest Hill, both along the Eastern Shore, Beaver Dam in eastern Halifax County, and Forest Hill in Guysborough County. The prospectus advises that Forest Hill was once a mine that produced 27,060 ounces of gold from 49,032 tons of ore. Seabright explored parts of Forest Hill with extensive surface drilling and one bulk sample, and it began underground exploration in the previous October, and a significant amount of underground drilling had been done. Based upon the data from the surface and the underground exploration, independent consultants, MPH Consulting Limited of Toronto, had calculated probable geological reserves of 61,425 tonnes grading 9.9 grams of gold per tonne. Assuming a mine extraction rate of 90% and a

dilution rate of 20%, MPH calculated mineable reserves of 66,300 tonnes grading 8.25 grams of gold per tonne. Possible geological reserves were 184,000 tonnes grading 9.9 grams. Also, Seabright had identified four new zones worthy of exploration. MPH was recommending and Seabright was proposing to start underground exploration and to bring the mine into production if the underground exploration established sufficient proven reserves. Seabright also proposed exploration in the newly found Forest Hill zones. According to the prospectus, the Beaver Dam property had been explored and mined off and on for decades starting in the mid-nineteenth century. Recorded historical production was 3,544 tons grading .27 ounces of gold a ton. The prospectus tells us that Seabright acquired some of the Beaver Dam claims from Acadia Mineral Ventures Limited initially, and completed its holdings by further acquisitions from Acadia and two other companies, the latest being almost contemporaneous with the prospectus. Results of twenty-nine drill holes were provided to Seabright by the former holders and Seabright drilled an additional ninety-one holes at a cost of $1,360,000. Again, MPH had analyzed the results. It calculated proven geological reserves of 249,377 tonnes at 10.64 grams of gold per tonne. These proven reserves were to be located to a depth of 80 metres. Below that, and going to a depth of 200 metres, MPH calculated

probable geological reserves of 361,340 tonnes grading 10.6 grams. In addition, MPH calculated possible geological reserves of 420,000 tonnes at 10.62 grams. MPH reported upon potential for further reserves below and beside those explored, and it recommended exploration of Beaver Dam claims not yet drilled. MPH concluded that underground exploration was necessary "to determine the mineability of the reserves", and it recommended a program of underground exploration and further surface exploration. Underground exploration and underground drilling at Beaver Dam were estimated to cost $2,435,000. Further surface drilling in the area of the proven reserves, and exploration outside that area were to cost $2,460,000. If the underground exploration confirmed mineability, MPH recommended bringing the property into production at an estimated cost of $4 million. The prospectus also said:

> The Corporation expects the underground exploration program to be completed by December 1986. If justified, production from the property could begin in early 1987. If production commences, gold ore from the property will be hauled 70 kilometres over existing roads to the Corporation's Gays River Mill for processing and gold recovery.

According to the prospectus, the MPH reports were available to the public at the time of the offering. Generally speaking, the grades and tonnages reported by MPH were encouraging, especially as regards Beaver Dam where MPH calculated significant

proven reserves with encouraging grades and MPH seemed to see mineability as the only question. However, the prospectus does warn: "Hazards such as unusual or unexpected formations or other geological conditions are involved in exploring for and developing mineral deposits." Of course, the prospectus contains other information that would have been of interest to the Westminer acquisition team, such as the financial statements, Seabright's capitalization, the trading history of its shares and a summary of past offerings. Also, it tells of Seabright's management. Each officer, director and senior manager is identified and a short biography is given.

[40] The public record included a press release dated May 15, 1986, by which Seabright announced the successful completion of the April offering, which raised nearly $16 million, of which $9 million was for exploration at Beaver Dam and Forest Hill. Also, the new class A shares had been conditionally listed on the Toronto and Montreal exchanges. This was followed by a June 26, 1986 letter to shareholders, which reiterated, in Imperial, the MPH reserve calculations of April, announced a further twenty-four drill holes, and stated "the reserves are increasing dramatically". Next, there was a news release of August 20, 1986 announcing MPH calculations which took into account results from the latest drilling. The figures are Imperial: 404,018 tons at .34 ounces proven, 422,750 tons at .36 ounces probable and 823,232 tons at .35 ounces

possible. The total of proven, probable and possible reserves is given as 1,650,000 tons. These are short tons, which would be 1,496,550 metric tonnes, which compares with a total of 1,030,717 metric tonnes reported by MPH before the April 1986 prospectus, the increase being mainly in possible reserves. Seabright used a factor of .029 to convert grams per tonne into troy ounces per short ton. So the grades are being reported as slightly better than in April: 11.7 g/t, 12.4 g/t and 12.1 g/t. The release reiterates that the strike is open east, west and at depth, that is, neither of the ends nor the bottom have been reached as yet. Changing subjects, the release reports that the decline at Beaver Dam began on August 1, 1986 with a 4,400 ton bulk sample anticipated by the end of the year, and production the next spring. As for Forest Hill, a 4,400 bulk sample was anticipated by late fall, with commercial production in the spring. Note that the references to production are unqualified. Time is the same as in the April 1986 prospectus, but positive results from the underground explorations appear to be assumed. The record certified by the OSC shows that there was another letter to shareholders concerning Beaver Dam and Forest Hill exploration on September 29, 1986, and the next public document referring to those subjects was an offering memorandum for a private placement of flow-through shares dated October 10, 1986. This more formal document is less exuberant than

some of the press releases and letters to shareholders. Although work began on the decline at Beaver Dam in August, only 210 metres had been dug and the decline had not yet intersected the ore zone although the four thousand tonne bulk sample had been advertised to begin in late October 1986. Also, cost of the underground exploration was now estimated at $4,019,000. Also, the qualifying language returns, "if the ... underground exploration program confirms the mineability of the reserves ". Next, an October 29, 1986 news release titled "Positive Results Continue at Beaver Dam" announced results calculated by Seabright's own staff. Total reserves were then stated at 2,279,594 tons grading .29 ounces a ton, which I believe to be 2,067,592 tonnes at 9.94 grams, a substantial increase in the total reserves but a drop from the concentrations reported in August. Among the public documents that were seen by the acquisition group was a press release dated December 3, 1986. This announced the results of a single deep hole which suggested reserves underneath those explored earlier, but showed much lower grades of 3.43 g/t, 5.25 g/t and 7.54 g/t. The company was obviously enthusiastic. It announced MPH will provide fresh reserve calculations. It said that consultants had been engaged for a feasibility study. For Mr. Lalor, the decision to engage the consultants was significant. A feasibility study is an important step towards production, and the

retention of a consultant shows that work is progressing towards that end. The public record also showed that Seabright engaged in two private placements by way of offerings dated December 3, 1986 and January 23, 1987. Offering memoranda of this kind are not necessarily filed with the OSC and I cannot say whether they were read by the acquisition team. The December 3, 1986 memorandum characterizes the purpose of underground exploration at Beaver Dam, "to define the location, extent and quality of the gold mineralization" or "to test the extent and quality of the ore".

[41] Information provided early in the 1987 new year leads the reader to have concerns. On January 23, 1987 Seabright issued a short press release concerning the latest analysis from MPH and it delivered a lengthy letter to shareholders to update them as the company's fiscal year drew to an end. Both documents were seen by the acquisition team, and the press release was public at the OSC. The press release indicates MPH had calculated reserves at 2,949,412 tons (2,675,116 tonnes) grading at .27 ounces (9.26 g/t). This includes 1,682,102 tons (1,525,666 tonnes) of proved and probable reserves, up from 610,777 tonnes in April 1986. The grade is down only slightly from April 1986. The release also announces that two bulk samples have been run through the Gays River mill, 4,000 tons from Forest Hill and 2,300 from Beaver Dam.

These do not appear to have been the bulk samples referred to in the August 1986 news release. That release anticipated samples of 4300 tons from each site and seems to suggest these would test grade. The press release of January 1987 refers to two bulk samples run for metallurgical purposes, to test the plant and establish a recovery rate, which was reported at an encouraging 95%. The release goes on to say "A further bulk test of 4,000 tons from each property will proceed to confirm drill indicated reserves." A fair reading of the two press releases leads to the conclusion that Seabright had failed to test grades through bulk samples by year end, as was planned in August. The letter to shareholders of the same date provides greater clarity. Strictly speaking it was not part of the public record. However, it was public to the extent that it received such wide publication a copy was to be found in the First Marathon library. It was in the hands of the acquisition team. Regarding the mill, the letter summarized work done that had made the plant "now fully functional" and the letter went on to say,

> The first two bulk samples for metallurgical testing have now been processed at the Gays River plant; 4,000 tons from Forest Hill and 2,300 tons from Beaver Dam. I am pleased to report that the recovery from both Beaver Dam and Forest Hill was in excess of 95%. This excellent recovery answers the question on the make-up of the ore and gives your company the necessary figures for calculating the revenue on production. The next two bulk samples from each property of approximately 4,000

> tons will be taken from areas where the corporation actually intends to mine and will be the samples that help confirm the grade of each deposit.

In the part dealing with underground exploration at Beaver Dam, the letter advised:

> Cross cuts on the ore zones have been made on two horizon and approximately 2,300 tons of material has been forwarded to the Gays River mill for metallurgical testing. We have just commenced a very extensive underground drilling program to further delineate the Beaver Dam ore body and to provide us with the necessary information for designing the proper mining method for this ore body.

In these passages, one sees Seabright's present understanding of its property at Beaver Dam: there is a substantial ore body, according to surface drilling, but it requires further delineation and the mining method needs to be determined. One sees that a bulk sample from the Beaver Dam property had been processed for a metallurgical test of the plant, with good results, but the sample was taken from outside "areas where the corporation actually intends to mine" and the results said nothing to "help confirm the grade" calculated by MPH. And, one sees that Seabright had yet to process a bulk sample of the Beaver Dam reserves. Indeed, underground exploration had "just commenced". In some respects Westminer's present criticism of the Seabright public record is too discrete. The reader, especially a member of the acquisition team who studied the whole of the public record at once and with sophistication, would read these statements in the context of the others. A most striking disclosure in the January 1987

documents is that the optimism Seabright had expressed in 1986 for bringing a mine into production had turned out to be wholly justified. In April 1986, Seabright told the public it expected underground exploration to be "completed by December 1986". The most senior officers and the directors certified that statement, with consequent statutory liability if it was a misrepresentation. In April 1986, Seabright told the public "production from the property could begin in early 1987", and the officers and directors assumed liability if this was a misrepresentation. In August 1986, when the underground decline had just begun, Seabright repeated these enthusiastic predictions in a press release that was filed with the OSC. The end of the year had passed and Seabright disclosed to the public and its shareholders that underground exploration had hardly begun and this disclosure contained no suggestion that unforeseen difficulties delayed the previously announced schedule. The reader knows about the statutory liability. The reader would have concerns about the quality of management's assessments and projections.

[42] The feasibility study on Beaver Dam was completed in early February 1987. A press release of February 16 was filed with the OSC and was sent to other commissions and to media. The release announced the name of the consulting engineers, Kilborn Limited. They were well known and respected. The release indicated that Kilborn had adopted the latest MPH calculation of proven and

probable reserves, but had restricted itself to a depth of 1,100 feet (335 metres), which encompassed MPH reserves of 1,100,000 tons grading .31 ounces (997,700 t at 10.63 g/t). Kilborn had established a mill recovery rate of 96%, projected capital expenditures of $6.8 million, and projected operating costs of $69 a ton. Kilborn projected a cash flow of $78.7 million over seven years and gold production starting at 330 tons a year and increasing by the fourth year to 775 tons. The press release said management expects production from Beaver Dam to exceed the Kilborn projections because of probable and possible reserves outside Kilborn's limit. A second deep hole had been drilled since the one announced on December 3, 1986. The second hole also intersected ore. For Mr. Lalor, this release demarked a significant step forward for the Beaver Dam property. It showed that much work had been done towards developing the reserve into a mine. Consultants had looked at operating costs, capital costs and cash flow, with good results. I accept Mr. Lalor's testimony as an accurate reflection of the positive features a reader with Mr. Lalor's sophistication would take from this release. However, I find that such a reader would also have some concerns. Note the lengthy reference to the deep hole surface drilling and the absence of any information on underground exploration. That program was still in infancy despite the predictions of April 1986 and August 1986. Also,

Seabright's ability to cost projects is brought into question again. The cost of capital expenditures calculated by Kilborn at $6.8 million compares unfavourably with the April 1986 estimated cost of bringing Beaver Dam into production if the underground exploration justified production.

[43] According to Mr. Lalor, the latest annual report of a target mining company was the principal document the acquisition team would focus upon early in the study, but all other documents tended to mesh into the analysis. The Seabright 1986 Annual Report was distributed in advance of the July 9, 1987 annual meeting and it was filed with the OSC on June 9, about the same time as operational staff advised corporate management at Seabright about problems being experienced underground. Of course, the report had the 1986 year as its focus, but it did provide much comment on activities after Seabright's year end, which was January 31. The reader can tell that much of the report was actually written about April 1, 1987. The annual report began with the President's report. Mr. Coughlan started with the mill, writing of its renovation and the bulk samples to establish rate of recovery. He said "This excellent recovery answers the question of the make-up of the ore ...", which causes one pause because the rate of recovery is a test or measure of the mill, not the ore. The sentence went on to say "... and gives your company the necessary figures for calculating the

reserve on production", which, accepting the evidence of the defendant's expert, John McQuat, on this subject, suggests that grade and daily tonnage had been fully established. That notion was contradicted by the exploratory nature of the underground work then ongoing, the subject of the very next sentence in the annual report: "The company further plans an additional two bulk samples at 4,000 tones apiece from each of the two [Forest Hill and Beaver Dam] properties." So, the reader sees from this and related references in past documents and in the annual report, that Seabright had sufficient confidence in the MPH analysis to proceed with the Kilborn study and to make decisions based upon the calculated revenue from production, but not so much confidence that it was prepared to attempt production on faith in the results of surface drilling alone. And, here is where the President's report is concerning. The company had planned bulk testing of about 4,000 tons from each property for over a year. It had planned to complete that by the end of 1986. The shareholders were still being told of plans. This is what the report said:

> The company further plans an additional two bulk samples at 4,000 tons apiece from each of these two properties. The Forest Hill sample is now being processed and, although not completed at this time, the results to date indicate the grade of ore from this property to be in excess of 0.40 ounces per ton.

So, the reader would take from this a high level of confidence that the smaller mine at Forest Hill was going to produce ore at a grade close to that calculated by MPH. However, results of a bulk sample from Beaver Dam were not yet in sight. The president's report then turned to the subject of underground work at Beaver Dam, which presumably would yield the 4,000 tons for bulk testing and which was also to provide extensive drill testing through direct contact with the reserves. As of April 1, 1987, the underground decline had progressed much since the information provided to the public in October 1986, December 1986 and January 1987. However, it had a long way to go. As to underground drilling, Mr. Coughlan wrote:

> We have just commenced a very extensive underground drilling program to further delineate the Beaver Dam ore body and provide us with the necessary information for designing the proper mining method. Assays from this close spaced underground drilling are confirming the grades indicated by surface drilling and management anticipates having the necessary information within the next two months to properly develop this ore body.

Based upon Seabright's past performance, the reader might have some doubts about information being ready within two months, but certainly the reader would expect to find a release reporting the results of the underground exploration long before December 1987. In a section dealing with finance, Mr. Coughlan wrote "Production will commence at Forest Hill in May of this year followed shortly by Beaver Dam."

Again, the reader would be looking for information on Beaver Dam production, certainly by the fall of 1987. Following the president's report, the annual report provided reviews of the company's major properties: the Gays River mill, Beaver Dam and Forest Hill. The MPH calculations for Beaver Dam were repeated. The annual report also contained an extensive commentary on Seabright Explorations Inc., called Seabrex. Seabright had acquired the majority of another company in September 1986 and had rolled over Seabright's interests in properties other than Beaver Dam and Forest Hill. Seabrex traded separately. The most promising of its properties was at Moose River where probable and possible reserves were reported to be 100,396 tonnes grading 6.9 grams of gold a tonne.

[44] In summary, there are statements in the annual report which, taken discretely, indicate that Beaver Dam is on the verge of production, but the informed reader would have seen the slow progress and the cost of the underground exploration to date. The context is such that, upon reading the 1986 annual report, an informed reader considering a substantial investment in Seabright would be looking for the next public document to state the results of the underground exploration, both to confirm the MPH reserves and to establish mineability. However, except for a press release concerning Forest Hill dated August 13, 1987, the annual report appears to have been the last public document seen by

the Westminer North American Acquisition Team before a bid to purchase the Seabright shares was made in December 1987. The questions obviously raised by the annual report went unanswered: Where are the results of the underground exploration and, specifically, the 4,000 ton bulk sample from Beaver Dam? And, has production commenced as expected?

[45] The questions about Beaver Dam become even more acute when one reads an offering memorandum dated November 18, 1987,which was filed with the Nova Scotia Securities Commission in early December and with the OSC in mid-December but which, through inadvertence, was not delivered to the acquisition team or their advisers until early 1988. This involved an issue of flow-through shares to raise $2 million for underground exploration at Beaver Dam. It made public some engineering and geological reports. The memorandum contained the same warning as in the April 1986 prospectus: "Hazards such as unusual or unexpected formations or other geological conditions are involved in exploring for or developing mineral deposits." It is obvious from the offering memorandum that Seabright had run into difficulties with the underground exploration program at Beaver Dam. The November 1987 offering memorandum reported $6,598,000 spent on surface exploration at Beaver Dam, and $7,803,000 spent on the underground exploration. Although Seabright had

spent much more than the April 1986 prospectus projected for exploration at Beaver Dam and although it was seeking to raise another $2 million for that very purpose, it had no results to report. Rather, Seabright had been engaged in "an in-depth detailed study of the geology of the deposit". The study is said to have been successful to the extent that "it has become possible to predict the location of specific gold-bearing veins." Obviously, it had not been possible to predict the location of specific gold-bearing veins on the basis of the surface exploration and the MPH calculations. The memorandum said this new geological information was now being used to guide the underground exploration. Obviously, the surface exploration and the MPH calculations had not provided useful guides for underground exploration. In addition to learning of difficulties finding veins, the reader learns that there was something wrong with the sampling methods Seabright had been using:

> The Corporation commissioned a study on underground sampling procedures by J.E. Tilsley and Associates ("Tilsley") of Toronto, Ontario. In its report dated August, 1987, Tilsley recommended changes in the sampling procedures currently being used by the Corporation. Specifically, because of the coarse nature of the gold, Tilsley recommended that approximately 30 kilograms of broken quartz ore be selected from each blasted round and sent for assay. This procedure has been adopted by the Corporation and preliminary results from this new technique have provided a more accurate representation of grade.

Nearly one year after the underground exploration at Beaver Dam was supposed to have been complete, the corporation is referring to "preliminary results" following upon a new sampling technique and a new understanding of the geology. The offering memorandum also indicates that Seabright was considering an entirely different mining method, bulk mining, in addition to narrow vein mining, which had been the only method assumed by Kilborn in its feasibility study. An open pit operation was in progress to aid "in determining the feasibility of underground bulk mining". The status of the Beaver Dam exploration is summarized as follows:

> The Corporation intends to pursue underground exploration in the directions described above. The majority of the efforts will be directed towards a combined evaluation of the extent of specific mineralized veins and the possibility of bulk mining in selected areas containing mineralized veins.

The November 1987 offering memorandum was eventually seen by Westminer. It was provided by Seabright's solicitors after the take-over bid but before closing. I will discuss later the optimistic projections formulated by Mr. Lalor's team. Mr. Lalor says that the offering memorandum did not alter his perception of the Seabright reserves. He emphasized that the offering memorandum referred to the Kilborn report, and stated that Kilborn had concluded that mineable reserves within the studied block were one million tonnes at a grade of 10.6 grams of gold per tonne. Mr. Lalor's

reliance on this places responsibility for a decision to spend nearly $100 million dollars upon the accuracy of the MPH calculations, which were the basis for Kilborn's assessment of grades and tonnage. Mr. Lalor also said that the suggestion of bulk mining would not disturb him. He already knew from private sources that Seabright was considering this method. Bulk mining involves more material and thus lower grade, but the extraction costs are much lower than narrow vein mining. Mr. Lalor said that it is usual to consider bulk mining or bulk mining in combination with narrow vein mining in the feasibility stage. I accept what Mr. Lalor said in that regard. However, his comments ignore a broader issue this news would raise in the minds of experts studying the record for Westminer. As I said, the Kilborn feasibility study demarked a significant step forward for Beaver Dam in the assessment of the acquisition team. As will be seen, it led the team to reclassify Beaver Dam although the team never read the document. The Kilborn study was based on narrow vein mining, not bulk mining. The news of bulk mining tends to show that the Beaver Dam underground exploration was moving away from the very feasibility study upon which the exploration was premised. I have difficulty crediting Mr. Lalor's assertion that the November 1986 offering memorandum would not have altered his perception of the Seabright reserves. Beaver Dam was then in the feasibility stage, between surface exploration and development. One purpose of underground exploration at the feasibility stage is to

confirm the reserves established during surface exploration. I do not see how Mr. Lalor's confidence in his team's optimistic projections for profits from Beaver Dam could remain unaffected when the underground exploration extended far beyond that originally planned in both time and in effort as represented by expense. Those facts had been patent on the public record. Concerns would increase when the public record showed that the corporation had had to revisit the geology of the reserve "in depth" and to look for ore according to new information not considered when the reserves were established. The concerns would increase when one learns that, after such a long time and additional expense, the company needs more money to pursue underground exploration that had yielded nothing but preliminary results. And, the concerns would also increase when one saw that the corporation was experimenting with a mining method different than the method assumed in the feasibility study underlying the underground exploration. All of this was public.

[46] It is not my present purpose to determine whether the public record on Seabright met the standard of full, plain and true disclosure. For now, the subject is what Westminer took from that record, a subject which goes to the risk Westminer knowingly took, which, in turn, goes to the motives of Westminer and its subsidiaries when they made allegations after the risk failed. Westminer was entitled to read the public record in light of the standard, but it also had to

consider source, quality of underlying information and implicit warnings if it was making any assessment of risk. I find that, even if the reader ignored the November 1987 offering memorandum, the public record did not describe the kind of operation Westminer now says it took Seabright to be. The record describes a company with significant proven and probable reserves established during surface exploration. But, it also describes a company that was having difficulty confirming the reserves through underground exploration. I find that, even ignoring the November 1987 offering memorandum, a reader of the public record with the sophistication of those who were serving Westminer would understand Seabright to be a highly speculative investment, and would have concerns both as to the technical strength of the company and the likelihood that the proven and probable reserves would be confirmed underground. I find that these concerns would sharpen upon reading the November 1987 offering memorandum.

Westminer's Investigation of Seabright: Beyond the Public Record.

[47] As I have already indicated, Westminer's initial investigation of North American gold companies was based on materials in its own library. To some extent these would have been secondary sources of the official public record, to some extent

they would involve information from other sources. Once in North America, the Westminer acquisition team acquired information besides amassing most of the official public record. A briefing book was finalized on October 30, 1987 for a meeting the following day. Mr. Morley, the Executive Director of Finance and Administration, and Mr. Morgan, the Managing Director, flew over from Australia to formulate the final recommendations, which were to be presented to the board of directors of Westminer in late November. Mr. Morley and Mr. Morgan met in Toronto with some members of the acquisition team, which had now grown to twenty or thirty people including representatives from outside advisers, Stikeman, Elliott, Coopers & Lybrand, and First Marathon. Mr. Morley's copy of the briefing book was the one produced in the Seabright case, so it became known as "Morley's book", although it was given to him, not written or compiled by him. The book is 130 pages long. Its main sections are the team's general report and recommendations (p.15), First Marathon's report and recommendations (p.20), the latest version of the team's summary of eleven companies (p.51), an analysis of the latest financial statements of five companies (p.87), reports on twenty-three companies prepared by Metals Economics Group (p.101) and a memorandum prepared by Stikeman, Elliott on laws governing

take-over bids (p.121). The book contains the most immediate information upon which Westminer made its decisions.

[48] The section provided by Metal Economics Group resulted from Mr. Lalor retaining its principal, Mr. Michael Chender, in September 1987 to make inquiries and report upon management of some thirty gold companies. On October 23, 1987 Chender telephoned Lalor. We have Mr. Lalor's notes of the conversation. Twenty-five companies were referred to, in alphabetical order. Of Seabright, Mr. Chender reported that Terry Coughlan "is a promoter", and the company has been a "bit too promotional with reserves". The head of exploration is a "good guy" but they "don't really have the expertise to know what to do", and the company has had "some trouble with stopping and starting on projects". Not an encouraging report on its own, the context of the entire call even more clearly gives one the message that close scrutiny was in order before deciding to buy the company. Mr. Chender was attuned to the promotional or conservative stance of each company. I refer to an article by M. Norman Anderson and Harleigh V.S. Tingley, "Due Diligence in Mining Investments", Mining Magazine April 1988, p.291, introduced through one of the defendant's experts, to explain why Mr. Chender would be careful to note the promotional stance of many of the companies he looked into. Mr. Chender characterized

some companies as “conservative, reserves underestimated” or “not particularly promotional” and he characterized others as “very promotional”, “over promotional”, simply “promotional” and one “lot of promoters”. As far as the record shows, Seabright was the only one thought to be too promotional “with reserves”. As for management, Mr. Chender’s comments respecting Seabright also sounded an alarm, especially in light of the whole of his oral report. The comment that operational staff lack the expertise to know what to do is the most negative assessment of technical management in any of the companies Mr. Chender reported upon. Some were positively reviewed, “good business/technical”, “good mark for management”, “well managed - very solid”, “good finance and knows remote location development”. Aside from Seabright, the negative comments on management of other companies are few and mild, “not a great deal of experience”, “mainly finance company”. Understandably, Chender’s written reports were more subdued than the oral reports. Still, they alarm one about Seabright. As to technical management, he did not write what he said, that they did not know what they were doing, but he did observe that the head of operations, David Armstrong, is young and relatively inexperienced, and he repeated the positive word on the head of explorations, Don Pollock. As for corporate management, Mr. Coughlan’s limited mining experience was noted,

as was his competence in administration and finance. Then this, "Coughlan suffers from being a promoter, eager to move on to bigger and better things before he sees his current situation stabilize." This criticism was balanced against three positive comments. Firstly, "he is regarded as honest". He is honest. Also, "his properties are legitimate". As will be seen, I find his understanding of his properties was legitimate. When he testified, Mr. Lalor seized upon this comment about the legitimacy of the Seabright properties to justify his position that the Chender advice had no affect on Westminer's assessment of the reserves. Of course, Chender was not retained to investigate the accuracy of stated reserves. In connection with another target company, Mr. Chender wrote this of MPH: "MPH is considered a solid company, particularly in the area of geophysical and mapping work". What if MPH had made a mistake with Seabright? What if these "solid" consulting engineers had made a mistake of a kind made by a skilled U.S. exploration and mining company, as reported in the article to which I just referred: "Grade recoveries in the deposit were less than had been expected ... because several high grade intercepts were given too much influence in the reserve calculation." Would one expect an honest, inexperienced and optimistic promoter to pick up quickly on the error? Would one expect inexperienced technical staff to easily challenge the experts?

The third of Mr. Chender's positive criticisms reads, "... to his credit, he has recently brought in David Robertson and Associates to help the company formulate a strategic mining and development plan." Robertson and Associates, highly respected mining consultants, were a subsidiary of Coopers & Lybrand, who had recently joined the Westminer acquisition team. I suppose the Coopers advisers of Westminer could not get information from the Coopers advisers of Seabright, but, as we shall see, Robertson was beginning to alert Seabright to problems. So, those are Mr. Chender's written comments on operational management and corporate management in Seabright, comments which tell the reader to approach stated opinions of the company with caution, not because of dishonesty, but because of optimism, inexperience and a promotional stance. Mr. Chender's general comments on Seabright read:

> Seabright is young and has been somewhat overly promotional, but also holds a number of legitimate projects whose potential is a function of the view one takes on the difficult Nova Scotia geology. The company's credibility in the marketplace was slightly damaged earlier this year when it pulled back after earlier announcements of imminent production at one of its properties (Seabright was forced to realize not enough underground work has been done[)]. The two major problems both the company and the marketplace see as facing it, are questions about Nova Scotia geology, and a management too thin to deliver on the development and exploration properties on their portfolio. It is the major player in the Nova Scotia goldfields and is making a serious attempt to develop its holdings responsibly.

I have already discussed the significance of "overly promotional" and "management too thin". Comments like these suggest cautious analysis of the inexperienced company's stated understanding of its own reserves. That caution is heightened by the subjects touched upon by the references to "the difficult Nova Scotia geology" and "too thin to deliver on the development and exploration properties". Taken completely out of context, as Mr. Morgan seemed to do when he testified, these comments could encourage purchase. Westminer certainly had the expertise to understand a difficult geology, and it had exploited gold mines in places geologically similar to Nova Scotia. Westminer certainly was not thin. It could deliver on properties where weak companies could not. A passage in a broker's report helps to make the point that needs to be seen. The report concerned Seabright and it was available before the take-over bid. It was not read by Mr. Lalor at that time. Perhaps others on his team saw it. Perhaps not. For the most part it is very positive about Seabright. The part that now concerns us reads as follows,

> The Meguma, the dominant geologic domain for gold in Nova Scotia, hosts gold which is generally coarse grained and as such it is difficult to evaluate these deposits by diamond drilling alone. It is imperative that significant drilling results be followed by a comprehensive underground exploration programme.

Particularly with a Nova Scotia gold mine, one important purpose of underground exploration is to confirm reserves established only by surface drilling.

[49] The Westminer acquisition team classified the various mines of the several companies in which it became most interested: EXPL for exploration, FEAS for feasibility, DEV for development, and PROD for production. The team classified Beaver Dam as being in feasibility, not development. The terse summary on Beaver Dam in Morley's Book cautioned "sampling not completed". The public record showed that Seabright was taking far longer than expected and was spending far more than expected without having neared the development stage. Further, Westminer had been warned that the exercise had faltered at least once, that there were geological difficulties and that Seabright management were too thin for both "development and exploration" properties.

[50] The section in Morley's book prepared by First Marathon extends for thirty-one pages. First Marathon studied nine companies and two separately traded subsidiaries. It made three alternative recommendations: a package of companies costing in the half billion range that Westminer was prepared to spend, a package costing close to a billion dollars, and an economical package which might have been a cautious first step towards further acquisitions.

Seabright was not in any of these packages. It and two other companies were classified by First Marathon as "Alternatives".

[51] The Westminer staff on the acquisition team studied eleven companies. Staff recommended two alternative packages. Seabright was in both of them. The team wrote that it had assessed operating and management personnel in each of the companies as to their ability "to continue and expand the operations and start up new operations". Its conclusion on Seabright was "Management is regarded as strong financially but weak operationally." The report on Seabright in Morley's book states the opinions that underground advances were "confirming drill indicated reserves" at Beaver Dam or Forest Hill, and that some sections had a slightly lower grade but the results were "all right" on average. With reference to Beaver Dam, Westminer staff made these remarks "Currently bulk mining two veins plus mineralized rock between Look O.K. but sampling not completed." This is hardly consistent with Westminer's present characterization of the public record or its persistent assertion that it relied exclusively on that record. No justification appears for "Look O.K." and no caution appears from the crucial observation "sampling not completed." Notwithstanding their recognition that sampling was incomplete, Westminer staff recorded this prediction "Beaver Dam at 5-600 t/d by May 1987.", although they also noted

"Recess undercapitalized and tonnage limited. Needs capital injection." Despite the recognition that sampling had not been completed, the exploration was undercapitalized and the tonnage was limited, Westminer staff provided very aggressive projections for production from Beaver Dam. The information on Seabright in Morley's book shows that the acquisition team took Seabright to hold 3,649,000 tons of reserves, counting every possible ton established by surface drilling for Beaver Dam, Forest Hill and the Seabrex properties of Caribou and Moose River. The team projected "base production" from Beaver Dam of 50,000 ounces of gold a year, and "likely production" of 100,000 ounces. Compare this with rates of production stated by Kilborn based upon the geological reserves calculated by MPH Consulting Limited and mining reserves calculated by J.S. Redpath Mining Consultants Limited. There, the possible reserves are taken to possibly increase mine life, and projected production is roughly equivalent to Westminer's "base production", that is, roughly half Westminer's "likely production". The works of Kilborn, Redpath and MPH were referred to directly or indirectly in numerous public documents of Seabright, and the Kilborn study, which included the reports of Redpath and MPH, was expressly offered to the public by the November 1988 offering memorandum. I find these studies were available to the Westminer acquisition

team. Westminer did not look at them. The aggressive stance of the Westminer acquisition team on likely production from target companies is expressed in the team's Summary and Recommendations: "The above packages represent the maximum production from companies currently recommended." and "Variations on the amount of investment compared to ounces of production, reserves and ease of acquisition will be discussed during the review." Whatever discussion there was about reserves when the acquisition team met with Mr. Morgan and Mr. Morley on Halloween 1987, the discussions did not lead to any variations in the amounts of investment. Evidently, all were satisfied to make decisions based upon maximum possible production.

[52] At least one other source of information became available to Westminer before the take-over bid. Through First Marathon, Westminer retained another mining consultant, Lawrence Stevenson, to surreptitiously visit offices and mines of some target companies. He was to pretend to be writing reports on a few mining companies for general publication. His instruction from Mr. Lalor, however, was to carry out an analyst's review and report to Lalor on whether the public record was satisfactory. Memories have faded. Exactly when Stevenson started work is not known to me. We know he met with Hallisey, Laydall and Lalor on October 21, 1987. We know he was on site in Nova Scotia for two days in late

November, 1988. We know that Seabright received visitors regularly, and that staff was unrestricted in what they might say and that the reports of Kilborn, Redpath and MPH were then publicly available and the retention of Robertson was public knowledge. We know that Mr. Stevenson spoke to Mr. Lalor on November 24, 1987 and Mr. Lalor's notes refer to the mill, Forest Hill, Beaver Dam and Caribou. The notes respecting Beaver Dam make it clear that bulk mining was the method then under consideration, the notes refer to a grade of a tenth of a gram a tonne in the wall rock, and include an unattributed grade of 3.4 grams. This conversation occurred before the take-over bid but after the acquisition team, Mr. Morley, Mr. Morgan and the Westminer Board had made the decision to make the bid. It is unclear whether Mr. Stevenson made any reports before the decision was made. The least this tells us is that Westminer did not fully trust the public record and it certainly did not rely entirely on that record. The Stevenson episode also confirms some facts already evident: Westminer was made aware that Seabright had departed from its original mining method, and much information was easily available to Westminer but was ignored by it.

[53] I find that Westminer relied on the MPH calculated reserves as stated in the public record for Forest Hill and Beaver Dam and for Seabrex's interest in

Caribou and Moose River. I find that Westminer received information from beyond the public record as regards those subjects referred to in Morley's book: the promotional stance of corporate management, the weakness of operational management, the use of bulk mining at Beaver Dam, the possible grade from bulk mining, the undercapitalization of Beaver Dam exploration, sampling still being incomplete, the limited tonnage, Robertson and Associates having been called in to assist, the failure of Seabright to meet projected production dates, and Seabright's difficulties understanding the geology of Beaver Dam. I find that there was much information available to the acquisition team which it did not bother to acquire, including the reports of MPH, Redpath and Kilborn.

The Decision to Purchase Seabright.

[54] Five companies were selected for take-over as a result of the discussions on October 31, 1987. They were Atlanta Gold Corporation, Northgate Exploration Limited, Grandview Resources Inc., Western Goldfields Inc. and Seabright. In effect, Mr. Morgan and Mr. Morley accepted the first package of companies recommended by the acquisition team except for one company, Pegasus Gold Inc., an established gold producer with, by far, the greatest value of any of the companies in the package. Further, they accepted to pay the full amount of the

investment reflected in the acquisition team's work: current share prices plus 40%. Such was the recommendation made by Mr. Morgan to the Westminer board on November 18, 1988. At that time, Westminer staff updated ratios and projections from those in Morley's book. Share prices had changed, as had some ratios, but I take it these changes were not significant to the decision. Beaver Dam and Forest Hill remained in the feasibility classification. The full tonnage and grades for Beaver Dam, Forest Hill, Caribou and Moose River were repeated, but "likely" annual production had been reduced slightly to 200,000 ounces of gold a year. A summary was prepared of projections for the five recommended companies, which showed Seabright producing 36,600 ounces in 1988, rising to 160,400 by 1991. This does not reconcile with the report on Seabright, which has Beaver Dam producing 20,900 ounces in 1988 and Forest Hill, 20,600. Mr. Morgan, Mr. Lalor and two others made presentations to the Westminer board, with Mr. Lalor doing the bulk of the work. Notes taken down during the meeting show that Mr. Lalor covered the history of his team's work, reviewed the projections and other financial information, and provided some thoughts concerning risk. The notes include "mention" of problems with buying smaller companies including "caution in assessing ore reserves". Whatever was

actually said about this, no caution is evident. The board approved the package and the price, and gave Mr. Morgan authority to make the final decisions.

[55] I find that Westminer's decision to purchase Seabright stock at 40% above trading prices was a deliberate choice to take a very high risk. This finding is based upon the risky strategies Westminer adopted for the North American acquisitions. Even as the strategy excluded opportunities for due diligence, it embraced smaller, unestablished and therefore riskier mining ventures. This finding is also based upon the information shown to Westminer by the public record and the information acquired by Westminer through private, sometimes clandestine, inquiries. To Westminer's knowledge, Seabright lacked sophistication in operational management while corporate management had an optimistic or promotional stance. The CEO was honest, but the quality of the company's technical judgments had to have been in question. Accordingly, company statements about those judgments needed to be treated with caution. The company was having difficulty confirming reserves and confirmation through underground exploration was imperative. To Westminer's knowledge, the company thought it was having difficulty understanding the geology of its own reserves. The possibility presented itself that errors of judgment had been made in the reserve calculations, and the company was deferring to those outside

experts who had made the calculations. This finding of a deliberate choice to take high risk combines with a second finding. Westminer chose not to look carefully at the degree of risk it was taking. Valuable information that was easily available went ignored. Lines of inquiry suggested by the public record itself were left unexplored. The decisions respecting each of the take-over bids was premised on very optimistic projections. And, as will be seen, when further opportunities presented themselves for Westminer to acquaint itself with the facts, Westminer spurned the opportunities. It was said before by Justice Nunn and now it has to be said again. Westminer was reckless.

[56] Why such a gamble by a sophisticated commercial organization served by people of obvious competence? The answer does not matter much for what I have to decide. The fact of the gamble and the fact of Westminer's utter failure to own up to the gamble when the gamble did not pay are what mattered for the conclusion Justice Nunn reached and they matter for the conclusion I am reaching. If I had to decide upon what accounted for apparent incompetence in people of apparent competence, I would look to the event of October 19, 1987, after Westminer's North American Acquisition Team set up shop in Toronto. That was the day of the worst stock market crash in the later twentieth century. Shares in resource companies dropped to distress prices. This led First

Marathon to commend Westminer: “WMC’s decision to acquire a base in North American gold ... could not have been more appropriately timed.” First Marathon recommend that Westminer “take immediate advantage of these distress sales”. Perhaps Westminer, with its enormous purchasing power and its great technical strength, believed it could not lose on several purchases at distress prices. It lost. Not just Seabright. All of them.

The Take-over Bid.

[57] Speed and surprise were intended. Mr. Hallisey of First Marathon called Mr. Coughlan and falsely told him First Marathon was representing some European investors who might be interested in acquiring a large amount of Seabright stock. Mr. Hallisey and an unnamed investor would like to meet with Mr. Coughlan, tour the mill and sites, and speak with the senior operations people. Hallisey made an appointment to meet Coughlan on the afternoon of Tuesday, December 15, 1987, and he left it to Coughlan to set up the tours and interviews for the next day. On the 15th, Hallisey and Morgan flew to Halifax. Morgan was introduced to Coughlan and his Vice-President, Dr. Jack Garnett. Morgan began by describing Westminer, then turned to the subject at hand. Sensing a dramatic event that a president should hear first, Mr. Coughlan asked Dr.

Garnett to leave. Then, Morgan announced Westminer would make a take-over bid the very next day. He presented lock-up agreements drafted by Stikeman, Elliott for signature by the three largest shareholders, Mr. Coughlan, Mr. William S. McCartney and Mr. Frederick Hansen, who were also directors. These provided for Westminer to bid $8.40 a share, the current price plus 40%, and for the three shareholders to bind themselves to sell at that price. Morgan said that if the three shareholders did not sign the agreements, the take-over bid would be made at a lower price and the rest of the shareholders would be told they were getting less money because three directors refused a higher price. Morgan and Hallisey told Coughlan that the tours and the meeting with operational management were not required. They left Halifax. The Seabright board was called together the next day, and intensive negotiations were conducted. Seabright offered to sell its assets to Westminer, which would have provided an opportunity for due diligence. Westminer was not interested. The negotiations led to a slight increase in price to $8.50. Lock-up agreements were signed and no one with Westminer spoke again with Mr. Coughlan or other Seabright employees until after closing on January 27, 1988.

[58] One of the larger shareholders was Westminer itself. It had begun accumulating Seabright shares shortly after the Halloween meeting. It already had a 6.2% toe

hold. Once Westminer acquired the whole, the plan was to merge Seabright with Westminer Canada, a private corporation. This plan brought s.163(2) of the regulations under the Ontario *Securities Act* into play. Subsection 97(1) of the *Securities Act* required offerors to provide an information circular with the take-over bid when the bid was to be delivered to shareholders. Subsection 163(2) of the regulations required that the circular include information from a formal valuation if the offeror planned to take the company private after take-over. One might think Westminer would have welcomed this requirement in light of the concerns apparent from the information it had received and in light of the recognized prudence of due diligence independent of the public record. I suppose the risk would be that a formal valuation might indicate that the shares were worth more than what was being offered. In any event, Westminer convinced the Director of the OSC to apply an exception, and Westminer did so on a representation that did not have a very strong evidentiary basis. The exception provided in s.163(2) read, "except where the offeror establishes to the Director's satisfaction that the offeror lacks access to information enabling the offeror to comply with this subsection." Note that it was not enough that Westminer did not have in its possession sufficient information from which a formal valuation could be made. It had to be that Westminer lacked access to

the information. Westminer made an application to the Director the day after Hallisey and Morgan met with Coughlan, the very day they were to be given access to the mill, the sites and operational management. Westminer represented to the Director "The offeror and its affiliates lack access to information necessary to comply with this section ...." It is remarkable that the ex parte, indeed confidential, application neglected to point out that the only reason the offeror lacked access to information was that the offeror had avoided it. I accept Braithwaite's testimony to the effect that exemptions of this kind were routine, and the regulations were later changed so the mere fact that the offeror had not acquired access to information needed for a valuation became sufficient to exempt the offeror from performing a valuation where it intended to take the target corporation private. Whether or not Westminer ought to have made more information available to the OSC in the application for an exemption, this is another example in one of the categories of fact underlying my finding of recklessness, the avoidance of opportunities for due diligence.

[59] The offer and the information circular went out to all Seabright shareholders on December 23, 1987. The circular included:

> The Offeror is not aware of any information which indicates that any material change has occurred in the affairs of the Company since the date of the last published financial statements of the Company for the six month period ended July 31, 1987.

The offer was for $8.50 a share. It was good until midnight, January 27, 1988. It provided that Westminer had the right to withdraw in some circumstances including if less than 67% of the shares were tendered or "if any undisclosed action or omission prior to the date of the offer ... results in a material change in the affairs of the Company ...." According to an opinion delivered by Stikeman, Elliott to Westminer, the Ontario legislation permitted any kind of condition to be attached to the take-over bid. The Westminer offer did not provide any mechanism by which Westminer might acquire information necessary to access the accuracy of the public record or do due diligence of any kind. Subsection 98(1) of the Ontario *Securities Act* required the Seabright board to also issue an information circular. By subsection 98(2) of the Act, the circular was to contain a recommendation or a statement that the directors were unable to make any recommendation. By section 172 of the regulations, the circular had to include a statement concerning material changes and a certificate signed by officers and directors in that regard. The Seabright directors issued a circular on December 29, 1987 recommending acceptance and referring only to trading transactions in the section on material changes. Mr. Coughlan, Mr. Hansen and, on behalf of the board, Mr. Hemming and Dr. Garnett signed the statutory certificate

certifying that the circular "contains no statement of a material fact and does not omit to state a material fact that is required to be stated". Most shares were tendered by the closing date, January 27, 1988. Westminer paid for them on February 2 and, after exercising the compulsory acquisition provisions under the *Canada Business Corporations Act*, the cost to Westminer was about $93 million.

The Truth about Beaver Dam.

[60] Beaver Dam contains little gold. No one suggests there was anything wrong with the drilling that underlaid the MPH calculations. No one suggests there was anything wrong with the sampling and assays from the drilling. No one suggests there was anything wrong with the raw data given to MPH. No one suggests there was anything wrong with the Redpath reserve calculations, which depended on MPH. And, no one suggests there was anything wrong with the Kilborn feasibility study, which depended on Redpath. Although Dr. Pearson has some reservations about MPH now, no one suggests there was anything wrong with Seabright's selection of MPH, "a solid company, particularly in the area of geophysical and mapping work" according to the report Westminer received from Metal Economics at the time. Dr. William N. Pearson is a learned and experienced geologist and an impressive witness in matters of science. He

testified as one of the defendant's experts subject to my exclusion of his general opinion comparing his reading of the public record with his assessment of results of underground exploration, where I followed Justice Nunn's ruling on the same matter. I do not accept Dr. Pearson's opinions that mix geology with psychology or with his assessment of what others understood. However, I do accept his scientific opinion which he summarizes as follows:

> The underground sampling, which was very extensive and thoroughly done, indicated that the assumptions upon which the original reserves were based were not correct. This sampling indicated that the high grade values upon which the potential viability of the project depended, were erratically distributed throughout the quartz veined zones in essentially a random pattern. No one quartz vein was found to be preferentially mineralized for more than a few metres along strike. The assumption of continuity of mineralization between drill holes was not confirmed hence the range of influence of 25 metres for "proven" and 50 metres for "probable" used in the MPH geological reserve estimation was invalid. The few high grade values intersected in surface diamond drill holes received a disproportionate range of influence in the reserve as compared to the actual very restricted distribution indicated by underground sampling.

So, I find that the MPH calculations based on surface drilling were shown to be entirely wrong through underground exploration. Despite warning signs, Westminer had counted every ounce of gold calculated by MPH, whether as proven, probable or possible, when Westminer decided to purchase Seabright. After spending $93 million, Westminer was about to discover Beaver Dam was nearly valueless.

[61] As discussed before, Seabright, to the knowledge of Westminer, called in the highly respected mining consultants, Robertson & Associates, during the fall of 1987 before the December take-over bid. Robertson delivered a report to Seabright on November 16, 1988, which was generally positive. Seabright canceled Robertson's retention when the lock-up agreements were signed because Westminer would have its own expertise. Although Robertson had been discharged, had billed for outstanding fees and had been paid, a draft of a second report arrived at the Seabright offices the very next day after the deadline for tendering shares to Westminer. The draft report does not appear to be particularly responsive to the latest retention, which was made on December 1, 1987. Further, the report indicates it is to be finalized in February 1988, it is based on information acquired in early December, it is very extensive and, yet, the main issue addressed by the report hinges upon "the final mill results and check assays" which were expected to be in hand very soon. Why write a tentative report when the essential information would soon be available? The draft report is not nearly as encouraging as the signed report of November 1987. One could conclude that Robertson had concerning information from its last visit of December 7 to 11, 1987 and felt that it should put the information on record tentatively by way of a draft report. The shares were tendered on January

27, before the draft report was received. The shares were paid for by Westminer on February 2, after the draft report. The next day, Mr. Lalor received a call from Coopers & Lybrand. They were the auditors of Westminer and they were represented on the acquisition team. Robertson & Associates was a part of Coopers. Coopers advised Lalor that there may be problems with the reserves at Seabright. Two days later, Mr. Lalor went to Halifax to meet with Mr. Coughlan and the senior people at Seabright. He heard a series of presentations from various individuals and he says it very quickly became apparent to him that there was no ore at Beaver Dam. He says he was shocked, but it was difficult to come to grips with the problem in the onslaught of numerous presentations. From Mr. Lalor's notes of a meeting with operational management, it appears that Mr. Keohane, who was in charge of the Beaver Dam project, and Mr. Campbell, the head geologist there, had concluded that the MPH calculations were wrong. Mr. Lalor says and, on review of his notes, I agree, that the upshot was that the MPH data needed to be reassessed. For Mr. Lalor, it was fairly obvious that the people on site had concluded Beaver Dam was hopeless. I do not get that from his notes, and it appears inconsistent with a subsequent report. However, it is clear that, because of the presentations and the information from Coopers, Mr. Lalor became extremely alarmed. At about this time, Mr. Lalor

also saw the draft Robertson report. From this, he took it that the 3 million tonnes in reserves Westminer had counted on "were not there" and he concluded "the jury was still out a little bit on whether there might be some bulk mining reserves". Again, I do not get such a negative impression from the draft report. The report is extensive and I cannot read it with Mr. Lalor's trained eye. Still, it speaks prospectively of the final mill results which were not to be available until March or April 1988, it speaks of the apparently equal possibilities that test results will "continue to be discouraging" or will become "more encouraging", and it speaks of the future of Beaver Dam as "uncertain" pending the "forthcoming mill results and evaluations thereof". The information produced to Mr. Lalor between February 3 and February 5 caused him to call the General Counsel of Westminer on Sunday, February 7, 1988. Lalor asked if the sale could be stopped. Mr. Colin Wise replied negatively. Mr. Lalor then called in technicians from Westminer to do a full study of Beaver Dam. And, Mr. Morgan was advised of the situation.

[62] Mr. Lalor's alarm and his conclusion that Beaver Dam had no ore contrast with the Seabright month end report for February 1988, the first month of Westminer's ownership. The report indicates exploration continuing at full force on six different levels of Beaver Dam. The geological report submitted by

Mr. Campbell does not say Beaver Dam is hopeless. The detailed reports on each of the levels speaks of confirmation of a plunge direction for one shoot related to high grade ore in level 1100, a high grade zone in which "unprecedented amounts and sizes of gold nuggets have been encountered" at level 1080, "many sights of visible gold have been encountered" and "good vein structure remains on both drives" at level 1065, "a few sights of visible gold have been noted but several rounds are required before we intersect the high grade core" for level 1050, and "the 6b zone is being prepared for rising ... through the high grade core" respecting level 1040. The only assessment that is obviously negative concerns level 1025 where results are indicating grades of two to three g/t. The report makes it clear that staff await completion of the bulk sample, including clean-up and reconciliation. And the report concludes:

> With more emphasis being placed on attempting to get some ounces to surface via ore drives, raises and turn down back stopes, a good picture of "shoot" continuity and grade will appear. Although I personally have reservations about the success of this project, the upbeat results in February indicate work is still warranted.

This is far from the utterly negative assessment Mr. Lalor made of the information he considered in February 1988.

[63] Whether or not the public record on Seabright adequately reflected reliable information on Beaver Dam in Seabright's hands, I am satisfied that staff's assessment as of February 1988 was far more positive than Mr. Lalor took it to be. This is not surprising. I attribute much of Mr. Lalor's alarm to the facts that the North American acquisition team deliberately took enormous risks and, with Seabright, it rapidly became apparent to Westminer that Westminer would lose that gamble.

[64] To this day, Mr. Coughlan believes there is much value in Beaver Dam, Forest Hill and the Seabrex properties. He believes that Westminer failed to extract or to protect extant gold. I accept his testimony as truthful statements of his beliefs. However, I find he is wrong about Beaver Dam. I have already discussed Dr. Pearson's opinion. After the bulk sample was complete, Westminer technicians calculated the Beaver Dam proven plus probable reserve at 41,000 tonnes grading 5.8 g/t and the possible reserves at 55,000 tonnes grading 5.4 g/t. These findings were confirmed in September 1988 by Mr. J.F. McQuat. I accept that these constitute the best estimate of the truth about Beaver Dam.

Westminer's Investigation of Former Directors.

[65] Colin Wise is a lawyer with over thirty years of practice, almost all of them at Westminer. He became General Counsel in 1984, and he was involved with the North American Acquisition Program until it matured to a point where Mr. Wise could assign responsibility to one of his staff lawyers. Mr. Wise received Mr. Lalor's distressed call on the morning of February 8, 1988, Melbourne time. He asked Mr. Lalor to have the technical staff at Seabright prepare written chronologies of events concerning Beaver Dam from which Mr. Wise could determine whether there had been wrongdoing. The reports were not produced for a month and a half, but, in the meantime, Mr. Wise visited Halifax as part of a tour to acquaint himself with the newly acquired operations.

[66] The visit to Halifax lasted for two days, March 1 and 2, 1988. Mr. Wise was accompanied by Richard Chamberlain, the staff lawyer who had taken over responsibility for the program, and Carl Harries of the Fasken Campbell firm, who were to provide ongoing legal services to Westminer where Stikeman, Elliott had been brought in just for the take-overs, on account of their expertise in corporate tax and acquisitions. Mr. Braithwaite was to join the other three lawyers on the second day of the visit.

[67] The first day began with a meeting with David Armstrong, the Vice-President of mining. This lasted for some time because Mr. Armstrong wanted to learn about Westminer and how it did things. Apparently, he said nothing about problems with Beaver Dam. Pat Keohane, the project manager for Beaver Dam, joined the meeting when it was partway through and, at the end, he asked Mr. Wise for a private meeting. He found himself in a spare office with Wise, Harries and Chamberlain. Mr. Keohane told the lawyers he was concerned about the reserves at Beaver Dam. He said the project had not been properly managed from a technical point of view, that the company had placed too much emphasis on financing, and it had not allowed the technical people to do their work properly. He advised of personal difficulties he had in working with Mr. Coughlan, and he intimated there were problems of integrity with both MPH and Coughlan. He said that technical staff had been up and down about Beaver Dam throughout 1987 but, by the end of the year, staff had become satisfied that there were no significant reserves at the site. He told the lawyers that he became increasingly distressed during 1987 because technical concerns were not being communicated, such that he was forced to write things down to make a proper record for later on. So, one would expect to see a note from late 1987 in which Mr. Keohane recorded staff's negative conclusion about Beaver Dam. There

does not appear to be any note of that kind. In the afternoon, the lawyers met with other technical staff at Seabright's office in Sackville, and that passed without significance for the present issues. Joined by Mr. Braithwaite, they met with solicitors at Patterson Kitz all morning on March 2. Then they met Mr. Ken MacDonald, Vice-President Finance, and Dr. Jack Garnett, Vice-President Administration, for lunch. During the ride to the restaurant, Dr. Garnett is said to have bared his soul to Mr. Wise. According to Mr. Wise, Garnett was on the verge of tears as he described his poor relationship with Coughlan and his concern that Seabright had paid inadequate attention to technical difficulties. Garnett said he had been stopped from performing his job. Later, there was a meeting with Mr. Coughlan, and it was unremarkable except in one respect, which I shall comment upon when making findings about Westminer's knowledge of Cavalier and the investors in it.

[68] Mr. Wise saw that Keohane's statement contained sinister overtones and, from what he said, there appeared to have been an attempt to give the MPH reserve calculations a longevity they did not deserve. He decided there needed to be an investigation, with an eye to a lawsuit. No doubt, that was a sound decision, but I pause to note the guarded approach any investigation would take to statements of the kind Mr. Wise heard from Keohane and Garnett. The truth about Beaver

Dam was emerging. Whatever was known in December, more was known in February, and the fuller truth was soon to be known. Lalor's shock had to be apparent to Seabright staff. If Westminer lost its gamble, there were three possibilities: the truth about Beaver Dam was not known until after take-over and Westminer was entirely at fault for its own loss; the truth was known by some staff who neglected to adequately inform corporate management, in which case staff were at fault and were facing one of the world's largest mining companies; or, corporate management were adequately informed and they neglected to publish the information, in which case corporate managers would be sued, or worse. In this context, one would listen guardedly to a mine manager coming out of the blue to make accusations against the president, away from the ear of his superior, to lawyers representing the supposed victim. And so, too, with the Vice-President of Administration, whose statements to Mr. Wise do not appear to have been given much credit in view of the fact Westminer sued him for fraud.

[69] The investigation was turned over to Fasken & Calvin. Mr. Wise instructed them not to pepper him with paper. They were to provide their conclusions, and Mr. Wise would study any documentation afterwards. The conclusions were

provided to the Westminer board of directors at a meeting held at the end of June, 1988:

(a) the President of Seabright (Terry Coughlan) and at least one of the other directors of Seabright (Jack Garnett) breached important disclosure obligations of the Ontario Securities legislation, conspired to injure WMC and fraudulently misrepresented the state of affairs of the Beaver Dam project;

(b) the other directors of Seabright may have had knowledge of the true state of affairs and if so, will be equally responsible in law; and

(c) in any event, it is likely that such other directors would be found negligent in failing to ensure that accurate information regarding the Beaver Dam project was filed on the public record and made available to WMC.

Mr. Wise advised the Westminer board that Fasken & Calvin had reached these conclusions, and that, on review of the evidence, Mr. Wise agreed with them. As I said, the investigation was carried out by Fasken & Calvin. No one from that firm testified. In fact, Mr. Peter Roy, who carried out much of the work, acted as counsel at trial. By agreement, various witness statements and other documents were entered to prove Westminer's information and understanding, just as the conversations with Dr. Garnett and Mr. Keohane and other conversations were related for that limited purpose, Garnett and Keohane not having testified. Of course, information of this kind, which was introduced mainly through Mr. Lalor and Mr. Wise, forms no part of

my fact finding on the other subjects, particularly the true state of Beaver Dam or Seabright's knowledge. However, the information is before me for Westminer's understanding of these matters, which is probably the more important question.

[70] The materials created by the investigation and reviewed by Mr. Wise included the chronologies Mr. Wise had requested in early February, one prepared by Mr. Armstrong on March 10, 1988 and one prepared by Mr. Joseph Campbell on the same day. Mr. Campbell was a staff geologist who had responsibilities respecting Beaver Dam. In addition, Westminer was supplied with a copy of an extensive report prepared by Mr. Keohane and addressed to Mr. Armstrong on February 16, 1988, and a copy of a draft inter-office memo prepared by Mr. Armstrong on March 11, 1988. The draft memo prepared by Mr. Armstrong cross- referenced over twenty internal Seabright documents, which were in the control of Westminer by this time. Fasken & Calvin also interviewed four potential witnesses and it provided a record of those interviews. The witnesses were Mr. Armstrong, Mr. Braithwaite, Mr. Leonard Kilpatrick of Robertson & Associates and Mr. Donald Pollock, the Vice-President of Explorations at Seabright. No one sought to interview Mr. Coughlan or any other former director. It does not appear that anyone from MPH, Kilborn or Redpath was interviewed. No record has been produced of any interview from this time of

any member of the North American Acquisition team except Mr. Braithwaite, who had no involvement in the technical analysis. And, there is no record of any interview from this time of those who gathered unpublished information about Seabright for Westminer. An extensive interview of Lawrence Stevenson, the analyst who investigated Seabright undercover, was conducted much later. The information gathered from these sources in the late winter and spring of 1988 suggested serious defalcations. Firstly, there is a suggestion that Seabright recognized by June 1987 that the plans and sections produced by MPH in January 1987 were in error and, from that recognition, Seabright ought to have seen that the published MPH reserve calculations were in greater question, such that a material change report ought to have been filed and published. Secondly, there is a suggestion that Seabright had abandoned narrow vein mining by the fall of 1987 and, since this was the mining method upon which the Kilborn study was premised and since Kilborn was summarized in the public record, a material change report was in order. Thirdly, there is a suggestion that by December 1987 or January 1988 preliminary results from substantial but incomplete runs of material from the underground exploration showed that Beaver Dam did not contain a grade of ore that could be mined economically by narrow vein or bulk methods, which suggests, depending on the timing of this

realization, the directors circular respecting the take-over bid could be false and, in any case, a material change report would have had to have been issued before the take-over bid closed at the end of January 1988. Fourthly, some witnesses indicated that Mr. Coughlan was informed in December 1987 of serious reservations Robertson & Associates had about the grade at Beaver Dam and they accused Mr. Coughlan of deliberately suppressing this information. Fifthly, from information provided to Westminer through a stock watch during the take-overs in combination with the information I have just described, Westminer took it that Coughlan and others had committed insider trading offences. I have used the word "suggestion" deliberately in describing the suspected defalcations, because the information acquired by this investigation, especially the interviews, supported these as conclusions but the investigation and information in the possession of Westminer indicated other lines of inquiry which might have undermined the conclusions. I shall summarize the information obtained by Fasken & Calvin, and then I shall discuss the indications for further inquiry. I shall treat the interviews separately from the other information gathered by Fasken & Calvin because statements made in the interviews should have been seen as less trustworthy than the raw information provided through the requested chronologies and the referenced company

documents. Indeed, the latter indicated avenues for challenge that should have been explored during the interviews where, as asserted by Mr. Wise, the object of the investigation was to ascertain the truth rather than to build a case.

[71] The chronologies and notes prepared by Mr. Armstrong and Mr. Campbell indicate that Seabright staff had disagreed with the MPH reserve calculations prepared during the first part of 1986 before the January 1987 recalculation and production of revised plans and sections. Mr. Armstrong says that the 1986 MPH ore reserve calculations were prepared with "minimal input" from Seabright staff. Mr. Campbell says the MPH calculations available as of October 1986 were considered to be "very liberal". As discussed in reference to the public record obtained by the acquisition team, October 1986 was the month in which Seabright published and filed a press release announcing staff's own calculation of the reserves, which was a half million tonnes greater than the last MPH calculation. Mr. Campbell's chronology states that staff's calculation was "based on MPH parameters", but staff discovered "fundamental errors in database and interpretation", and geological staff at Seabright agreed "that ore reserves are wrong and impractical for mine use". Mr. Armstrong is more subdued in his comments on the events of that time. He states that questions were raised concerning the accuracy of the MPH reserves calculation, but no re-

evaluation was done at that time because the staff calculation focused on additional reserves indicated by the latest drill results outside the areas originally considered by MPH. We see that Mr. Campbell was the person challenging the MPH calculations, and Mr. Armstrong relates the discussion among technical staff as follows:

> Joe Campbell reviewed with the senior Beaver Dam group, including D. Armstrong, concerns that the current ore reserves had misinterpreted the geology. Joe reported that he felt that high grade values from different veins had been connected geometrically to calculate the reserves. He alerted the group to the possibility that the gold in various zones may be randomly distributed so that wide zones would be mined with a grade in the 3 gram range. In the general discussion it was recognized that a problem may well exist but that further investigation could only be carried out through the underground development program.

Albeit that technical staff were focused on areas additional to those studied by MPH and that staff was of the view that certainty could only come from underground exploration, technical staff presented full reserve calculations and they were responsible for writing the technical parts of public documents including the press release. One wants to know what, if anything, technical staff did towards announcing "that a problem may well exist" with the MPH reserve calculations.

[72] It is evident from the documents gathered for Westminer that the concerns of October 1986 were addressed with MPH before the last reserve calculation and before MPH produced the revised plans and sections that were supposed to

guide the underground exploration. Mr. Armstrong writes of the time contemporaneous with the last MPH work, December 1986:

> In early December Bill Riddel and Howard Coates from M.P.H. Consulting visited the underground workings to inspect the work completed to date. Their initial assessment was that the underground development program must focus on exposing total mineralized package in order to begin to understand the mineralization controls. They also commented that in their opinion nothing from the underground workings could be observed which would change their estimating techniques for calculating the geological reserve and deposit.

This was in the context of Seabright moving to the feasibility stage. Decisions had been made in October 1986, after the reserve calculations made by staff, to retain Kilborn and Redpath. Technical staff had recommended Redpath and, according to the comments Mr. Armstrong prepared for Westminer, staff "expected that the plan prepared by Redpath could be a long term plan and used for the development and production scheduling". In recommending Redpath geological staff recognized Redpath would not "carry out a detailed review of ore reserves" and that Redpath and Kilborn were to base their work on the MPH calculations. Thus, both the discussions with MPH in December 1986 and the expectation of staff in October 1986 as to the usefulness of the Redpath report put into perspective the problem Mr. Campbell emphasized in the chronology he wrote for Westminer. Considering their involvement in writing the public record, their expectation for the usefulness of Redpath's work

based on the MPH reserves, and the advice they received from MPH in December, staff could not have been very concerned that the previous work of MPH had been defective. One denotes a certain defensiveness in Mr. Campbell's emphasis. At least, one wants an explanation for the contradiction between his assertion the MPH reserves were wrong and the general agreement of technical staff that a report based on the MPH reserves would be useful for development and production.

[73] Strangely, the chronologies and comments do not specifically identify the event of the last MPH calculation and production of revised sections and plans. A reader unfamiliar with the background might think that references to MPH reserves related to the calculation announced in April 1986, but that had been superceded by three others, and the most recent, the one identifying 3m tonnes at 9 g/t, is the subject of the discussions recorded subsequently in the chronologies, in the comments and in the referenced Seabright documents. By June 1987, Seabright staff appear to have recognized the work of MPH was unhelpful for finding gold reserves in Beaver Dam. However, neither Seabright generally, nor geological staff particularly, recognized that this debunked the latest MPH reserve calculations. The reference for this dichotomy is in a report prepared by Mr. Keohane on June 4, 1987, which was discussed by geological staff and senior management at a meeting held on June 5, 1987. This is one of

the documents Mr. Armstrong cross-referenced in his commentaries for Westminer. The report referred to the new MPH plans and sections developed as part of the latest MPH reserve calculation, stated that discrepancies between the plans and sections were noted by both Mr. Olszowiec of Seabright and professionals at Redpath, and said "the accuracy and value of this work was further investigated". In his chronology, Mr. Keohane asserted that these events led to a number of decisions "in the later half of December 1986", including "MPH plans and sections would not be used for exploration/development planning". There seems to be something wrong with Mr. Keohane's timing. The MPH report is dated January 21, 1987, and the Redpath report, where "geological sections and plans presented by M.P.H. Consulting Ltd. were accepted as presented", was signed on January 19, 1987. Certainly, any recognition of deficiencies in the plans and sections would have had to have come after they were produced, and Redpath would not have signed its report without noting discrepancies detected by its professionals. Mr. Coughlan says that information concerning any deficiencies in the MPH plans and sections was conveyed to him much later than December 1986. A reader of Mr. Keohane's June 4, 1987 report together with the MPH and Redpath reports, would see that the subjects attributed to December 1986 must have actually arisen sometime

later. The June 4th report went on to record that a detailed reinterpretation was being conducted under Mr. Campbell, and that his work "should be completed by mid-June". Then comes the dichotomy: "MPH data, while valid and defensible for geological ore reserve calculations are virtually useless for exploration/development/stoping planning." Geological staff are telling senior management that the MPH reserve calculations are valid, but the data are not useful for underground exploration. I accept the opinion of Dr. Pearson that this is not a dichotomy, but a simple contradiction. However, this is what Mr. Coughlan was told, and, on the evidence before Westminer, this is what Seabright's technical staff believed. Mr. Coughlan had his own explanation for the apparent dichotomy. His explanation involves an analogy to construction. For him, the architects had provided their conceptual drawings and now the designers had to find their own way. However one resolves the contradiction, this record, which was in the possession of Westminer and brought specifically to its attention during the investigation, indicated that the very people who Westminer was using for information had informed Mr. Coughlan that the MPH reserves remained valid even as the entire geology of Beaver Dam was to be reinterpreted. Also, at this time Mr. Keohane reported "Veins/vein sets can be correlated to assays such that areas of higher potential do emerge." and he said

"Insufficient work underground does not allow any assessment of those target areas at this time." I understand Dr. Pearson to disagree with this latter statement. This disagreement says something about the quality of advice senior management in Seabright was getting from technical staff, but it says nothing against Mr. Coughlan. This part of Westminer's materials leads the reader to believe that Seabright understood the surface drilled reserve calculations to be valid, it understood the geology to be uncertain and it understood more work was necessary to confirm reserves or locate them. There may be problems holding these understandings all at one time, but that only suggests another necessary avenue of inquiry: why were these understandings conveyed? To get an answer, one would have to challenge Mr. Armstrong, Mr. Campbell and Mr. Keohane.

[74] The comments provided by Mr. Armstrong to Westminer also reference Mr. Keohane's report of June 28, 1987, which was repeated in a report for a management meeting on July 6, 1987. Despite the June 4th advice that Mr. Campbell's full-time, detailed reinterpretation should be complete by mid-June, Keohane wrote "little progress has been made in our understanding of the geology/ore occurrences of the Beaver Dam deposit." He referred to generally poor results from areas sampled. He reported that geological staff were "at a

loss to provide new potential ore target areas" and said that the underground exploration was "lacking direction." He recommended a halt to full force underground exploration, sending the miners to Forest Hill, and sending in the geologists. Among other things, he recommended a re-sampling of all the developed areas, which is consistent with the indications that sampling during underground exploration had seriously understated grade. He also proposed re-doing the MPH ore reserve calculations "to ensure original predictions are in fact valid." And, he proposed to investigate bulk mining.

[75] Mr. Armstrong's comments referred Westminer to further reports prepared in August, September and October 1987. Mr. Campbell's chronology summarizes the results of the geological work to August 1987 in these words: "Good chip results from all ore headings and confidence in geological interpretation leads to optimistic outlook." and, for September: "Continued good chip results increases optimism for project." On October 15, 1987, Mr. Keohane reported to the Seabright board. The minutes reflect a complete turnaround from the reports of June and July 1987. As to the re-evaluation, the board minutes report Keohane's advice, "Personnel have excellent control on the veins Seabright is interested in but are experiencing difficulty in determining which vein should be mined as all are providing good results." As to sampling, he reported "The

resampling program is now underway." As to bulk mining, he reported "an estimated underground grade of .16 is anticipated", which I believe to be the equivalent of about 5 g/t, and he spoke of "a 10-12 million tonnage" with a "potential of .15-.2 ounces of gold [4.7g to 6.2g] per tonne". Thus, by October 1987, the re-evaluation appeared to have been successful, the possibilities for bulk mining appeared to be very encouraging and the third major subject addressed in July, re-sampling, was underway. We need to take a closer look at the re-sampling issue before we turn to the next events reported to Westminer through the chronologies, comments and referenced documents.

[76] Gold is sometimes completely infused in host rock and is invisible. Sometimes it is visible but it will adhere to the broken ore, as with the flecks of gold one sometimes sees in broken quartz. Most of the gold found at Beaver Dam was not like these. It is coarse gold. From what has been shown to me, these are small nuggets, smaller than a match head, which may appear like a knob on the broken host rock. Coarse gold presents some special problems for assessing. It is easy to miss and easy to lose, so grade becomes understated. On the other hand, a few large pieces falling haphazardly into a sample will overstate the average grade. As to missing the ore, coarse gold is concentrated in spots. Where one is looking for a few grams in an entire tonne of rock, the chances of

finding it reduce as the samples reduce in size. Ordinary sampling may only involve a few kilograms of rock. As to losing the gold, this is always a problem with gold mining because of the metal's weight and malleability. However, the problem is greater with coarse gold. It will break off and fall away during excavation and travel. Also, much gold will always be lost in initial production as the gold fills all available voids in the machinery of the mill. One cannot have confidence in the rate of gold production from new machinery or cleaned machinery until the voids have filled with gold. Also, even today, some gold will remain in the host rock to the end and will be left in the tailings. As to overstated results, the gold is concentrated and odd samples may be spectacular. A few nuggets found in one sample will produce a very high ratio that is not representative. Thus, geologists normally cut high samples to a norm when calculating reserves. These simplified points, perhaps overly simplified points, are subjects of highly complicated work in the geology and engineering of gold mines. Two subjects are germane to the present inquiry: confidence in sampling techniques and confidence in certain periodic assays during a bulk sample.

[77] Just as geological staff at Seabright had expressed, at least among themselves, a lack of confidence in the MPH plans and sections, they also lacked confidence in assays taken during the underground exploration. As late as his summary for

November 1987, Mr. Armstrong stated in his chronology for Westminer: "Mill grade of 0.89 grams/tonne indicates that all sampling to date might be seriously in error." In March 1987, Seabright retained a firm of consulting geologists and engineers, James E. Tilsley & Associates Ltd., to study sampling at Beaver Dam and Forest Hill. Tilsley carried out field work during April and May. Laboratory work was completed in June, and conclusions were stated on July 2, 1987, followed by an extensive report in August. Tilsley described the gold distribution in veins his firm studied and confirmed that over half the grains of gold were too large to pass through a 20 micron mesh. This distribution led Tilsley to say that "normal samples of the auriferous veins will tend to miss the larger grains". The methods employed by Seabright likely understated gold content to a significant extent. Tilsley recommend a system using much larger individual samples and treating the sample to separate the larger grains and to allocate them over the rest of the sample. This tells us that no confidence could be assured for the sampling from the underground exploration to date. Thus, Mr. Keohane's recommendation to re-sample the entire work. As was said, this did not get underway until October 1987.

[78] The mill at Gay's River contained two milling machines. One was a ball mill, the other a rod mill. The rod mill discharge is a source for assaying the ore being milled. Tilsley said:

> A very preliminary study of the rod mill discharge samples indicates a low probability (0.20) of the currently standard samples containing a representative number of the larger grains observed to be present, with the result that the grade calculated from assay results will probably be understated, perhaps significantly.

Nevertheless, reference was made to rod mill discharge assays in the materials provided to Westminer during its investigation. Of course, Westminer was in possession of the Tilsley report after take-over and it is referred to extensively in the materials provided to the investigators. Rod mill discharge assays have to be understood in light of Mr. Tilsley's conclusion.

[79] The re-sampling program conducted in accordance with the Tilsley recommendations continued in the months before and after the Westminer take-over. The underground exploration and processing of the entire bulk sample continued until four months after the take-over, when Westminer announced a radical devaluation of the Beaver Dam ore reserve. The question which presented itself to the investigators was whether knowledge gained by Seabright before all the results were in hand constituted a material change or whether

Seabright was justified to wait until all results were in hand. The question of a material change was to be assessed in light of the definition of that term in the Ontario securities legislation and in light of the latest public record.

[80] The initial results from some rounds for the re-sampling program were in hand by the end of November 1987. On this subject, Mr. Campbell's chronology stated: "Re-sampling returns generally low results." but he refers to results from only one level, where a grade of 2 g/t was apparent, "half anticipated grade". And yet, on November 10, he had written that there was "no geological reason why Beaver Dam should not meet or exceed its tonnage/grade requirements." Mr. Armstrong's chronology did not specifically refer to any results from the re-sampling. Rather, he summarized on-going work on four levels as well as an open pit and a shaft. As for mill results, Campbell's chronology stated that they were "extremely disappointing" in November 1987, such that the feasibility of the project was in "serious question". Mr. Armstrong's chronology took a different perspective. He indicated a rod mill discharge of only .89 g/t and stated that it "indicates that all sampling to date might be seriously in error". The commentaries Mr. Armstrong provided to Westminer referred to a memorandum of November 24, 1987 prepared by Mr. Keohane. Keohane said he was then of the opinion that Beaver Dam could not be mined economically

by the narrow vein method and that there was only a 50/50 chance of final results indicating 4 g/t as would justify some bulk mining. He stated that the re-sampling under Tilsley's methods was not likely to alter results in a sufficient "order of magnitude" to alter Keohane's conclusions. These reports attributed to November 1987 raise a few questions. Why were rod mill discharge assays being asserted with such certainty by Mr. Keohane and Mr. Campbell when Tilsley had so recently reported the likelihood these significantly understated grade? If the opinions attributed to Campbell and Keohane were accepted by technical staff, why was the radical shift in their opinions from October 1987 not reflected expressly in the technical parts of the November 1987 offering memorandum, which were written by technical staff?

[81] The length of time it took to extract and prepare a sample, to deliver samples to the laboratories, which were out of province, to receive the results and for Seabright staff to digest them, are crucial to knowing whether and when a material change occurred in Seabright's understanding of the Beaver Dam reserves. Under "December 1987", the first comment on the results of re-sampling appears in Mr. Armstrong's chronology. He refers only to the Austen Shaft and he says only "waiting for sample results of 30 kilo samples". Again, Mr. Campbell's chronology differs with Armstrong. He refers to 30 g/t as a

required grade for bulk mining a wide passage and he states "Re-sampling shows quartz veins generally grades less than 30 grams per tonne in mineralized areas." He appears to continue relying on the rod mill discharge assays, and can only suggest a "possibility" to explain why the results continue to be well under those anticipated. The possibility relates to overestimation at chip assays rather than Tilsley's finding of understatement at rod mill discharge. According to Mr. Campbell's chronology, he or others reached the conclusions that wide packages were too low grade for economic mining and high grade veins represented too little tonnage for economic mining. Under "December 1987" Mr. Campbell also records "Buy out offer by Western mining prevents any hard decision making on project." While it appears that senior management failed to ask technical staff to address their minds to the question of material change, it is also clear from the chronologies that technical staff did not address the question of their own accord despite the drastic conclusions Mr. Campbell says he reached. So another question appears. If Campbell had reached these drastic conclusions and had reported them to his superiors, Keohane or Armstrong, why would technical staff merely await the new owners rather than raise the issue of disclosure?

[82] Mr. Campbell's summaries for "January 1988" in the chronology he prepared for Westminer also shows this attitude of awaiting the new owners. In full, they read:

> - Confirmation of low grade from 30 kg re-sampling
> - Continue developing most favorable zones
> - Future of project in Western Mining's hands.

With the assistance of Dr. Pearson's work and opinions, Westminer contends that the re-sampling program was complete or very near complete by the end of January 1988 when the take-over bid closed. I have already referred to the crucial issues concerning the timing of the results and to Mr. Coughlan's evidence, which I accept, to the effect that there was a large backlog of samples awaiting assay. As a matter of fact, I reject Westminer's contention. However, the more important question is what Westminer understood of Seabright's knowledge and Mr. Coughlan's knowledge. Although Mr. Campbell wrote broadly that the re-sampling program had confirmed low grade just before the take-over was closed, Mr. Armstrong's chronology does not support this. His summary under "January 1988" refers to re-sampling results from only one, possibly two, locations, the Austen zone at the 1040 level and, possibly, various zones at the 1025 level. At the least, this suggests to an investigator that Mr. Campbell may have jumped the gun and Seabright may have been far from gaining reliable knowledge from the re-sampling program. Under "February 1988", after Westminer took control,

Mr. Campbell repeats the statements found in his chronology under “January 1988”. So we see that, even for him, the re-sampling program was far from ended when the take-over closed. We know what Mr. Coughlan understood. He, with good reason backed by strong advice from a respected expert, would not credit assays from the rod mill discharge. He, with justification, did not consider that sufficient certainty could be had as to whether the reserves at Beaver Dam were confirmed until completing the Tilsley re-sampling, processing the entire bulk sample, and performing the cleanup and reconciliation. This would take us to May 1988, precisely the time when Westminer publicly announced that Beaver Dam did not contain the reserves established by MPH. Westminer did not seek to interview Mr. Coughlan during its investigation. Nevertheless, the discrepancies between Campbell’s chronology and Armstrong’s chronology, Campbell’s continued insistence in the face of Tilsley on results from the rod mill discharge, the technical parts of the November 1987offering memorandum and many other circumstances that should have been apparent to the investigators, suggest Mr. Coughlan’s explanation as a strong possibility worthy of investigation.

[83] The interviews were more accusatory of Mr. Coughlan and Dr. Garnett. Both Armstrong and Pollock suggested Coughlan had deliberately muffled Robertson and Associates after the take-over bid, and Armstrong, Pollock and Kilpatrick suggested that Coughlan and Garnett knew Robertson was in possession of

information showing the publicly stated Beaver Dam reserves were doubtful. Mr. Kilpratrick and a Mr. Peter Grimley had been on site doing the work reflected in Robertson's second report. Seabright staff were then about halfway through sampling a quantity of ore from Beaver Dam that has been described as a "bulk sample" of 6000 tonnes. The characterization and significance are controverted. In any case, Robertson and staff discussed the poor grades. Robertson was coming to the views expressed in its second report and these were said to have been reported to Coughlan and Garnett. There were reasons to proceed cautiously before accepting the allegations of these informants. The interview notes themselves record concerns about the veracity of Kilpatrick, who was "very nervous", and Pollock, a "fuzzy thinker" about whom one "would be concerned at hearing him cross-examined". Cross-examination or challenge on a number of critical points would have been appropriate if Westminer had embarked on a truth-finding inquiry as described by Mr. Wise. I have already discussed at length Westminer's early knowledge of weaknesses in Seabright's technical staff, a knowledge that preceded the decision for an unfriendly take-over. I have already discussed the stance of technical staff in light of the emerging truth about Beaver Dam immediately before or after the take-over, and the guarded approach one might take to informants who saw

reason for Westminer to assess blame against them. Also, I have mentioned lines of inquiry suggested by the record and, in the case of the most drastic accusations, the absence of any record despite Mr. Keohane's assertion that he had been writing things down out of a distrust of Mr. Coughlan. The interviews themselves disclosed other lines of inquiry, challenge or cross-examination. The record from the summer of 1987 showed Dr. Garnett speaking of the need to tailor information about Beaver Dam for public consumption, a concerning indication of possible defalcation. However, the interviews disclosed later statements made by Dr. Garnett to the press, which were forthcoming. Indeed, even before the interviews, in fact before sale, Westminer knew Dr. Garnett had made statements to the press about the Beaver Dam reserves. Westminer does not appear to have pursued this obvious line of inquiry with any vigor. It would have revealed much against fraudulent intent. Further, the accusations about what Seabright was told by Robertson in December 1987 go far beyond what appears from the October 1987 Robertson report, the letter retaining Robertson for further work in December 1988 and the second Robertson report at the time of closing. Furthermore, something which had been implied in the stance of technical staff and would be implied by Westminer for years to come, became explicit in the May 12, 1988 interview of Armstrong. He stated his suspicion

that MPH had deliberately overstated the reserves, that it had discarded cutting factors in its final calculations "to maintain reserves". The Westminer allegations imply serious professional misconduct on the part of MPH. Statements by technical staff, whom Westminer understood to have been weak, against MPH, with whom technical staff had been in conflict, deserved challenge and inquiry of the professionals who stood accused. Finally, the interviews impress for their attempt to paint the darkest picture. Other records show technical staff's exuberance about Beaver Dam in September and October 1987, but, when interviewed, this was downplayed by Armstrong, "hope had not been given up", and by Pollock, "there were problems with the project but these were being evaluated".

[84] What emerges from a fair reading of the chronologies, commentaries, referenced Seabright documents and the interview notes are very serious accusations against Coughlan and Garnett and serious reasons to doubt the accusers. Cross-examination along some of the lines I have indicated and further inquiry were indicated. The most obvious sources for further inquiry were Coughlan, Garnett and MPH.

[85] On the subject of what Mr. Coughlan actually knew about Beaver Dam, I have reached the same conclusions as Justice Nunn. I accept the testimony of Mr.

Coughlan as to his understanding of Beaver Dam, his assessment of the various reports he received from technical staff and outside consultants and the events related to the second Robertson report. I will not provide a detailed explanation for my findings. In painstaking detail, Justice Nunn provided an explanation of his fact finding. While the evidence before me is synoptic and the evidence includes Justice Nunn's findings themselves, I also embrace the logic of Justice Nunn's explanations. To explain in detail would be to repeat. Instead, I shall set out the general findings and I shall comment very briefly upon some of the major issues of fact that underlay them.

[86] Justice Nunn found that, during the time of the take-over, not only Coughlan and Garnett, but also the senior technical staff at Seabright, understood they had a problem with confirming the Beaver Dam reserves but were encouraged by Robertson and Associates to seek a solution. He characterized the second Robertson report as indicating that "the moment of decision was drawing closer as to whether a minable grade could be obtained" (p.158) and closure was only one possibility (p.158, 186 and 187). Just as Coughlan did not consider that any material change had yet occurred, the evidence before me shows that technical staff deferred the decision to the future, when Westminer and its experts would be in charge. Justice Nunn's findings respecting Dr. Pearson's opinion are

instructive for the reasonableness of the understanding held by Coughlan, Garnett and senior technical staff. Of Dr. Pearson's work, Justice Nunn said at page 172:

> He did not agree with Tilsley's report which stated that the rod mill discharge grades were substantially understated though he acknowledged Tilsley was a recognized professional consultant as, indeed, were MPH, Redpath and Robertson and Associates, nor does he agree with Robertson's statement that Lakefield's tests are needed to resolve the question of the rod mill discharge assays. As well, again with hindsight, he did not see any reason for the optimism expressed by Keohane, Pollock, Armstrong and even Campbell which they had attested to.

In various parts of his decision, Justice Nunn referred to the competence of the consultants hired by Seabright and, following the quoted passage, he stated that Coughlan, Garnett and technical staff relied upon the consultants with whom Dr. Pearson disagreed. Justice Nunn found no fraud (p.184 and 185). As to material change, he observed "Before a fact can become material, it has to be established." (p.193) and he found that Seabright had not yet reached that point (p.193). Seabright was nearing the point of material change but that had not occurred at the time of take-over, and "they were entitled to proceed as recommended so as to be able to determine just what the actual facts were." (p.193-194). He found that Coughlan and the others had not been in breach of any statutory obligation to report a material change or to disclose a material fact (p.194). I follow Justice Nunn in these findings. The

defendants argue that a decision of the Supreme Court of Canada released after Justice Nunn's decision leads one to a different reasoning than Justice Nunn followed on the subjects of disclosure of a material fact or reporting a material change. I shall deal with that argument in the discussion portion of this decision. In summary, I believe Justice Nunn's work to have been consistent with the Supreme Court decision.

[87] In conclusion, Mr. Coughlan's knowledge was that the MPH reserves had not yet been sufficiently tested by underground exploration to warrant any conclusion on the question of confirming the reserves established by surface drilling. His understanding was that that issue awaited the conclusion of the entire underground exploration and bulk sample. His understanding was justified by what he had been told by technical staff and outside consultants. This would have been stated to Westminer had Coughlan been interviewed.

[88] The investigation being carried out under Mr. Wise's direction was the real focus of a public announcement released by Westminer on May 13, 1988. The release included: "A review of the companies acquired is being undertaken to verify information available to WMC prior to acquisition offers being made." Although this statement refers to all of the take-overs under the North American Acquisition Program, Seabright is singled out "where present indications are that the published ore reserves will be down-graded, in particular at the Beaver

Dam mine." Mr. Wise confirmed when he testified that, notwithstanding the broader reference in the press release, only Seabright was under review. After the press release, Mr. Wise personally reviewed some of the record during two trips to Toronto. He did so in order to form his own opinions, apart from those of Lasken & Calvin. During his direct examination it was made clear that he had taken account of a number of Seabright documents generated in the first half of 1987. He referred to minutes of a meeting held on January 9, 1987 when "underground sampling and mapping, and underground and surface diamond drilling has been initiated." The record includes, "All present concurred that more time than previously estimated is required to systematically probe and test the mineralized areas adjacent to the decline." I have already discussed the delays in exploring Beaver Dam which were obvious from the public record. Mr. Wise said that this and another passage, "the viability of a low tonnage/high grade versus a high tonnage/low grade operation will be determined", suggested there might be some problems with the Beaver Dam deposit. The Kilborn report was produced more than a month later. Mr. Wise referred to a memorandum from Mr. Pollock to Mr. Coughlan dated February 11, 1987 including "we are having difficulty in reconciling drill assays, and underground chip and muck sampling, with perceived mill recovery." However, this relates to the first

recognition of sampling problems and retaining Tilsley to assist with that problem, a matter of record and within Westminer's knowledge before take-over. Mr. Wise referred to minutes of a meeting held on February 13, 1987 including "We are attempting to find the continuity of the geology to plan for further development." as indicating difficulties in maintaining continuity of veins. Given the early stage of exploration, I have difficulty reading this statement as significant for the charges Westminer was to make. Also, Mr. Wise did not mention comparing this with information available to Westminer at the time of take-over. The difficulties were made known. He referred to Mr. Coughlan's memo of April 9, 1987 "a clearer picture of the situation at Beaver Dam is not available, the appropriate decisions will be made as to the future of this project." This memorandum ordered a full review of Beaver Dam exploration to be conducted in early June 1987. It suggests a desire for information so that conclusions can be drawn. That led to the Keohane memorandum of June 4, 1987, to which Mr. Wise next referred and which I have already discussed. Mr. Wise took it that the technical staff had thrown out the "central building block" in saying that MPH reserves were "meaningless" from a "practical mining viewpoint." He did not attempt to explain the advice given to management that the MPH data was "valid and defensible for

geological ore reserve calculations." Mr. Wise next referred to the June 18, 1987 memo of Dr. Garnett. This precedes Mr. Keohane's report of June 28th, which I discussed in reference to the comments provided by Mr. Armstrong to Westminer. Dr. Garnett's memo records and discusses subjects dealt with at a management meeting. The discussion appears to be consistent with the June 28th Keohane report, and the report shows that Seabright was moving towards the decision to curtail exploration at Beaver Dam and move in the geologists. Mr. Armstrong had, on June 18 , reported upon the discouraging results of efforts following the June 5th management meeting and of Seabright's continuing difficulties in understanding the geology of Beaver Dam. At the end of his discussion, Dr. Garnett wrote of "External Orchestration", "This very critical element of establishing a balanced, plausible story for shareholder and public consumption should be the major item of business if something close to this recommended plan of action is approved...." The "plan of action" included reducing operations at Beaver Dam while Seabright attempted to gain a better understanding of the geology. According to Mr. Wise, this statement concerning a "plausible story" for shareholders and the public had a profound impact upon the assessment he was making. Mr. Wise's concentration upon Dr. Garnett's disturbing written comments of June 18, 1987 is remarkable for its

failure to read the comments in light of what Dr. Garnett actually did by way of so-called "external orchestration". Some of this was known to Westminer even when it was formulating the take-over bids, at least because of the report of Mr. Chender. Dr. Garnett's public comments became known to Westminer in some detail when, in January 1988 before the closing, Mr. Lalor's attention was drawn to the December 21st issue of the *Northern Miner*. Dr. Garnett had told the press that bulk samples were being batched from Beaver Dam "to get a handle on the grade" and *Northern Miner* said, "Actual ore reserves will not be known until after the full bulk testing program has been completed and revisions to current estimates are done." Again, information that Dr. Garnett had given details about the Beaver Dam exploration to the public through the press ought to have led the investigation to enquire into what Dr. Garnett had actually said to the press in 1987 and what had been reported in the press and in stock analysts' reports. Such an enquiry would have indicated against fraudulent intent and would have shown, in yet another way, how well Westminer ought to have known the risks of Beaver Dam before it bought Seabright. For example, Wood Gundy published a report early in September including, "Since that time [July 1987], our assumptions for Seabright have not been borne out as expected. Problems were encountered at Beaver Dam due to the complex nature of the ore body."

And, at the end of November Wood Gundy reported management had now elected bulk mining over narrow vein mining as the approach for Beaver Dam "[p]rovided the bulk sample leads to a positive feasibility study".

[89] Mr. Wise also referred to Mr. Keohane's report of June 28. This report followed Mr. Keohane's of June 4 and the management meeting of June 5. Mr. Wise took the recommendation "that the project be scaled back and expenditures on the site be reduced" as being at variance with the public record, particularly the annual report. Keohane's comment that "... geology staff is now at a loss to provide new potential ore target areas and the underground development program is lacking direction" was taken by Mr. Wise as confirmation of what Keohane had said to Mr. Wise in March 1988 to the effect that there was an absence of continuity in veins identified by MPH. I have already discussed other parts of this report. According to Mr. Coughlan, the information in this report was consistent with reports he received through June and early July 1987 to the effect that staff were having difficulty understanding the geology rather than that staff had uncovered information seriously calling the ore reserve calculations into question. I note that, where Mr. Keohane's report of June 4 had confirmed that the MPH data were valid "for geological ore reserve calculations," the June 28th report recommended re-doing the calculations "to

ensure original predictions are in fact valid." This indicates that staff were beginning to question the accuracy of the reserve calculations, but it is inconsistent with staff having reached any conclusion in that regard. Mr. Keohane was interviewed again in July 1988. In cross-examination, Mr. Wise referred to Keohane as having been recalcitrant and inconsistent. Once again, Westminer had serious reason for a guarded assessment of its sources.

[90] Late in June the Westminer board made a tentative decision to proceed with a civil action against the former Westminer directors and to make complaints against them to the RCMP and the OSC. Final decisions were made by board members, Westminer's senior management and its subsidiaries in July, 1988. According to Mr. Wise, during this time investigations continued with a view to establishing further information for or against action. He suggested that new information tending to exculpate the former directors might have led to a final decision against a civil suit or a decision to tell the OSC that Westminer did not favour prosecution. The new information identified by Mr. Wise in direct examination consisted of notes of a further interview with Mr. Armstrong, a memo following a meeting with Mr. Campbell and notes of an interview with Mr. Peter Grimley of Robertson and Associates. The first two are not new sources, and Mr. Kilpatrick of Robertson had already been interviewed.

[91] Notes dated July 8, 1988 prepared by Mr. Roy recorded the further interview of Mr. Armstrong. This did not add much to the information already provided by him. He stated that "As far as Terry Coughlan would have known in October, 1987 the Beaver Dam project was still viable." He went on to say,

> All of this changed when we started to process the material on November 17, 18, 19 and 20th which we had estimated at 3.5 to 4 grams. We were getting one gram a ton. We had a meeting on the 24th of November and at that time I told him that the results we were getting from the mill after 1800 tons were 1 gram. He said let's wait and see what happens - keep milling.

Coughlan is said to have brought Robertson back in during December 1987 "because he had lost confidence in the people running the Beaver Dam project." According to the interview notes, Robertson personnel did not report to Coughlan while they were on site from December 7 to December 11 but "... they told me that they were surprised that we had been processing material and getting such low grades." They were very concerned and had a "suspicion" that the rod mill discharge results were going to prove accurate. Nevertheless, their recommendation was going to be to continue processing the entire sample before making decisions. Mr. Armstrong said he advised Mr. Coughlan of the low rod mill discharge results, but he could not recall specifics. Mr. Armstrong's confidence in the viability of Beaver Dam was estimated at 20% as of December 1987. The interview notes conclude with Mr. Armstrong's opinion "It was

unreasonable for us to think that we could still have a major ore body." Mr. Wise said he took from this as further confirmation that there had been non-disclosure of a grossly deteriorating situation with the ore reserve.

[92] Mr. Roy also met with Mr. Campbell. He sent a memo to Mr. Wise dated July 28, 1988. Mr. Campbell's antipathy towards MPH was expressed. He joined Seabright in May 1986. By August he claimed to have given advice at a production meeting that the reserve figures had to be properly calculated. "He stated that at that time he could not believe the M.P.H. interpretation of the drilling and stated that it was a standing joke with the geologists that the M.P.H. analysis was ludicrous." This conflicts with the information given by Mr. Campbell's superior, Mr. Armstrong, and the strong language invites a challenge in light of the professional responsibility borne by Mr. Campbell and his superiors for the technical portions of public documents issued after August 1986. Also, Campbell's comment upon MPH's review of its own work does not appear to have been solicited. However, his opinion that the "ludicrous" MPH calculations resulted from professional misconduct on the part of the geological engineers was volunteered and recorded: "... while he had no proof, he suspected that Terry Coughlan was leaning on Howard Koates to have M.P.H. increase the reserves." Also, he charged that the engineers had accepted instructions from

Seabright to discard cutting factors when the last opinion of ore reserves was given. When the subject of Mr. Campbell's responsibility might appear, his claims are equally sweeping but they are somewhat inconsistent with ludicrous ore reserve calculations being maintained under pressure. As at about August 1996 he claimed "He did not think that anybody was trying to fool the public but since Beaver Dam was not producing any gold they [the Geological Department] were under pressure to have good results." As at the summer and fall of 1987, "when anyone came onto the property for a tour, we told them we had no reserves but we were hoping for a big hit." As of the time of take-over, "if anyone from Western Mining had toured the property before the completion of the bid, he would have told them that they did not have reserves." The interviewer, Mr. Roy, knew that Lawrence Stevenson had toured the property under instructions from Mr. Lalor and First Marathon. In the interview, Mr. Campbell was able to describe Mr. Stevenson "but he does not recall any specific discussion." Mr. Campbell said "he would have been surprised if anyone went away from the property, after talking with him, with the impression that the grades contained in the prospectus were real." The interview calls for: a response from MPH to the serious allegations of professional misconduct made against them; a response from more senior members of the geological

department to the implied charge that they had let Seabright place on public record ore reserve calculations known to be "ludicrous"; interviews to determine what Lawrence Stevenson had to say about being told there were no ore reserves; and, a careful assessment of Mr. Campbell's credibility in view of his sweeping charges against others and his sweeping statements about what he himself disclosed or reported. However, Mr. Wise said he took from the memo that there was confirmation the geological department knew since August 1986 that the published ore reserves were untrue, that there was compelling evidence of non-disclosure of a material charge. This uncritical acceptance of Mr. Campbell's reported statements diminishes the credit I can give to Mr. Wise's portrayal of an investigation being conducted with a degree of objectivity by a party reluctant to sue or to request prosecution. MPH was not contacted as far as I have been made aware. None of Mr. Campbell's superiors appear to have been questioned about his accusation the department knew the reserve calculations to be ludicrous. Lawrence Stevenson was interviewed, but not until months after the decisions had been made to sue and to advocate prosecution. Let us see what light Mr. Stevenson might have shed.

[93] The interview notes of Lawrence Stevenson were introduced for very limited purposes. I could not bear them in mind when making findings as to

Westminer's knowledge at the time of acquisition. They were introduced only to show what was given by Westminer to the OSC in February 1989 and what Westminer may have known at November 28, 1988. Late in November 1987, Stevenson went underground at Beaver Dam with Mr. Pollock and "a mine geologist", who must have been Mr. Campbell. "At no time during his visit was Stevenson told that Seabright was no longer relying on the MPH reserve calculations or the MPH data." He "definitely" would remember being told such a thing. He was told, by David Armstrong before the underground tour, that the reserve figures "were being recalculated because they were going to a bulk mining method and that, while they expected the grade to go down, they expected the tonnage to go up."

[94] Mr. Grimley's interview notes record that he and Kilpatrick had spoken with Mr. Coughlan and Dr. Garnett following Robertson's work at the site in December 1987. Grimley and Kilpatrick had noted the poor results from the first half of the 6000 tonne "bulk sample", and had discussed this with Armstrong and Keohane. Kilpatrick now "felt that the narrow vein would not be workable." Mr. Grimley said he advised Mr. Coughlan and Dr. Garnett "that the underground sampling had not produced the values expected" and results of the first half of the bulk sample were "ever worse" based on rod mill discharge

tests. Grimley was pessimistic about the second half of the bulk sample and he could see no reason why the Lakefield assays would prove better than the rod mill discharge tests. According to the notes, “We concluded the conversation by saying that they should complete the sampling. Once this was completed the economics would have to be looked at again because of the low grades - this was definitely implied ....” One would have to hear Mr. Coughlan and Dr. Garnett to assess what was definitely inferred. In any case, at the end of the interview Mr. Grimley made it clear that he did not state directly that he then considered the mine uneconomic. He felt the conversation was consistent with the second Robertson report.

[95] Mr. Wise also considered certain dealings with Seabright’s Halifax solicitor as possibly suggestive of wrongdoing. During his May interview, Mr. Armstrong had claimed that after the take-over bid Mr. Coughlan had told the vice-presidents not to concern themselves with whether disclosure had to be made because Mr. Coughlan had received legal advice on the subject. Mr. Wise and Mr. Braithwaite were interested to know what advice had been given by Seabright’s counsel, Ms. Gordon. Mr. Braithwaite telephoned Ms. Gordon. It does not appear that he told her specifically what was required. Rather, he proposed that she might meet with Mr. Wise and himself to discuss matters

relating to Seabright in November and December 1988. Ms. Gordon took the request under advice. After conferring with colleagues, she wrote:

> Following our telephone discussions yesterday, I reviewed with my colleagues your request to discuss with certain Western Mining representatives matters relating to Seabright Resources in November and December of last year. We feel it would not be appropriate for me to participate in such meetings without the knowledge and consent of the former Board. If you wish me to approach the former Board members for consent, then I would appreciate your clarification of the matters which you would like to discuss.

According to Mr. Wise, Westminer did not want the former directors to know that inquiries were being made and Ms. Gordon was instructed not to seek their consent. Not long afterwards, her firm was discharged as solicitors for Seabright by Mr. Braithwaite. Ms. Gordon turned over her files on Seabright but she advised Mr. Braithwaite that her firm was retaining, for the time being, "any material pertaining to advice given specifically to the members of the Board of Directors." She wrote that this material "does not appear to be consequential" but her firm felt it would inappropriate to deliver what "may be the property of other clients." She referred to "your stipulation that we not disclose to the former Board members the nature of your communications with us." Mr. Wise testified that this episode left him concluding either that there had been no advice or that there was something there that someone did not want Westminer to see. The latter is a groundless suspicion of Ms. Gordon's

truthfulness with her client. The former is the truth and it indicates another reason for careful assessment of information provided by Mr. Armstrong. Armstrong required assurances from Mr. Lalor that Westminer would not sue Mr. Armstrong and that Westminer would cover his costs if Mr. Armstrong was sued by the former directors. Armstrong appears to have been very conscious of his own exposure. Further, as Mr. Lalor knew that Armstrong and other technical staff had taken the responsibility of writing the technical portions of public documents, which would include the November 1987 offering memorandum, it is to be inferred that Mr. Armstrong was conscious of his responsibility in that regard. Armstrong had motive to suppose that Coughlan had represented or misrepresented to Armstrong the existence of a legal opinion that the public record did not require amendment through further disclosure.

[96] Through the course of Mr. Wise's direct examination, my attention was drawn to various evidence gathered after Westminer sued the former directors. This included notes of further interviews and reports of experts retained by Wesminer in the course the suit brought against it by the former directors. He said he took the evidence to which he was referred as confirmatory of the conclusions reached by Fasken & Calvin and by himself. I refer generally to the decision of Justice Nunn in saying that there was also much evidence coming to light which contradicted those conclusions. Through the course of Mr. Wise's cross-

examination, it was made clear that the investigation paid scant attention to the work of the North American Acquisition Program. However, representations made to the enforcement section of the OSC, averments in the statement of claim and a statement made by Westminer to the public had two components: the supposed knowledge of Coughlan and the other directors, on the one hand, and, on the other, Westminer's enquiries and state of knowledge. In light of all the evidence, I find that Westminer chose not to investigate in any detail the true state of its own knowledge at the time the take-over bid was made or the time it was closed.

[97] I do not accept the evidence of Mr. Morgan or Mr. Wise to the effect that the purpose of the investigation was to discover the truth. Their characterization of Westminer's efforts as an objective fact-finding exercise is belied by the evident failure to challenge Campbell and Armstrong where grounds for challenge appeared, the failure to request any explanation from Coughlan or the other directors, the apparent failure to demand explanations from MPH and the focus upon Coughlan's knowledge to the exclusion of knowledge gained by members of the acquisition team. Westminer was gathering evidence against Mr. Coughlan and the others, it was not attempting to objectively ascertain relevant facts.

<u>Westminer's Actions and Motives</u>.

[98] In mid-February, 1988 the Seabright board was called together so members could be replaced. Except for Mr. Coughlan, the directors resigned and were replaced by Westminer nominees. The new board members included Mr. Morgan, Mr. Morley and Mr. Braithwaite. The new board then elected Mr. Morgan to be president, and Mr. Coughlan was to serve as deputy chairman. Mr. Morgan is recorded as having thanked Mr. Coughlan "for the co-operative manner displayed". This was after Mr. Lalor had sounded the alarm about Beaver Dam within the parent corporation.

[99] Early in May the Westminer Board was advised that the Beaver Dam was now forecast to produce only 40,000 to 50,000 tonnes at three grams a tonne. On May 13, 1988 Westminer made an announcement, which was filed with the exchanges. As I said before, it stated that a review of the companies acquired in North America was being undertaken "to verify the information available to WMC prior to acquisition". The release also stated "Work to date suggests that the operations and properties meet WMC's expectations, with the exception of Seabright Resources Inc...." A release was made the same day by Mr. Lalor as

president of Seabrex. It referred to the Westminer release and pointed out that the Seabrex properties were separate. Not surprisingly, the announcement led to press comment. *Northern Miner* referred to the Seabright purchase as an operational disaster “which stands to potentially become the granddaddy of the decade”. The article mentioned talk of a suit against former management, then criticized Westminer thusly, “Once again, we bring to our readers attention two simple yet powerful words - due diligence - the rigorous application of which is known to prevent such monstrous investment decisions.” In Australia, the *Sydney Morning Herald* ran an article titled “Have Hugh and the Boys Bought a Lemon?”, which referred to expectations of 45,000 ounces of gold a year from Seabright compared with “paltry” first quarter production and “a miserable 3.7 grams a tonne”. It reported, “Canadian sources have maintained all along that the locals got a damn good price for a fairly ordinary mine.” The evidence, particularly that led through cross-examination of Mr. Morgan and Sir Arvi Parbo, makes it clear that for a corporate interest, Westminer is quite topical in Australia. The Seabright purchase and the litigation were widely reported upon. It was made clear enough by the evidence as a whole and it was explicitly stated during the cross-examination of Mr. Wise that perceptions of public image

motivated Westminer's decisions respecting Mr. Coughlan and the other directors.

[100] Press reports indicating that Westminer may be considering a suit against the former directors, came out in early June. Before that, Mr. Lalor asked Mr. Coughlan to resign as a director of Seabright. He made no mention of the press release or the investigation into Mr. Coughlan's activities. Rather, he referred to Westminer's decision to operate "in its own right" and said "you also seem to be fairly committed to other developments".

[101] In June 1988 Mr. Wise prepared a briefing book concerning causes of action against and regulatory violations by the former Seabright directors. He submitted this to Mr. Morgan, who prepared a presentation for the Westminer board including the briefing book. The book was the subject of a claim of privilege and an application before Justice Kelly. Some extracts were released, and those are before me. A further extract touching upon Cavalier was produced at trial. The book includes the conclusions quoted above in reference to the investigation, that Coughlan and Garnett were liable to Westminer for violation of disclosure requirements, for conspiracy to injure and for fraud and that the directors were, at the least, likely to be liable in negligence. The recommendation was to sue Coughlan and Garnett in fraud, conspiracy and

negligence, to sue the other directors in negligence only, to claim damages of $70 million and, on an allegation that the sale of their own shares to Westminer constituted a violation of insider trading restrictions, to claim an accounting and attachment of traceable proceeds. Mr. Wise had written that the evidence against Coughlan and Garnett is "very strong" and Westminer would "probably" succeed against the rest. He referred to the possibility the other former directors might receive some sympathy "if they can demonstrate that Coughlan largely kept them in the dark" and he stated "If we conclude after such oral examination [discovery] that the proceedings should be pursued only against Coughlan and Garnett, then we can easily delete the other directors...."

[102] A special board meeting was convened on June 29. Present were ten directors including two who gave evidence, Sir Arvi Parbo and Mr. Morgan. Also present were the secretary and Mr. Wise. The minutes read:

> Discussions took place on the Managing Director's memorandum dated 28th June, 1988 and attached report from the General Counsel. It was noted that the Company's investigation into the affairs of Seabright suggests that the information provided by that company to its shareholders and stock exchanges was incomplete and known by at least the President of Seabright to be incomplete at the time of Western Mining's bid, and therefore it was considered that the Company should in all likelihood commence a civil action against the former directors of Seabright and advise the Royal Canadian Mounted Police and the Ontario Securities Commission that in the Company's view, relevant Canadian laws had been breached.

As indicated by “in all likelihood”, a final decision was not then made. The minutes conclude “Directors would be contacted individually over the next week or so after they had been able to study the report, to confirm the above decision.” That was done and all directors agreed the company would commence action and report the former Seabright directors to the RCMP and the OSC. According to Mr. Wise, Mr. Morgan and Sir Arvi Parbo, the preference was for prosecution by the authorities rather than suit. Mr. Wise portrayed Westminer as a reluctant litigant. Although he said he had information that Westminer could realize about $10 million on judgments against the former directors, the preference was that the facts be established through prosecutions.

[103] Notes from the board meeting and the evidence of Mr. Lalor, Mr. Wise, Mr. Morgan and Sir Arvi Parbo made it clear that vindicating Westminer’s reputation was the motive for this decision. The board was warned by Mr. Morgan that any award might not be recovered, even “in part”. As Sir Arvi Parbo put it when he testified, Westminer had suffered a very severe loss financially and to its reputation. He said the corporation was out “to set the record straight with our shareholders, with the public, and also to try to recover some of this loss.” As for the reputations of the former directors, the damage caused by allegations, even allegations of fraud, in a civil action or a prosecution “just seems to me a part of the system”.

[104] After the Westminer board made its decision, Mr. Wise was dispatched to Toronto. By then, Seabright and other newly acquired companies had been taken private and they were being amalgamated into Westminer Canada Limited, which was wholly owned by Westminer Canada Holdings Limited. The boards of these corporations met on July 11. Various officers were appointed for the operating company, including David Armstrong who was made a vice-president locally managing the Seabright operation. Both corporations resolved to retain Fasken & Calvin in reference to possible litigation over Beaver Dam. They also authorized Mr. Lalor, as president, to cause the corporations to commence suit against the former directors. Mr. Lalor testified that his own views were divided. On the one hand, he thought Westminer should try to vindicate its decision to take Seabright over. On the other hand, litigation involves time, energy and expense and is not usually financially attractive, he said. Ultimately, he approved the suit because he had no choice. The board and managing director of the parent corporation had made the decision.

[105] Three efforts launched by the Westminer corporations require assessment: reporting to the OSC, suing the former directors and making public statements.

I will deal with the suit and the public statements. The approaches to the OSC began in mid-July, but I shall come back to that subject later.

[106] Westminer was up against a limitation period which limited a statutory cause of action it was planning to plead against all directors. Subsection 75(1) of the Ontario *Securities Act* prohibited insider trading when the insider was aware of an undisclosed material fact or material charge. Subsection 131(1) made the insider liable in damages to the person with whom the insider traded. Section 135 provided that actions such as those under 131(1) could not be commenced after 180 days from when the aggrieved party first had knowledge of the facts giving rise to the cause of action. Westminer calculated that its claim could be prescribed at the beginning of August 1988. Mr. Wise and others had met with representatives of the enforcement branch of the OSC and Westminer was later advised that no decision for or against prosecution could be made before the end of the month. During the evening of Thursday, July 27, Toronto time, a conference call was held in which Morgan, on behalf of Westminer, and Lalor, on behalf of the Canadian subsidiaries, authorized the suit. Counsel were instructed to file a statement of claim with the Supreme Court of Ontario the next day, Friday, July 28, and see to it that Mr. Coughlan was served in Halifax on Saturday the 29th. According to Mr. Lalor, Mr. Morgan indicated "very

strongly" that he wanted the suit to proceed. The statement of claim was issued and filed. It was given to a courier for delivery on Saturday to the home of Westminer's new Nova Scotia solicitor, Mr. Bill Cox, Q.C., who was instructed by Mr. Wise to have a process server on standby to serve Mr. Coughlan at home. Why such expeditious service? Mr. Wise says it is good practice that a person being sued for fraud should know of it as soon as possible. No doubt that is true, but such a practice would better be achieved by warning the person before public filing if, for some reason, a private demand or a request for explanations had not already been made. I doubt that good practice was the only motive. The Westminer board met at 9:00 a.m. on Wednesday, August 3, Melbourne time, which was the evening of Tuesday, August 2, Halifax time. When it met, the board was asked to approve a public announcement of the suit and that very day a lengthy public announcement was released to all exchanges trading Westminer stock. I believe the rush was to have Mr. Coughlan served, if not other defendants, before Westminer's story hit the presses, and the motive was to get the story out as quickly as possible, if not also to create a division between Mr. Coughlan and the other directors. In fact, the courier failed. The documents were not placed in Mr. Cox's hands until Tuesday, August 2, and it appears that, to the knowledge of Mr. Wise and Mr. Morgan, Mr. Coughlan was not aware of

the claim or the suit until just about the time the Westminer board was meeting in Melbourne. Mr. Coughlan managed to contact the other defendants not long after the process server left his home. This was the height of the summer. Westminer certainly took the risk that some defendants would learn of the allegations from media.

[107] The public announcement broadly published by Westminer on August 3 was a distortion of the facts known to Westminer. It began by announcing the suit in Ontario against the former Seabright directors, then it ran at length presenting information as established fact, not as allegations made in the suit, discrediting what Sir Arvi Parbo said in cross-examination about damage to defendants' reputations being a mere consequence of the legal system. The announcement included, "WMC researched and priced its bid for Seabright on the basis of the public record which had been filed by Seabright with the Ontario Securities Commission." This implies that Westminer did not acquire extensive information from beyond the public record, which is untrue. The announcement refers to the 1986 annual report including the results of the Kilborn study then stated, "The public record therefore clearly stated that the Beaver Dam property contained substantial proven resources of gold ore which could be profitably mined." I refer to my review of the public record that was in the hands of

Westminer's acquisition team in finding that this statement is a distortion of what Westminer knew about the public record. Also, any statement on Westminer's understanding of the public record cries out for the caveat that Westminer failed to read the latest public document available when the bid was made and did not avail itself of the latest reports referred to in that document. Instead, the announcement skips to the lock-up agreements and the take-over bid as if the annual report had been the last word on Beaver Dam. The announcement advises the public "WMC has conducted a comprehensive review of Seabright's internal records and activities". The review was by no means "comprehensive". This review and the results from Beaver Dam were said to have led Westminer to conclusions "... that the public record of Seabright contained serious deficiencies, was misleading and was not corrected through the Director's Circular or otherwise during the take over bid." To bolster this, the announcement said: "Seabright's own underground exploration and mill treatment of bulk samples of ore during 1986 and 1987 had failed to confirm the publically stated Beaver Dam ore reserves.", leaving out the facts that the underground exploration was regarded as a single bulk sample and it was not complete. Then this,

> On December 11th and 15th, 1987 Seabright was advised by a firm of consulting geologists it had retained that there was considerable doubt whether sufficient mineable reserves could be identified and consequently that the economic viability of the Beaver Dam property was in serious doubt.

In fact, Westminer had received advice just a month before from Mr. Grimley that the direct question of Beaver Dam being economic had not been asked or answered in the discussions with Mr. Coughlan on December 15.

[108] I do not propose to review in any detail the courses of the various litigation after July 1988. The Westminer allegations harmed Mr. Coughlan's reputation in business until the trial and appeal decisions. In addition, he was burdened with massive expenses and much of his time was consumed and his energy sapped to the detriment of the business he was attempting to develop. These are subjects to be discussed in the next part. Westminer withdrew its suit six years later, after the findings against it were made at trial and confirmed on appeal. In those six years Westminer's animus remained the same. Two subjects deserve the briefest mention as I assess Westminer's intentions towards Mr. Coughlan and the other directors. The first concerns the policy of insurance for directors' and officers' liability, which Westminer allowed to lapse almost contemporaneously with its making the former directors aware of the claims against them by serving Mr. Coughlan. I will summarize most generally

evidence discussed in detail by Justice Nunn because little new information has been provided to me, though much the same evidence was repeated. The policy was on a claims made basis and Seabright, now Westminer Canada, was agent to report the claims to the insurer for the former directors. Employees of Westminer, including one who kept all corporate insurance organized, were aware that Seabright had purchased the policy and that it remained in effect until August 1, 1988. They intended to let it lapse. In the weeks leading up to the suit, Mr. Braithwaite persistently inquired after such a policy. Mr. Lalor says he thought he had instructed all policies were to be cancelled. Mr. Wise says Mr. Lalor told him the directors' and officers' insurance had been cancelled. Mr. Braithwaite was told by Mr. Peter Maloney it had been cancelled. I refer to Justice Nunn's decision for his discussion of the uncertainties with whether the insurer might have provided cover to the policy limits and for legal fees in the action brought by Westminer and for his discussion of negligence in that regard. For the purposes of this case, it is sufficient to observe that there was serious neglect on the part of Mr. Lalor and Mr. Maloney and such is a further indication of the attitude of Westminer towards former directors. (It was not submitted by the plaintiffs and, in any case, I would not find that Westminer deliberately timed commencement of action with the lapse of the policy.) The

second subject concerns Westminer's amendment of the statement of claim in the Ontario proceeding. It will be recalled that the Westminer board was told that the directors other than Coughlan and Garnett might seek to show that Coughlan had kept them in the dark, and the strategy was to see what evidence they would give on discovery with the possibility of dropping the case against them. As decided by the board, those directors were sued in negligence, not fraud. Although discoveries had not taken place, the concerted approach of the other directors with Coughlan and Garnett would have been apparent by December 1988 because the outside directors had launched their own counter-suits following those of Coughlan and Garnett. As Mr. Braithwaite had seen before the suit, the Seabright by-laws contained a usual provision indemnifying directors for negligence but not willful misconduct. Toronto counsel for the outside directors let it be known that he was considering an application to strike the claim against his clients because the claim and the indemnity were circuitous. Mr. Wise saw merit in this. The subject was discussed with Mr. Morgan. Westminer amended the statement of claim to allege wilful misrepresentation, in effect, fraud. Not readily but eventually through cross-examination, Mr. Wise's testimony established that Westminer had no new evidence against the outside directors since Mr. Wise's report to Mr. Morgan

and their presentations to the board. Allegations of fraud were made for entirely strategic reasons. This is an instance showing the vehemence with which Westminer pursued the directors in order to persuade others that Westminer had not been the victim of its own bad judgment.

[109] The dealings between Westminer and the enforcement branch of the OSC go to two subjects. The first is the question whether Westminer influenced the enforcement branch to bring administrative proceedings against Mr. Coughlan. The second concerns what the communications between Westminer and OSC show of any intent on the part of the Westminer companies to cause harm to others, regardless of any actual influence. Based largely upon my acceptance of the evidence given by Mr. Joseph Groia, head of enforcement for the OSC at the time, I find that Seabright was brought to the attention of the enforcement branch by Westminer and Westminer remained in communication with the branch throughout its sixteen month investigation, but actions were taken by members of the branch in accordance with their responsibilities to conduct investigations independently and to make judgments independently. Westminer did not instigate the investigations that were undertaken and it did not instigate the administrative charges. Later, I will attempt to explain the basis for these findings by reference to the course of the investigations and of the

administrative proceeding, subjects which bear on other issues as well. However, I will begin with the numerous communications between Westminer and the enforcement branch of the OSC, few of which were disclosed by Westminer to the plaintiffs in the Seabright case or placed before Justice Nunn.

[110] Shortly after the decision of the Westminer board and Mr. Wise's arrival in Toronto, a meeting was held at the offices of the Ontario Securities Commission. A request had been made to the Acting Executive Director of the OSC and he and Mr. Groia attended. They met Mr. Braithwaite, who Mr. Groia describes as a colleague, and Mr. Roy and Mr. Wise. Mr. Groia made some notes of the initial presentation by Westminer and Mr. Braithwaite prepared a memorandum recording what had taken place initially and through the course of the meeting. Mr. Roy made an oral presentation of the events as understood by Westminer, and Mr. Braithwaite supplemented this with some comments of his own. Subjects noted by Mr. Groia included the 1986 annual report, a statement that there was in fact no mine and no ore, results of less than one gram a tonne were apparent from the 1986 and 1987 exploration, no material change reports were filed, there was "some hope" in November 1987, Armstrong had had a 30% confidence of success, Kilpatrick, Grimley and Armstrong communications in December including Armstrong reported Robertson's

comments to Coughlan, Coughlan's reported remark that staff had negatively influenced Robertson, Coughlan emphasizing a need for secrecy, Armstrong being reassured by Coughlan, and "defer written report". It is clear from Mr. Groia's notes that representations were made as to Westminer's actions including "decided to do value by public record". Mr. Braithwaite's memoranda is generally consistent with the evidence of Mr. Groia and Mr. Wise as to what was said after the initial presentation. I accept it as an accurate record. There was a discussion of civil remedies under the *Securities Act*. Mr. Groia is recorded as having said the presentation indicated a number of offences under the *Securities Act* and, in his view, "everything would depend on his ability to prove beyond a reasonable doubt that there had been a material change". He said he would review materials compiled for Westminer, he would involve the OSC staff geologist in assessing the public file and the materials supplied and it would take Mr. Groia a few weeks but he would provide his assessment of the case. Mr. Groia asked Mr. Wise if Groia "had the green light to proceed". The memoranda records:

> Colin Wise took a moment to give Joe and Frank some background on Western Mining and to provide them with a flavour for what WMC's thinking generally was on matters such as this. Colin indicated to Joe that his preference at the present time was for Joe to consider that he had a red light from Western Mining. Joe indicated

> that he accepted that and that he would have the OSC conduct their review of the file nonetheless. After the review was complete Joe would speak to Western Mining and a decision will be made at that time as to whether the OSC would initiate proceedings. Joe made it clear that he could not promise that the OSC would not proceed if Western Mining asked them not to, but in the circumstances Joe indicated that the wishes of the party which has been harmed like Western Mining would be taken into account by the OSC.

It is said that Mr. Groia stressed the integrity of Ontario's capital markets and he "was adamant that if wrong doing had occurred he would go for severe sanctions against the wrong doers, such as a jail sentence." In cross-examination Mr. Groia, who had no recollection of the subject independent of his notes, said he may have mentioned jail when indicating what the statute provided for maximum penalties but in a case of this nature, case law would not have supported a jail sentence. The meeting appears to have closed on Mr. Groia's advice that the one year limitation period on prosecutions had begun to run and his request that Westminer's lawyers forward their "research memoranda". The latter appears to mean the interview notes and other documents. The reference to a one year limit indicates Mr. Groia's mind was then on criminal prosecution. A decision was later made against prosecution and in favour of administrative proceedings, which must be brought within two years of the OSC receiving information. Mr. Groia described Westminer's characterization of the alleged violations as restrained, and he said that Westminer's conduct in general was

restrained. That word does not describe Westminer's stance at the next meeting, which did not include Mr. Groia.

[111] Between July and October 1988 Mr. Roy delivered various packages of materials to the OSC. This and subsequent deliveries were as expected by Mr. Groia because of the request he made at the first meeting. It is clear that Mr. Roy was also in telephone contact with the enforcement branch and knew that no decision had yet been made about prosecution but the subject was being investigated by Mr. Frank Allen, a corporate finance lawyer temporarily assigned to enforcement, and Mr. Nigel Campbell, a litigator in the branch on secondment from Blake Castle. In October Mr. Roy received a call from Mr. Campbell. I have Mr. Roy's memorandum and it was admitted by agreement for its contents. Mr. Campbell advised that enforcement believed there had been a breach of the *Securities Act* but any action ought to be referred to the Nova Scotia Securities Commission. Mr. Roy replied that "Westminer would be extremely displeased if the matter was referred to the Nova Scotia Commission". He said that commission had almost no staff and would not be adequate to the task. (Indeed, our commission had only been established by legislation passed in the previous year, and regulations had not yet been made.) Mr. Roy requested a meeting. Mr. Wise was available and they met with Mr. Campbell and Mr.

Farr at the OSC offices, the same day as the telephone call. Mr. Wise made a lengthy memorandum of this meeting. At the meeting, Mr. Roy produced a letter showing that Seabright had never been a reporting issuer under the Nova Scotia Securities Commission. Campbell is recorded by Wise as having said "it might mean that if the OSC decided as a matter of principle that Coughlan ought to be prosecuted then they would have to do the work." Mr. Wise wrote that Campbell said "they had completed their investigations". (In light of the evidence of Mr. Groia, it is more likely that Campbell said they were completing their preliminary assessment. Formal investigation had not even begun at this time.) Campbell and Farr are said to have "concluded that a breach of the law had taken place" but they felt the civil action brought by Westminer "would be enough to redress the wrong that had occurred". Mr. Campbell and Mr. Farr stressed that no final decision had been made and they would review the matter with Mr. Groia. The singular interest of Westminer to show the business world that it was a victim rather than a complainer refusing to take responsibility for its own bad judgment was made clear by Mr. Wise:

> I described at some length who Western Mining was and our position of credibility in the world's exploration and mining industries and in the securities markets. We were reticent about bringing this action recognising that it was most unlikely that we would recover much money from the defendants but nevertheless felt that our

> creditability had taken a severe hammering in the press in both North America and in Australia and very considerable interest was being shown in the case by securities analysts almost to the extent that questions were being raised about the judgments that Western Mining had shown in making this purchase without conducting proper due diligence. I pointed out that we were determined that the truth should finally be brought out in this case and we wanted the smart guys on the street to understand that we had not made an error of judgment but that a fraud had been committed.

Westminer's desire to influence the enforcement branch towards prosecution is obvious from this:

> I also emphasised that we had already listed the company's shares throughout the main exchanges in Europe and were now seeking listing on the New York Stock Exchange. We had plans to remain in America and in Canada in the long term eventually replacing our Australian expatriate staff with Canadian senior management. We were a law abiding corporate citizen and had made our investment in Canada in the expectation that the integrity of the law would be upheld and maintained at all times and we therefore looked to the OSC to enforce the law in circumstances like these.

These remarks of Mr. Wise caused Mr. Campbell and Mr. Farr to observe that they had to consider the cost of prosecution against the potential return. The enforcement branch "had to choose their cases to prosecute very carefully". The vehemence of Westminer's attack upon Mr. Coughlan is evident in the response to that observation:

> We responded by saying that Coughlan had got away with a significant fraud and would do it again to the detriment of the capital markets unless he was stopped. He was either going to be stopped now or within the next ten years because it was likely that he would repeat the scam. So far as we were concerned we wanted to see Coughlan jailed.

The memorandum indicates Westminer considered Coughlan "the main law violator" and Garnett "just a small bit player". As for the outside directors, McCartney "may have known what was going on but we were presently uncertain about the culpability of the other members of the Board." This, less than two months before Westminer added a claim of fraud against the outside directors without having any additional information. At the time this meeting was held and for some months afterwards the enforcement branch was considering criminal charges or administrative proceedings for insider trader violations. That would have brought the take-over bid into issue. At the time of the meeting Mr. Campbell and Mr. Farr asked questions which show they were beginning to look into Westminer's approach to the acquisition and the accuracy of Westminer's representation made at the July meeting and elsewhere that it had relied exclusively on the public record.

> They asked me to describe what due diligence work had been conducted and whether or not we had sought the views of any person to try to seek an inside view on what the ore reserves were like. I gave them a detailed run down on the methodology of how we had bid based entirely on publicly available information in the desire to not arouse anyone's suspicions in such a way that would inflate the share price prior to our attaching a premium to the then current market price. The only outside person that we sought a view from was Michael Chender.

This is a remarkable statement because of the warnings Chender sounded and because of the work of Lawrence Stevenson. Similarly, Campbell and Farr wanted to know what was wrong with the MPH work.

> We explained that they should seek their own technical advice with regard to the difference between cut cores and cores which had not been cut emphasising that the problem with the MPH report was that they had earlier cut some cores but later changed this practice without letting the world know and in any event a review of the MPH reports on file would not give any idea of the ore reserve calculation difficulties with Beaver Dam.

In fact, the public record provided that the Kilborn report was publicly available at the Seabright office at the very time of the bid and Kilborn states explicitly that no cutting factor was applied by MPH in formulating its latest reserve calculations. The following shows the extent to which Westminer was prepared to conjecture wrongdoing by Mr. Coughlan and to vilify him:

> We suggested that Coughlan held notes and legal advice belonging to the company which would be highly relevant to any OSC prosecution and that they should conduct an enquiry with a view to inter alia getting hold of those notes.

In cross-examination, Mr. Wise related this serious accusation only to the episode where Westminer requested information and documents from Ms. Gordon. I have already discussed the exchange between Mr. Braithwaite and Ms. Gordon in June

1988, and to her deleting some materials but offering to get consents from the former directors. As I mentioned, she was instructed by Westminer to maintain secrecy. About two weeks before Westminer sued and issued its press release, Westminer no longer required secrecy. Through Mr. Cox, Westminer indicated to Ms. Gordon "it wants you to seek the consent of those former Directors of Seabright Resources Inc. you claim to have been acting for". The Ontario rules for disclosure were engaged by Westminer's suit, and the Nova Scotia rules were engaged at the time Mr. Wise met with Mr. Campbell and Mr. Farr. Unlike Westminer in the Nova Scotia action where the existence of the very document now under discussion was not disclosed, Ms. Gordon had disclosed the fact of the materials though, out of concern for possible claims of confidentiality, she did not disclose the contents except to say they appeared inconsequential. The fact of the materials had been disclosed, and Mr. Coughlan was to be under obligations to swear an affidavit of documents in Ontario and serve a list of documents in Nova Scotia, with any claim of privilege particularized. What a thin basis for alleging to a prosecutor at the OSC that Mr. Coughlan was withholding notes and legal advice belonging to Westminer Canada.

[112] Mr. Wise's memorandum contains a compendium of evidence showing Westminer's intentions as found against it by Justice Nunn, although he never saw the document. The attitudes it evidences cannot be taken as exclusive to

Mr. Wise. He was discussing OSC developments regularly with Mr. Morgan and he frequently reported to the board about the OSC and Seabright. The attitudes, the tenor and the representations evident in what Mr. Wise said that day must be taken as showing the attitudes, tenor and intent of many within Westminer and as corporate. Firstly, this was clearly an attempt by Westminer to lobby the enforcement branch to prosecute and to seek incarceration. Also, this is another instance of Westminer failing to state the truth about its own knowledge and efforts before the bid was made or closed. Further, we see the willingness of Westminer to make a groundless accusation against Mr. Coughlan. And further, Westminer's objective, to lead the business world to believe that its acquisition program was a competent rather than a reckless exercise, is made express. And over-all, we see in Mr. Wise's statements the vehemence with which Westminer was prepared to attack the former directors in order to achieve that objective.

[113] It appears that shortly after this meeting Mr. Roy was advised that a determination had been made that "the matter should proceed". According to the process described by Mr. Groia, this would mean that the enforcement branch had reached a preliminary assessment and had determined that a formal investigation was warranted. Mr. Roy continued supplying materials, but there

is no evidence of communications with the OSC respecting anything other than supply of materials until after a notice of hearing was issued late in 1989. By this time the enforcement branch had decided not to proceed with criminal charges, and to seek administrative sanctions against Coughlan only.

[114] The notice of hearing alleged that in mid-June 1987Coughlan was aware that the MPH work had ceased to bear relevance to the work at Beaver Dam and reinterpretation commenced at that time, which involved scaling back the work force at Beaver Dam. These were alleged to have been material changes, which ought to have been disclosed in June. The offering memorandum of November 1987 was alleged to contain misrepresentations because it repeated the MPH reserve calculations without stating they now lacked significance and without stating contrary indications from the underground exploration. Further, the notice alleged that by late November 1987 there were significant indications that high grade ore did not exist and bulk mining had only a 50% potential; this was said to have been conftrmed by Robertson in mid-December. This was alleged to be a material change, which was not disclosed. No allegations were made of insider trading violations. On the basis of the allegations, the OSC was to consider restricting Mr. Coughlan's trading activities in Ontario by excluding

him from the exemptions provided in the then sections 34, 71, 72 and 92 of the *Securities Act*.

[115] Shortly after the notice of hearing was announced by the OSC, Mr. Roy and Mr. Wise met with Mr. Groia. The meeting is recorded in a memorandum of Mr. Roy's. They expressed Westminer's pleasure and offered any assistance Westminer could provide. Mr. Groia felt it would be appropriate for Mr. Roy to contact Mr. Campbell, who would lead the case before the Commission on behalf of the enforcement branch. Insider trading was still on the minds of Mr. Roy and Mr. Wise. They discussed "Clarkson's trading analysis," an expert report prepared for Westminer, and "refining that report with the hope of pursuing the RCMP". This must be a reference to contacting the RCMP with a view to fraud charges under the *Criminal Code*. "Mr. Groia indicated that he felt our money could be spent more efficiently elsewhere." At the meeting, Mr. Groia appears to have raised the possibility that the enforcement branch may subpoena documents disclosed by the plaintiffs in the Nova Scotia action. Westminer was prepared to instruct Halifax counsel to make an application for relief from the implied undertaking against collateral use of the disclosed documents.

[116] Two months later, in February 1990, Mr. Roy spoke with Mr. Campbell, "for the purpose of offering any assistance". The only evidence of this communication is Mr. Roy's letter to Mr. Wise reporting on the discussion. Mr. Campbell said he would get back to Mr. Roy but Mr. Roy said "that we have some documents he has not seen". These were among documents produced by the plaintiffs in Nova Scotia, and release would require relief from the implied undertaking. Apparently, Mr. Roy had in mind advice given by Ms. Gordon to the directors at various times explaining generally their disclosure obligations. Also, the two discussed the strength of the case before the OSC and penalty. Campbell is reported to have said "that they felt reasonably comfortable with the strength of their case" and "they 'wanted to shut him down for a period of time'". Mr. Campbell also said "they had intentionally followed a line of inquiry that ended before any involvement by Western Mining."

[117] It is evident that Mr. Wise was following developments closely and he reported them to Mr. Morley, Mr. Morgan and the board. He arranged for Mr. Braithwaite to attend the hearing before the OSC, which was held late in March 1990. To Mr. Wise's disappointment, no evidence was called. Staff and Mr. Coughlan had entered into a settlement agreement, which was presented to the Commission with a recommendation for approval. I will refer to the agreement

and to a contemporaneous agreement or assurance designed to permit Mr. Coughlan to continue as an officer and director of Cavalier Energy in some detail when I set out the facts relevant to Cavalier. In summary, the settlement agreement included Mr. Coughlan's consent to trading restrictions for a period of twelve months, an undertaking respecting disclosure of his activities with any reporting issues and respecting supervision of his activities by the issuer's directors or officers, and his paying $40,000 in costs. The agreement also recorded Mr. Coughlan's denial of the allegations against him and recorded that he "maintains that at all material times he acted lawfully, honestly, in good faith, with a view to the best interests of Seabright". The Commissioners retired and came back with an announcement they would grant an order approving the settlement.

[118] Within two days Mr. Wise reported in writing to all Westminer directors. He summarized the settlement agreement but included this statement, which is not supported: "Coughlan admitted that the public record on which Westminer Canada based its bid was in fact the public record of Seabright Resources." Mr. Wise expressed disappointment and frustration "that the OSC settled with Coughlan without there having been a specific finding on the facts, which

provide the basis for Westminer's action against Seabright directors." Once again, it was made clear that the play was to the street:

> The fact that he has agreed to the loss of his trading rights, a restriction on his business activities, and to pay the OSC's costs, in itself could be construed as a sufficient admission of guilt. To this extent we should not be disappointed. Nevertheless, it would have been nice to have seen the OSC hearing proceed to its logical conclusion by having Coughlan admit to the facts as alleged. The media and industry will have to draw their own conclusion about just what the Settlement Agreement means, because a penalty against Coughlan has been imposed without the nature of the crime having been specified. It is all left to implication.

Mr. Wise provided the directors with various materials, the last of which was "Press cuttings from the following Canadian papers relating to the Settlement: Toronto Globe & Mail, Financial Post, Halifax Chronicle Herald."

[119] This traces the OSC proceedings from the perspective of Westminer. It remains to summarize the proceedings from the perspective of the enforcement branch in order to explain my finding that the enforcement branch was not influenced by the representations it received from Westminer. Mr. Groia testified that the enforcement branch would look into possible *Securities Act* violations based on information coming to its attention from any number of possible sources, including complaints of the kind made by Westminer but also including newspaper reports of law suits involving securities. He said, and I accept, that complaints from sophisticated parties represented by counsel are treated very

carefully because the OSC enforcement branch is intent to ensure the OSC is not misused as a private enforcement agency. The branch conducts its own independent investigation if the initial information warrants. It begins with an informal investigation leading to a preliminary assessment. This will usually involve the head of enforcement, Mr. Groia at the time, and lawyers reporting to him, often one with a litigation background and one with a background in corporate finance. The effort will often also involve experts in fields such as accounting or geology and investigators on staff who are usually drawn from backgrounds in commercial crime investigation with the OPP or the RCMP. If a preliminary assessment is made in favour of possible charges or administrative proceedings, the branch will apply to the Commission for a section 11 order, which authorizes a formal investigation and affords the branch the power of subpoena to hold private examinations, which are kept in confidence as required by the statute. A decision is made whether to lay criminal charges under the *Securities Act*, which Mr. Groia considered one of his most serious responsibilities. Alternatively, the decision may be to seek administrative sanctions from a board of commissioners acting judicially or the decision may be to drop the matter.

[120] In the course of the July 1988 meeting, Mr. Groia concluded that if what Westminer said was true they had raised very serious issues as to whether or not there had been a violation and, if so, the violation would be of a serious order because of the amount of money involved. He expressed this concern at the end of the meeting and requested Westminer to divulge its materials. He became aware at the meeting or shortly afterwards that litigation was intended and he received a copy of the statement of claim issued at the end of the month. He said that if the claim had come to the branch's attention from any source they would have been duty bound to look into it because the apparent issues of non-disclosure allegedly resulting in very significant losses and the issues of potential insider trading struck at the heart of the integrity of the capital markets in Ontario. He ordered the public record, the Commissioner's files on Seabright containing insider trading reports and any records of prior proceedings or other complaints. He also arranged for Mr. John Drury, a staff geologist with expertise in reserves and results, to do his own assessment. Mr. Drury reported late in August. This and other information is before me only to assess Mr. Groia's knowledge and understanding, and it would only serve to confuse if I were to detail it. Based on the documents supplied by Westminer to date and the record obtained internally, Mr. Drury's preliminary assessment was that there

had been a failure to disclose material facts and material charges. Contemporaneously with Mr. Drury's work, Mr. Campbell and Mr. Farr were assigned. Assisted by Drury, Campbell and Farr, Mr. Groia came to a preliminary assessment similar to that stated by Mr. Drury. Although he did not say so and although his ability to relate detail was restricted by memory of events that occurred twelve years previous and by the statutory confidentiality, this preliminary assessment must have been reached shortly after the meeting between Mr. Farr, Mr. Campbell, Mr. Roy and Mr. Wise in October 1988 where Mr. Campbell indicated some reluctance but indicated a meeting with Mr. Groia was imminent. Mr. Campbell did not testify. Based on Mr. Groia's evidence, I find that the decision to go forward was made on an assessment of the evidence to date including Mr. Drury's expert work rather than upon the dramatic statements made by Mr. Wise to Mr. Campbell. Indeed, I detect from the questions posed by Mr. Campbell and Mr. Farr some hesitancy to accept certain representations made by Westminer.

[121] The investigation team was composed of Mr. Drury, Mr. Campbell, who would lead any prosecution, and Mr. Farr, who was later replaced by Ms. Susan Epplet. Mr. Campbell presented a s. 11 application to the Commission by which it was asked to order "an investigation ... into the affairs of the former Seabright

Resources Inc. and the individuals named". We cannot know the names of the individuals, except that Mr. Coughlan was one of them. Most of the written submission is before me, and it clearly presents the Westminer allegations according to the statement of claim in the Ontario action rather than referring to anything said on behalf of Westminer to officials of the OSC in the July 1988 meeting, the October 1988 meeting or at any time. Based upon the documentation supplied, the public record and insider trading reports, the opinions of Mr. Drury, an examination of trading activities by a Ms. Joanna Fallone and "[w]ithout speaking to any witnesses", Mr. Campbell submitted "we have reason to believe that Seabright and its officers and directors knowingly violated the Act." The Commissioners issued an order. Obviously, the order was based on the information submitted, including the public record of the Westminer allegations, and not upon anything said by Westminer at the two meetings.

[122] We cannot know who was interviewed or examined by OSC staff through the course of the formal investigation, except we know Mr. Coughlan submitted to an examination. However, we do know, in Mr. Groia's words, "many, many summonses were issued, many, many examinations were conducted". By the summer of 1989 Mr. Groia decided this was not an appropriate case for

prosecution in the Ontario Provincial Court, and the limitation period was allowed to lapse. Mr. Groia, with the assistance of the investigative team, did determine that administrative proceedings should be taken against Mr. Coughlan. In various ways, he expressed his high level of confidence that the allegations set out in the notice of hearing would be sustained. He also said that Westminer did not exert pressure on the OSC. Mr. Campbell was under instruction from Mr. Groia when the settlement agreement was reached. Mr. Groia regarded the trading restrictions as severe and was satisfied the agreement was in the public interest. He did not say so, but it must have been clear, at least to Mr. Campbell, who had attended the October 1988 meeting, that the agreement would not meet with favour at Westminer, which further supports the finding that there was no actual pressure at play.

CAVALIER

Mr. Coughlan Purchases Cavalier.

[123] Dome Petroleum was a large Canadian oil and gas concern. It ran into trouble during the 1980s, and, by 1988, Dome was under sale to an American interest.

Dome had control of and managed some junior oil and gas producers, which were publicly traded. If Dome's interests in those companies were to pass to the American purchaser of Dome, the companies would become less valuable because they would lose tax advantages when they ceased to be controlled by Canadians. Word was that Dome would sell its controlling interests. This prospect attracted the attention of Mr. Coughlan and Mr. McCartney. At first, they looked into acquisitions from Dome on behalf of Seabright, but, after the take-over of Seabright by Westminer, they pursued opportunities for themselves and for their following of investors. Cavalier Energy Limited became the most attractive of the Dome subsidiaries. It appeared to have strong cash flow and good prospects for expansion. The purchase and operation of Cavalier Energy Limited became Mr. Coughlan's occupation after he left Seabright in 1988 until the failure of Cavalier Energy in 1992. Mr. Coughlan ascribes the failure to his inability to raise capital for Cavalier on the public markets and he ascribes that inability to the actions of Westminer.

[124] Dome invited Coughlan and McCartney to submit a proposal for purchase of Cavalier soon after Dome decided to sell off its interests in junior oil and gas producers. The two made it to a short list of potential purchasers. They were invited to submit a more detailed proposal. In the end, Mr. Coughlan decided

to make an offer. McCartney later invested in Cavalier, but it was Coughlan who decided to buy. The decision was made after an extensive investigation assisted by accountants familiar with oil and gas, lawyers in Calgary and Halifax, and consulting engineers who specialized in oil and gas.

[125] Cavalier Energy had been incorporated under the laws of Alberta, and it was governed by the *Business Corporations Act* of that province. Its shares were publicly traded, it was a reporting issuer with the OSC and it was listed on the TSE. Cavalier was an operating company, but it also owned a controlling interest in another publicly traded company, Western Resources Minerals Limited. The business of Cavalier Energy and Western Resources was exploration, development, production and marketing of crude oil and natural gas. They were established, junior oil and gas companies. They held interests, on average about one third, in 168,000 acres of undeveloped oil and gas territories, 131 producing wells and 156 shut-in wells, mostly in Alberta. Reserves were estimated at 2.5 million barrels of oil and 33.5 billion cubic feet of natural gas. Production of oil had increased dramatically in recent years, production of natural gas had decreased slightly. As of December 31, 1987, consolidated revenues from operations were $6,690,000, net income was $3,098,000 and retained earnings stood at $17,560,000. Mr. Coughlan and

others believed that these ventures had been neglected by Dome during its financial stress, and more aggressive management could quickly expand business. Mr. Coughlan saw Cavalier as a well established base upon which to develop a greater enterprise. It had good cash flow, due, in part, to farm-in arrangements with cash-strapped Dome, where Cavalier or Western undertook developments on premiere Dome properties in return for a share of the profits once a well was developed. The good cash flow was also due to an above average rate of success with probable reserves. Cavalier had no debt. Its holdings had been quite successful. And, transitional management was available from Dome for a year.

[126] Mr. Coughlan and his advisors prepared a bid which was designed to reflect the present value of Cavalier including its 54% interest in Western. Of course, valuation of the reserves was an important part of this exercise and that is a subject to which I shall return. The proposed price was $13.05 per common share. Dome held 67.4% of the shares. Canpar Holdings Limited held 20.7%. Of the short listed potential purchasers, Mr. Coughlan made the best offer, and Dome and Canpar signed lock-up agreements in April 1988. After the lock-up agreements were signed, Cavalier Energy disgorged its cash reserves by declaring a dividend of $3.80 a share, and the agreed price dropped from $13.05

to $9.25 a share. In accordance with the lock-up agreements, Mr. Coughlan's newly incorporated company made an offer to all Cavalier Energy shareholders and the offer closed at the end of May, 1988. Dome and Canpar tendered their shares under the lock-up agreements, and a sufficient number of minor shareholders took up the offer such that the new company had over 90% control of Cavalier Energy. That was the threshold under the compulsory acquisition provisions of the Alberta *Business Corporations Act* applicable at the time. The new company acquired all the shares in Cavalier Energy for about $24 million. The short term and intended long term financing of this purchase are most important for the decisions I have to make.

Interim Financing.

[127] When his negotiations with Dome Petroleum were nearing the end, Mr. Coughlan caused a company to be incorporated under the Alberta *Business Corporations Act*. It was later named Cavalier Capital Corporation. The plan was to turn Cavalier Energy into a private corporation soon after take-over and amalgamate the two, then take the amalgamated corporation public. The cost of purchase would be covered in two stages. Mr. Coughlan refers to the first stage as bridge financing. Investors would back a loan made by a bank to Cavalier Capital to cover part of the cost of the acquisition. In the second stage,

this loan, and the investor's liability, would be retired through the public offering of Cavalier shares. The rest of the purchase price would be covered by a conventional bank loan to be secured against the acquired shares initially, and Cavalier Energy's assets later. In the second stage, this loan would be paid down or paid out with funds from the public offering.

[128] The Calgary Branch of the National Bank provided a commitment letter about the time of the lock-up agreements. It was for a loan of $20 million, but only ten of that is relevant. The other ten was to be repaid out of cash held by Cavalier Energy, and became redundant when the cash was disgorged and the purchase price was reduced. As for the ten million that was advanced, the commitment letter called for security against the assets of Cavalier upon amalgamation, and a pledge of the shares in the meantime. It provided that the bank would convert the loan to a $2 million line of credit and an $8 million term loan, but it also required Cavalier to become listed and to reduce the loan out of the proceeds of the public offering to the extent the funds were not required to retire the loan backed by investors. This requirement appears to have been dropped when the commitment letter was replaced by a more formal loan agreement. The formal loan agreement provided for the amalgamated company to "raise not less than $20 million from the public", but it did not require that any of those funds had

to be paid in reduction of the conventional loan. The other loan was committed about the same time as the conventional loan. The commitment came from the Halifax Branch of the National Bank. It provided for a loan of $15 million to be repaid through funds raised by a public offering. The security was to be bank letters of credit expiring no earlier than October 12, 1988, an outside date for closing the planned public offering. As I said, the loan agreement provided for Cavalier to make best efforts to raise $20 million on the public markets. It also provided that the proceeds would be applied to retire this loan.

[129] These bank loans were to be interim financing, and were to be replaced by share capital and subordinated debt convertible to shares, with some room for senior bank debt. The exact details of the permanent financing could not be settled until the exact results of the sale of shares and subordinated debentures were known. Although there were times when Mr. Coughlan and others considered proceeds from the planned public offering would be as low as $20 million with some remaining bank debt, the anticipation of Cavalier and its advisors settled at $24 million or more. A pro forma balance sheet later attached to the preliminary prospectus describes the intended financial structure. It shows bank debt of $24,151,000 being retired from the public offering, new debt of $15 million on account of convertible debentures that were to make up half of the

public offering, and $3,849,000 in working capital raised through the public offering.

[130] I find Cavalier anticipated replacing the two bank loans with funds raised by the public offering. More specifically, it anticipated raising more than $25 million and as much as $30 million from the public offering and it planned to apply the funds first to the $15 million loan backed by letters of credit, next to the $10 million conventional loan, and thirdly as working capital to enhance expansion of the business. Cavalier anticipated being free of bank debt, having extra working capital, and having established credit to the extent of the repaid $10 million conventional loan, which might be set up as a permanent line of credit. Cash was the main attraction of Cavalier with the purchase price permanently financed in this way. Money was tight after the crash of October 1987, and cash-strapped junior oil companies had difficulty capitalizing on opportunities. With the purchase financed through equity, or near-equity in the case of the subordinated, convertible debentures, Cavalier would be in a position to capitalize on these opportunities because of its cash flow and because of Mr. Coughlan's talents and contacts, which would be used to raise financing earmarked for specific exploration and development. The concept was to return Cavalier approximately to the financial structure it had before take-over, debt

free with good cash flow, and to use it as a base for an expanded business by taking advantage of opportunities beleaguered Dome had ignored, and by taking advantage of opportunities that cash-strapped junior oil and gas companies had to ignore after the market crash. Cavalier's apparent ability to raise cash from operations, its success in converting probable reserves to proven reserves, and Coughlan's apparent ability to raise cash from capital markets were central to this concept, and, as will be seen, apparent soundness of management is central to the question of the marketability of the initial public offering.

Initial Investors.

[131] Very soon after the commitment letters were delivered by the bank, Mr. Coughlan raised about $13 million through letters of credit provided by various investors he knew or was introduced to, and he raised more than the remaining $2 million by mid-May. By one means or another, many of these initial investors had been invited to a meeting at Halifax where, after signing a confidentiality agreement, they were provided with information released by Dome and they were informed by Mr. Coughlan of his plans for Cavalier Energy, including the proposed financing of the take-over, and the plan thereafter. Numerous of the plaintiffs attended that meeting and some had a

good recollection of the contents. Those who did not attend received similar information elsewhere. I find that it was made clear to the investors that Mr. Coughlan was raising bridge financing to cover the purchase price and this was to be retired within three to six months by bonds raised through a public offering. Potential investors received a document signed by Mr. Coughlan, which described the financing in two stages. In "Stage 1":

> A group of investors, predominantly the Seabright group, will provide bridge financing by way of letters of credit to the National Bank of Canada for approximately $12 million plus for a period of 60 - 90 days. These investors will receive for their initial risk a payment in stock of the new corporation equivalent to a 30% annualized return on the amount of their letter of credit. Example: a $1 million letter of credit for a period of 60 days will enable that investor to receive $50,000 worth of stock in the new company.

The investors' exposure under the letters of credit would be extinguished in the next phase. The plan for stage two at that time involved the marketing of a private placement immediately after closing the Cavalier purchase, to be followed by a public offering. The private placement was to involve convertible debentures, which, being an expense to the corporation, would reduce taxes being paid by it. The plan was to raise $15 to $20 million through the private placement. The public offering was expected to raise another $15 million. The corporation would be left with a maximum of $5 million in bank debt and $15 to $20 million of debt which would be near-equity.

The investors were referred to cash flow projections and they were told that Cavalier Energy would be in a position to become the "cornerstone" of a larger resource enterprise.

[132] Based upon the information provided by Dome and explanations given by Mr. Coughlan, numerous investors were persuaded to sign subscription agreements and to put up letters of credit from their bankers in favour of the National Bank. The subscription agreements provided for the investor to put up a bank letter of credit in an amount determined by the investor expiring July 15, 1988 but automatically renewing to October 15 unless notice of termination is given before July 5. The letter of credit was to be pledged as security for the National Bank letter of credit loan and Cavalier Capital was obliged to repay the secured debt before October 12. In return for the security, Cavalier Capital agreed to issue common shares to the investor according to a formula based on the amount of the letter of credit. The number of common shares would double if the letter of credit was extended from July to October. The shares would be distributed according to their trading value under the planned public offering or five dollars each, whichever was lesser. The public offering was to be completed by December 31.

[133] A further meeting was arranged for investors in late May 1988. The purchase was then complete, except for compulsory acquisition. The investors were advised of progress towards a public offering and the discussion at that time concerned a public offering during the summer in the range of $27 million to $30 million. Obviously, the detail of the plan for "Stage 2" was changing.

Retention of Underwriters.

[134] Mr. John Byrne was in charge of corporate finance for Levesque Beaubien Inc. outside Quebec. He had come to know Mr. Coughlan because of offerings for Seabright and Seabrex. When Seabright was sold, Coughlan let Byrne know he was interested in building an oil and gas business and he was looking for an acquisition that would start him in that direction. Byrne, whose career had been devoted to corporate finance and who had much experience in oil and gas, said Levesque would be interested in helping with finance if Coughlan found what he was looking for. Late in March 1988, Byrne was furnished with a confidentiality agreement required by Dome, and he became fully informed of Cavalier and the purchase. He understood that the bank loan backed by letters of credit was interim financing, and it was to be replaced with a publicly financed capital structure. Cavalier was looking for $25 to $30 million, of

which twelve to fifteen would be put up by Mr. Coughlan's investors, and the balance would have to be raised by Levesque.

[135] The process by which Levesque becomes involved as lead on a new issue involves a study conducted in-house, a recommendation, and approval by Levesque's underwriting committee. The members of the group proposing the issue, in this case corporate finance in Toronto, would do enough research to satisfy themselves involvement was desirable. They would then seek support from other relevant groups, such as the retail sales department and the oil and gas analysts. A recommendation would then be made by the head of the proponent group, in this case Mr. Byrne, and the subject would be studied by the underwriting committee, who would approve or reject. That process had begun before the closing of Cavalier Capital's offer to purchase all outstanding shares of Cavalier Energy. By mid-May 1988, Levesque and Cavalier's Halifax solicitors had pretty much settled on a timetable for the public offering. All due diligence was to be complete and a preliminary prospectus was to be filed towards the end of June. Road shows, by which Cavalier and Levesque would introduce the new issue to investment dealers in various cities and begin marketing the issue, were to be conducted in mid-July, with Securities Commission approvals and the filing of a final prospectus anticipated for late-

July. The timetable called for listing Cavalier on the TSE in mid-August. Something happened which put these deadlines off by about a month.

[136] Levesque ranked as the seventh or eighth investment house in Canada. It was concentrated in Quebec, and was well known in Atlantic Canada, but it had little presence in Toronto and was not well known in the West. In fact, that is why John Byrne was hired by Levesque in 1985 to head up corporate finance outside Quebec. His efforts to expand Levesque's business were hampered in one respect. Levesque resisted making underwriting agreements with small or intermediate issuers, especially in oil and gas. It would take these kinds of issues on an agency basis, promising to make best efforts to sell the issue, rather than on an underwriting basis, by which the investment house agrees to purchase securities at a discounted price and then sells them. Levesque undertook risk on some issues underwritten by other houses through participation in the banking groups that are formed by lead underwriters to spread risk, and Levesque certainly sold securities underwritten by others through participation in selling groups formed by lead underwriters, but it would not underwrite an issue such as Cavalier's. This was a source of frustration for Mr. Byrne because underwritten deals were the trend in oil and gas, and Levesque was losing business to competitors in fields where Levesque was already weak.

[137] Andrew Scott came to Halifax in 1984. He had worked in corporate finance at the Calgary office of Wood Gundy for a number of years, and had much experience in financing junior oil and gas companies. He came to Halifax with an assignment to promote Wood Gundy in Atlantic Canada, to increase its business here. Colin MacDonald, the former Seabright director and now a director of Cavalier Capital, was also the manager of Wood Gundy's Halifax office. He brought the Cavalier Energy acquisition to Mr. Scott's attention. In the three weeks before the closing, Mr. Scott met twice with MacDonald and Coughlan, he acquired information on Cavalier, he led a thorough study by various professionals in Wood Gundy, and he prepared a memorandum for the firm's new issues committee recommending that Wood Gundy attempt to secure the lead position by offering an underwritten deal. Coughlan had not requested an underwritten deal in his discussions with Scott. Wood Gundy had been invited to consider becoming co-lead with Levesque, which was working towards a best efforts, agency contract. The new issues committee of Wood Gundy met to consider Scott's recommendation of Cavalier early in June 1988, just after the close for tendering shares in Cavalier Energy. The committee met in Toronto. Present in person or by telephone were Mr. Scott and a number of advisors including two oil and gas specialists from the Calgary branch, who had

studied and commented upon the proposed issue at Mr. Scott's request. The committee decided Wood Gundy should offer an underwritten deal.

[138] Cavalier was not able to file a preliminary prospectus at the end of June as planned. One reason for this is that a lead underwriter had not been selected. Early in June, Mr. Coughlan wrote to Mr. Byrne and Mr. Scott asking the two firms to work out an arrangement for Cavalier under which both firms would act as brokers on an underwritten basis. He expected this to be done while he was abroad, and he asked that the arrangements be ready for finalization upon his return late in the month. This was a mistake. Mr. Scott believed that the question was primarily one for Levesque, who had been acting as lead. Mr. Byrne believed that selection of a lead underwriter was properly a question for the issuing company, not the brokers. Arrangements were concluded at the beginning of July. Wood Gundy signed an agreement with Cavalier Capital and Cavalier Energy, by which Wood Gundy would act as lead underwriter on the proposed initial public offering. This was not a formal underwriting agreement. Such are signed contemporaneously with the filing of the final prospectus, after terms, including the price of offered securities, have been settled. This agreement in principle includes broad terms under which the underwriter may withdraw. It is subject to a formal underwriting agreement satisfactory to the

issuing company and the broker, with price of securities being a major question outstanding. It terminates if either decides on reasonable grounds not to go ahead. Nevertheless, the agreement secured Wood Gundy's work towards the public offering and it provided at least a moral assurance that, if conditions remained, Wood Gundy would take up the entire balance of the issue after sale to Mr. Coughlan's followers. Commissions and fees were settled. The approximate size of the issue was known. Price would be the major question. As for Levesque, its participation would have to be agreed between it and Wood Gundy, but Coughlan encouraged an arrangement for equal commissions and he was intent that the issue should be approved by the regulators in Quebec where Levesque's opportunities were strongest. Levesque decided that if Wood Gundy was prepared to underwrite the offering, Levesque would do the same. An understanding was reached under which the two firms would act as co-leads. They established a target of $30 million, made up of $10 million for each of the two underwriters and ten for Coughlan. I find Mr. Scott and Mr. Byrne and their firms had confidence in their ability to raise this money through the planned offering, and that that confidence remained as they completed due diligence and participated in producing the preliminary prospectus.

Preliminary Prospectus.

[139] Provinces regulate public trading in securities under regimes requiring full, true and plain disclosure of all material facts relating to the securities (e.g. *Securities Act*, R.S.O. 1980, c.466, s.55). Although Cavalier and its underwriters worked towards filing in every province, the Ontario Securities Commission played a major role in this story, and the laws of Ontario applicable at the time provide a ready reference for describing the regimes under which Cavalier attempted to bring itself: *Securities Act*, R.S.O. 1980, c.466, as amended by S.O. 1984, c.59; S.O. 1985, c.5, s.7; S.O. 1986, c.64, s.63; S.O. 1987, c.7, various sections; and, *Regulation made under the Securities Act*, R.R.O. 1980, reg.910 as variously amended to O.Reg 448/88. Some exemptions aside, this regime calls for marketing under a prospectus for which the Ontario Securities Commission has issued a receipt: *Securities Act*, s.52(1), s.68 and s.70(1). The prospectus must disclose all material facts fully, plainly and truly (s.55). Some of the content of a prospectus is prescribed by way of a form under the regulations (R.R.O. 910/80, s.31), including statements of estimated proved and probable oil and gas reserves: *Reg*. s.31, form 14, item 9(c)(5), and a summary of the factors which would make purchase of the securities risky is also prescribed: item 10. The prospectus must contain income statements, surplus statements and statements

of changes in financial position for a number of years and for the stub period, and it must contain a recent balance sheet and a balance sheet for the previous year: Reg. s.41(1). Usually, these must be prepared in accordance with generally accepted accounting principles: Reg., s.2(1) and the auditor is required to refer to the audit reports and consent to their use: Reg., s.23(1) and (3). Similarly, the requirements for disclosure respecting reserves and related information will involve the work of engineers specializing in oil and gas, and their consent is also necessary: Reg., s.23(1), as is that of lawyers who may comment on tax or other issues: Reg. s.23(1). The chief executive officer, the chief financial officer, the board of directors, and the underwriters are required to certify the prospectus as to full, true and plain disclosure of material facts. The experts who provide their consents and those who certify may be liable to purchasers if the prospectus contains a misrepresentation: *Securities Act*, s.126(1) and see s.130 and s.131(1). Other than the issuing company, parties can escape liability under various circumstances if they can show reasonable investigation affording reasonable grounds for belief in a representation: s.126(3). In addition to prescribed civil liability, the requirements for full, plain and true disclosure are backed by administrative and criminal sanctions. More will be said later about administrative sanctions. As to criminal sanctions, it is

an offence, punishable by fine or imprisonment, to make a misrepresentation in a prospectus: s.118(1), but a defence is available where the person can show "he or it ... did not know and in the exercise of reasonable diligence could not have known that the statement was a misrepresentation." We hear the phrase "doing due diligence" in many contexts now. I believe it applied originally and primarily to the diligence required of those involved in promotion of securities, without proof of which, civil or criminal defences would not be available.

[140] The scheme provides for filing a preliminary prospectus, for which the Director must issue a receipt "forthwith" (s.54), and this preliminary prospectus can be used for limited marketing during the waiting period between filing and issuing a receipt for the so-called final prospectus: s.64(1). A preliminary prospectus contains notices that the prospectus "has not yet become final", "information ... is subject to completion or amendment" and the "securities may not be sold" until finalization: Reg. s.38. During the period between preliminary receipt and final receipt limited information may be advertised concerning the proposed issue, the preliminary prospectus may be distributed, and expressions of interest may be solicited: *Securities Act*, s.64(2). The *Act* specifically provides that a preliminary prospectus need not name an offering price: s.53(2), and this accommodates the practice where promotion under a preliminary prospectus

assists in determining the offering price under an underwriting agreement to be signed when the receipt for the final prospectus is issued. A preliminary prospectus does not have to contain auditor's reports but it must substantially comply with other requirements for a prospectus: s.53(1), and it must be certified by the same parties, including the underwriters: s.57(2) and s.58(1). The Ontario legislation provides for a "waiting period" of at least ten days between the issuing of a receipt for a preliminary prospectus and the issuing of a final receipt: s.64(1). The director may refuse to issue a final receipt "if it appears to him that it is not in the public interest to do so": s.60(1) and he must refuse in some specified circumstances: s.60(2). In addition to affording an opportunity for limited promotion and testing of the market, the waiting period is the time in which staff of the Director will communicate with the issuing company to obtain explanations or to request improvements leading to an amended prospectus satisfactory to the Director. Staff comments on the preliminary prospectus are sometimes referred to as statements of "deficiencies", but this seems too strong a word. It is evident that a dialogue occurs. The dialogue might involve major obstacles identified by staff. It will often involve refined and technical issues.

[141] As I said, the working group for the Cavalier prospectus involved over twenty people. Mr. Byrne and Mr. Paul Moase were involved for Levesque. Their firm would certify the preliminary prospectus and become responsible for misrepresentations unless the firm could show due diligence. Mr. Scott headed up the Wood Gundy people, which included his assistant and the oil and gas specialists in Calgary. Their firm would also certify the prospectus, necessitating their due diligence. Coles Nikiforuk Pennell Associates Ltd. provided engineering services for evaluation of the reserves, and engineers in that firm were part of the group. Coles would provide a consent for use of its report in the prospectus, and assume responsibility for representations derived from the report. Thorne Ernst & Whinney were the auditors of Cavalier Capital and accountants at the Halifax office were part of the group. That firm was prepared to consent to the use of its audit reports. Clarkson Gordon were the auditors of Cavalier Energy, and accountants at the Calgary office of that firm provided assistance. Patterson Kitz acted for Cavalier, and Blake, Cassels & Gordon for the underwriters. Lawyers from both firms were among the working group. In addition to providing advice to their clients, these firms provided legal opinions for inclusion in the discussion of income tax in the prospectus, and Patterson Kitz provided opinions concerning the Nova Scotia Stock Savings

Plan. In addition, Dome Petroleum employees provided assistance and Cavalier officers, Mr. Coughlan particularly, assisted in writing the prospectus, especially the description of corporate strategy. The work of this group was intensive, and they were aiming for a quick filing. It is not necessary for me to review all of the work. And, those subjects requiring a close look will be reviewed when I discuss the prospects for successful marketing of the issue. Suffice it now to observe that throughout the process of gathering all material information and opinions, studying and challenging proposed statements, and writing the preliminary prospectus, the underwriters remained so confident in the issue that they were prepared to purchase it for resale. On July 22, 1988, the preliminary prospectus was signed by Wood Gundy Inc. and Levesque, Beaubien Inc., as well as by Mr. Coughlan as CEO of Cavalier, Frederick Hansen as CFO, and Colin MacDonald and Robert Hemming on behalf of the board. A few days later, the prospectus was filed with the Alberta, Ontario and Nova Scotia securities commissions.

A Concession from the Initial Investors.

[142] The underwriters were not only interested in the production of a document that fully, plainly and truly presented information material to the proposed issue.

Given their financial interest in the success of the issue, which interest was heightened by the agreement in principle for an underwritten rather than an agency arrangement, as well as their statutory duties and their duties of professionalism, the underwriters were concerned that the issue should be as marketable as possible. It was at their instigation that the existing shareholders gave up rights to a large block of shares. As I have indicated, the subscription agreements provided for the letter of credit investors to receive common shares as compensation for their risk. The amount of shares was to be double if the letters of credit were extended from July to October. The letters of credit had to be extended. As a group, the investors were to acquire rights to an additional 225,000 shares. Mr. Scott and others believed rights to these additional shares would affect both the general perception of the issue and the specific question of price. As to general perception, the markets would have been impressed by an offering under which the existing owners did not receive an undue premium for having been there first. As to price, during his testimony Mr. Scott pointed out that the dilution caused by a future issue of these additional shares would amount to over five percent. The underwriters were planning an issue of four million shares. Obviously, the issue of another 225,000 shares with no new money or other value coming into the corporation would dilute the value of

issued shares, and that dilution would be taken into account when share price settled in the markets if the planned figure of four million held. The alternative, increasing the issue to dilute the present and future shares of the initial investors, would have been offensive to a group from whom Coughlan was to raise much of his ten million dollar commitment and it would not have addressed market perceptions. As a consequence, the underwriters requested the owners to give up their rights to additional shares, and Mr. Coughlan convinced all of them to do so. This was a significant concession.

[143] Amendments to the subscription agreements were signed during the latter half of July, 1988. It is evident from these agreements that the concept presented in the spring of 1988 by which the purchase of Cavalier would be followed by a private placement and then a public offering had changed such that there would be no further private offering. Rather, investors would have the opportunity to purchase shares and convertible debentures under the IPO, just like any member of the public. The investors were asked to indicate in their amended subscription agreements how much they intended to invest under the IPO. In addition to relinquishing the additional shares for the extension of letters of credit to October and providing for an indication of the investor's intent for participation in the IPO, the amendments made some changes to the detail of the

subscription agreement. Investors were offered the alternative of putting up cash in exchange for interest bearing promissory notes, which option some investors chose. The obligation of Cavalier to make best efforts to carry out a public offering was made explicit, and it agreed to use the proceeds to pay the notes or to pay down the bank debt to the extent of the investor's letter of credit.

The Initial Public Offering and the Westminer Suit.

[144] The preliminary prospectus was filed on July 27, 1988 with the Ontario Securities Commission. The "waiting period" began. This is the period in which a prospectus will be amended in response to Commission comments and during which the company and underwriters are free to do some promotion using the preliminary prospectus, and when the parties may settle the offering price for inclusion in the underwriting agreement and in the prospectus. Mr. Byrne, Mr. Scott and those in their firms who had been working on the public offering expected Commission comments would be dealt with and a prospectus would be receipted in about a month. Both Mr. Byrne and Mr. Scott expected their firms would sign an underwriting agreement with Cavalier, and their joint counsel produced a draft. They anticipated a $30 million target, raised about evenly by each of Coughlan, Levesque and Wood Gundy, and they had

confidence that at least $25 million would be raised. Underwriters will set up road shows for proposed issues of this kind. A summary of essential information, called a green sheet, is prepared by the underwriters. They and company representatives organize presentations at various centres, and invite investment dealers to attend. The green sheet is given to these and other dealers. The presentations involve speeches by representatives of the underwriters and the company. Among other things, a tentative price will be passed on. Thus informed, the dealers then discuss the proposed issue with clients, and those who express interest will be contacted when the receipt is issued. The expressions of interest are communicated to the syndication departments of the underwriters. So, the marketing process begins in earnest during the waiting period, and the underwriters and the company receive much information that will be helpful in gauging demand when price is finalized. Cavalier, Levesque and Wood Gundy scheduled road shows across Canada for the second week of August, and they planned European road shows for the third week. Production of the first draft of the underwriting agreement, booking of rooms for the road shows and printing the green sheet coincided with news of the Westminer suit.

[145] The suit caused the underwriters to reconsider their participation. Wood Gundy decided it was not interested in promoting the Cavalier issue on any basis. Mr.

Scott explained his firm's position in a letter to Mr. Coughlan dated August 22, 1988. He referred to the attractiveness of Cavalier Energy's financial performance over the previous five years, but noted the conditions that had prevailed since the October 1987 crash would make it difficult to market the initial public offering. He said that Wood Gundy had been "enthusiastic as to the marketability of [Cavalier] Capital as an IPO" and he attributed the enthusiasm to the expertise of Coughlan and the other directors. Then, he explained,

> The recently launched lawsuit by Westminer Canada Holdings Limited and Westminer Canada Limited against all of the former directors of Seabright Resources Inc., and thus against all of the directors of Capital, unfortunately calls into question the integrity of the directors of Capital in the minds of the investing public. The suit thus attacks the heart of the marketing effort for Capital as an IPO in a very difficult market.

He felt that the suit substantially diminished demand in Nova Scotia, and virtually eliminated it elsewhere. He recommended Cavalier stay out of the market for at least six months.

[146] For its part, Levesque was prepared to continue with the offering only on a best efforts basis. Mr. Byrne advised Cavalier that the suit substantially reduced the amount that could be raised, and he suggested a total subscription of $15 million

to $17 million, more probably at the low end. Levesque also demanded an option to act as sole lead on any future offerings. These terms were unacceptable to Cavalier, and Levesque was so advised on August 30, 1988.

Would There Have Been an Underwriting Agreement?

[147] I accept the evidence of John Byrne and Frederick Scott. Based upon the testimony of Mr. Byrne and Mr. Scott and upon the circumstances surrounding the decisions made and to be made by their firms, I find that, had the Westminer allegations not surfaced, Wood Gundy, Levesque and Cavalier would have entered into an underwriting agreement if they could settle price and if a receipt for a final prospectus was to be issued in the late summer or early fall of 1988. The deliberate decisions of the two investment houses to agree in principle to an underwriting arrangement were based in large measure upon their assessment of the management abilities and commercial reputations of Coughlan and the other board members who had come to Cavalier from Seabright. The Westminer allegations, if true, would devastate these reputations. Backed by the credibility that comes from the size and sophistication of Westminer, the making of the allegations undermined the assessment, causing Wood Gundy to withdraw

altogether, and Levesque to propose terms for a mere agency arrangement with a target half that which had been discussed before the Westminer allegations.

[148] The defendants argue that, despite the agreement in principle, Wood Gundy and Levesque would not have signed an underwriting agreement even if Westminer had never made allegations. The defendants point out that the draft underwriting agreement would not have been executed until the price of the units of shares and convertible debentures had been negotiated and the defendants point out that the New Issues Committee of Wood Gundy and counterparts at Levesque would have had to approve the recommendations of Mr. Scott and Mr. Byrne. Execution of any underwriting agreement would have been contemporaneous with the issue of a final receipt by the director of the OSC, and the defendants say that, in the period between the filing of the preliminary prospectus and the issuing of any final receipt, the underwriters would have done a penetrating analysis of Cavalier and would have come to the conclusion that a marketing effort for $30 million overvalued Cavalier by double. I say that Wood Gundy and Levesque had made their analysis before they signed the preliminary prospectus, and what remained was to settle price in light of information gathered through the road shows. I am satisfied that there was a high degree of commitment on the parts of Levesque and Wood Gundy. Thus, my finding on

the balance of probabilities, that the commitment would have led to an underwriting agreement if price was settled and if a final receipt was issued. This finding rests upon various underpinnings. Of greatest weight is the level of commitment of Mr. Byrne, Mr. Scott and their firms as evidenced by the testimony of Mr. Byrne and Mr. Scott on that very subject and as evidenced by the actions of Wood Gundy and Levesque in June and July 1988. Secondarily, I shall delve into some of the underwriters' considerations for and against the offering and the question whether these would have been reassessed negatively after the preliminary prospectus was filed.

[149] Both Mr. Byrne and Mr. Scott testified to the confidence they had in the planned offering. Indeed, when Wood Gundy withdrew from the offering Mr. Scott described his firm's previous attitude towards the marketability of Cavalier as "enthusiastic" and he reaffirmed this when he testified. Before the Westminer allegations, Wood Gundy and Levesque demonstrated their strong interest in a Cavalier offering by various concrete actions. After analysis, Wood Gundy made efforts to receive the lead role by suggesting an underwritten deal. It subjected itself to the moral obligations that come with an agreement in principle, and the damage to business reputation that would befall an investment house upon backing out of an agreement in principle without good cause.

Levesque also agreed in principle to take the offering on an underwriting basis, something it normally refused to do for any junior resource companies. Both firms devoted efforts, including the work of senior and experienced professionals, to a costly due diligence effort that was the more demanding on account of the short schedule. The firms asked the initial investors to give up rights to bonus shares in order to make the issue more marketable. Both signed the preliminary prospectus, and both prepared for the initial marketing on a tight schedule. Against the enthusiasm evidenced by these actions and by Mr. Scott's own testimony, the defendants draw my attention to a note made by Ms. Susan Fraser early in August 1988 after the Westminer allegations had become public. Ms. Fraser's notes and her potential testimony became problematic during the course of the trial and, to the credit of the defendants, the problem was largely resolved. Ms. Fraser and Ms. Dara Gordon had acted as solicitors for Cavalier throughout. They provided numerous services for Cavalier that touched in various ways upon the facts of this case. They witnessed much that was relevant. The need for them as witnesses became the more acute as the trial progressed. The problem was that they are partners of counsel for the plaintiffs. The problem was resolved by an agreement permitting their notes and correspondence to be entered for proof of the truth of the contents. In view of

this agreement, the evidence deserves much weight, particularly where it tends to assist the defendants, who gave up their right of examination in order that a problem not of their making might be resolved. Still, there is another price. Particularly with handwritten notes, it is sometimes hard to understand what the "witness" is saying to me. The note on this point is dated August 11, 1988, after the Westminer suit and before Wood Gundy withdrew. It is of a conversation with Mr. Coughlan. It sets up seven subjects, one of which is "A. Scott", under which the note says, " - - - wanted out for some time - - - the street." Mr. Scott denies the implication. Mr. Coughlan denies the report. The most I can put on this note is that it records Mr. Coughlan saying Andrew Scott had wanted out of the agreement in principle for some time according to word on the street. If Mr. Coughlan said this, I cannot find he took it very seriously. In any event, if it was true that this was word on the street, the street was wrong. I accept the evidence of Mr. Scott. He did not want out. Not until the allegations.

[150] As to considerations for and against the offering, the defendants stress a calculation of value often considered by merchant bankers in reference to a junior oil and gas company. One ascertains projected annual cash flow and applies a multiple, usually as low as four or as high as six. A discount is applied for first issues. For some reason, the resulting "capitalized cash flow" is a guide

to what one might expect for total market capitalization, share price times all shares issued. In the beginning, Mr. Coughlan suggested Cavalier might realize a cash flow of $7 million, and Mr. Scott made a calculation using four as the multiple. By late May 1988, Cavalier's accountants were projecting cash flow of $3.7 million, which would suggest an offering of only $14.8 million to $22.2 million, less the discount. Later in the summer, it appears that Wood Gundy was considering a cash flow of $4 million a year although oil and gas prices had been dropping steadily. Using four, the multiple that seems to have been current in the spring, this rule of thumb would suggest that going to market for $25 million to $30 million was out of the question. However, as I will discuss later when I deal with the chances of a successful offering, there is justification for using a higher multiple. Also there is evidence that someone at Wood Gundy made some calculations using a multiple near six, which would come close to justifying the low end of what Mr. Byrne, Mr. Scott and others were considering when the Westminer suit became known. More important than arguments about the correct multiple is the evidence of Mr. Byrne and Mr. Scott that this valuation, and other valuations, are factors to be employed in the art by which a merchant banker projects share prices. They can be important factors, but they are never the last word. Mr. Byrne, Mr. Scott and others at Levesque and Wood

Gundy had the latest information on Cavalier at their fingertips throughout July 1988, and the calculation is easy for them to make. It is argued that as oil and gas prices continued to drop during the spring and summer of 1988, the capitalized cash flow would have likewise dropped and that would have been particularly noticed when the second Coles reserve valuation arrived early in July. All of that is true. It is also argued that this would have come to the attention of the New Issues Committee when it received Mr. Scott's recommendation, and it would have been seen that Wood Gundy was proposing to invest in an issue twice the value of the company. I do not believe Mr. Byrne, Mr. Scott and the others deferred such considerations into August even as they executed an agreement in principle, certified a preliminary prospectus and readied themselves to immediately market the issue to investment dealers who would be well familiar with the various techniques for valuation. On the contrary, I am sure that Mr. Byrne, Mr. Scott and those working with them at Levesque and Wood Gundy carefully considered this and many other factors before making the decision embodied in a draft marketing memorandum Mr. Scott prepared for his New Issues Committee just before the Westminer allegations surfaced. That marketing memorandum suggested the issue would

be marketed to investment dealers on the basis of $30 million to be raised, one third each by Wood Gundy, Levesque and Coughlan.

[151] Another method of valuation considered by Wood Gundy involved taking the net asset value of Cavalier, and discounting it in light of current trading in the shares of junior oil and gas companies. This, rather than the capitalized cash flow calculation, was employed by the oil and gas specialists in Calgary when Mr. Scott first referred the issue to them. Their initial thoughts are in evidence by way of an internal memorandum prepared in Calgary and copied to Mr. Scott in Toronto. The memorandum also gives some insight into the role played by calculated values in the art of a merchant banker. The work is Mr. Adler's. It was prepared under Mr. Slater. These are the oil and gas experts to whom I have been referring. The report indicates that Cavalier then had a discounted net value pre-tax of $32 million. The amount of the offering then under discussion between Cavalier and Wood Gundy was $24 million. The report points out that this produces a ratio of 75% for price over net asset value. There was information that many junior oil and gas companies were trading in the range of 65% to 75% of net asset value at the time. So, the $24 million price would be justified. The defendants point out that the net asset value of Cavalier was to decline substantially with the decline in oil and gas prices, just as the second

Coles valuation of reserves shows. Thus, the ratio deteriorates and the justification disappears. Again, the answer is that the merchant bankers were well aware of this and remained confident enough to sign an agreement in principle even when prices were continuing to go down, and to sign the preliminary prospectus and prepare for marketing a $30 million issue after the second Coles valuation was in hand. They did not ignore the information.

[152] As I said, Mr. Adlam's report gives insight into the art of a merchant banker. He does not stop at calculated value. Having established that the proposed price is within an apparently normal range for the time, he goes on to set out less tangible considerations. In light of the evidence of Mr. Byrne and Mr. Scott, I think the less tangible considerations very important in the hands of an experienced professional. Mr. Adlam sets out these "pros":

- company had no long term debt
- relatively good asset base
- strong cash flow
- increasing oil production

He then sets out these "cons":

- relationship with Dome (who will continue to manage the company for another year)
- no proven oil and gas management team in place

- company will have a small market cap, and will still be controlled by a major shareholder, which will likely result in a price/NAV in the 65-75% range - given that the issue will be priced at a 75% price/NAV relationship, there appears to be little upside potential for an investor

- investors tend to be focusing on senior oil producers only - there appears to be little interest in juniors

- Cavalier has been a public company, with a known trading history - we propose to take it private, then immediately take it public again - what has this added for a potential investor?

Certainly, if Mr. Adlam's comments were the last word from Wood Gundy on Cavalier then the issue would not have been supported. He sees more problems than opportunities, and prices were to go down. However, his positive and negative criticisms were the subject of a dialogue at Wood Gundy, and they became more refined as greater information was exchanged. In the end, the oil and gas analysts encouraged Wood Gundy's involvement. One sees in this that calculated values are important in the work of merchant bankers, but they are not necessarily determinative. Even where a calculated value is encouraging, less tangible considerations have to be assessed against a perspective issue.

[153] My finding that Wood Gundy and Levesque would have signed an underwriting agreement was subject to two contingencies: the issue of a final receipt and agreement on share prices. These are the next two subjects.

When Would the Securities Commissions Have Issued Final Receipts?

[154] Some guidance for answering this question may be found in the experience Cavalier had in dealing with securities commissions as it tried to press ahead with the public offering in 1988 and when it made a second attempt in 1990. Finding the guidance is a challenge because the allegations became a part of the dealings. Let us look at the comments on the preliminary prospecti that did not concern the allegations made against Mr. Coughlan. Those comments, and the dialogue resulting from them, should give an indication of how and when a final receipt might have been issued.

[155] The first comments came from staff of the Alberta Securities Commission Agency. A four page letter provided numerous requests for changes to the prospectus and a few requests for information or justification. Each request was assigned to members of the working group, and it was able to produce a response two weeks after the comments were received. This exchange said nothing of the Westminer suit. That appears to have first been raised as an issue relevant to the prospectus in discussions with the Alberta and Ontario securities commissions late in September 1988 or early in October. Throughout the latter part of October, Cavalier's counsel was involved in discussions with

representatives of both the OSC and the ASC in an attempt to define their requirements in light of Westminer's suit. It appears that these issues had stalled the dialogue with respect to more technical issues. Counsel recorded the commission's requirement for a new prospectus, and she attempted to get agreement for an expedited review but that does not appear to have been acceptable to the commissions. One of the requirements was that the present directors of Cavalier, who had all been directors of Seabright and had been sued by Westminer, should place their Cavalier shares in trust with no power to vote the shares. The requirement was not well defined, and the directors were concerned to know whether it was proposed that they could not sell or hypothecate the shares. Counsel wrote to the commissions on November 1, 1988 pointing out that the directors had invested $7.5 million and requesting clarification. There was further correspondence late in January 1989, and the Board of Directors met on February 7 to consider a position. It decided the terms were unacceptable. Although the board decided to appeal to a joint hearing of the Alberta and Ontario commissions, this did not occur. Mr. Coughlan was now under official investigation by the OSC, and that impeded any further efforts at a public offering. Thus, the first attempt at a public offering offers insight into how the prospectus would have fared only to the

extent of the initial comments by the ASC, and Cavalier's timely response. Let us look closely at these.

[156] Staff of the ASC provided a series of "General Comments", then a series of comments specific to various parts of the prospectus. For each of the seven general comments, Cavalier responded by providing requested information or draft language for insertion in the prospectus. The response appears to be compliant and uncontroversial. The balance of the ASC staff comments were divided into fifteen points, some subdivided into more refined points. Some of these comments requested revisions to the prospectus. Others required Cavalier to justify some aspect of the prospectus. The response accepted requests for revision and provided draft statements or tables, and it provided the required justifications without apparent controversy except with respect to three points. Two of these appear minor: whether acquisition costs for property, plant and equipment should be included in the summary or left elsewhere in the prospectus, and whether it was necessary to provide information on a certain drilling program where the funds were being raised to retire bank debt and add to working capital rather than for a specific drilling program. The third point concerns discounting probable reserves. The section of the prospectus dealing with reserves summarized the Coles findings, including 1,426,000 proved

barrels of crude and gas liquids and 739,000 probable and 21,374,000,000 proved and 10,867,000,000 probable cubic feet of natural gas in Cavalier Energy. In bold print, the prospectus stated: "The estimates of probable additional net reserves have not been discounted to reflect the uncertainty associated with recovery of such reserves." The staff comment was, "Please justify why the probable additional reserves have not been discounted. This information is available in the CWP reserve report dated July 1, 1988." The response was,

> Management of Cavalier Capital Corporation is of the view that the arbitrary discounting of probable reserves does not provide a precise enough nor true reflection of the value of such reserves. Management feels that the process of discounting such reserves by 50% or some other arbitrary number is an inexact process which does not lend itself to substantiation and therefore should not be adhered to. As you are no doubt aware, numerous factors influence the amount of reserves actually recoverable from probable reserves. To arbitrarily select a discount factor to reflect the impact of such factors is, in Management's view, inappropriate.

ASC staff responded to this by insisting that National Policy 2-B required 50% discounting of probable reserves. On October 28, 1988, Calgary counsel for Cavalier replied "We will comply." I find that the preliminary prospectus was uncontroversial, except, perhaps, for the question of discounting reserves and except, of course, for the question of the integrity of management. Westminer argues that the length of time Cavalier took to resolve the discounting question with the ASC indicates that, even

without the Westminer allegations, a final prospectus could not have been receipted and the public offering could not have begun until late October, when market conditions may have been worse than in late August, the time Cavalier and the underwriters planned to go to market. I disagree with this argument. The working group was not under the same pressure it would have been under without the Westminer allegations. When the underwriters withdrew, the object of a late August IPO was lost. Delay was inevitable as Cavalier would seek to renegotiate with Levesque or others and as Cavalier would have to deal with the regulators over the allegations. As Mr. Coughlan put it, Cavalier had plenty of time to argue with the commissions over issues such as discounting probable reserves. I find that discussions with the securities commissions would have progressed much more quickly without the Westminer allegations.

[157] Cavalier filed a new preliminary prospectus on April 26, 1990. As will be discussed further, the financial position of Cavalier had deteriorated, and its share structure had changed. This public offering was intended to raise less money and to involve somewhat different equity interests than with the July 1988 prospectus. Nevertheless, some comments on the preliminary prospectus dealt with matters that could have been raised in respect of the earlier preliminary prospectus, and the progress of the second effort offers some insight

into how the first might have progressed unencumbered by the Westminer allegations.

[158] The preliminary prospectus of April 1990 was signed on behalf of the Board of Directors of Cavalier, and it was signed by Mr. Coughlan as CEO, Mr. Hansen as CFO, Levesque Beaubien Geoffrion Inc., J.D. Mac Limited, an investment firm in Halifax, and Scotia Bond Limited, another Halifax firm. The prospectus included recent financial statements with draft auditor's reports, and it summarized the latest opinion of Coles Gilbert Associates Ltd., who consented.

[159] Staff under the Director of the Ontario Securities Commission provided comments about two weeks after the preliminary prospectus was filed. The comments were divided into eighteen subjects following parts of the body of the prospectus, and many of these subjects involved a number of points. The working team was able to respond in another two weeks, and the response provided was extensive, a thirteen page letter dated May 29, 1990. The points raised by the director's staff involved requests for amendments, requests for additional information, and requests for justification of certain statements or omissions. Some of the requests for amendments concerned the integrity of management in light of Westminer's allegations. These aside, the response appears complicit except as regards three points. One of the comments which

Cavalier accepted concerned discounting probable reserves. Once again, the prospectus had emphasized probable reserves undiscounted, and the preliminary prospectus had alerted the reader to that fact in bold print. Staff took the position that National Policy 2-B required "that the values assigned to probable additional reserves be reduced for risk", and they requested compliance. Cavalier accepted this position. It proposed to deduct half of the probable reserves as presented in tables of reserves and estimated future net cash flows, and it proposed to refer to the discounting in bold print. The points in contention, aside from those raised by the Westminer allegations, concerned complying with paragraph 3 of OSC Policy 5.1, placing information on net losses at the face page of the prospectus, and providing information on promoters as suggested by the OSC's form of prospectus. As for the first point, policy 5.1 para.3 required that "the minimum subscriptions necessary to accomplish the purposes in the prospectus must be specified" where the offering was undertaken by investment dealers on an agency, or best efforts, basis, which was all Levesque was prepared to do for Cavalier at the time. Cavalier argued that this policy should not be applied where there is no minimum subscription necessary to accomplish the purposes, which were to raise $1.8 million for capital expenditures that could be made through other funding and to pay down

bank debt. The second contentious point, emphasizing the net losses, was met with an argument that to do so eschews the reader's appreciation of the financial status of the corporation by de-emphasizing the facts of increasing production and positive cash flow. However, Cavalier agreed to mention the losses on the face page provided it could also state that these resulted from depreciation connected with exploration. Finally, Cavalier indicated in response to the point concerning identification of promoters, that there were no such within the meaning of the Ontario *Securities Act*. One month after the Cavalier response, OSC staff provided further comments. With some minor modifications of proposed language, it accepted most of the responses on the points now under discussion, including the responses concerning minimum subscription and net losses. On promoters, staff merely required confirmatory information. Aside from a question concerning the closing date for the offering and last minute or housekeeping issues, all matters other than the demands for various actions and statements concerning the integrity of management appear to have been resolved by July 13, 1990 and, in its letter of that date, staff stated "less time may have been taken" had Cavalier agreed in the beginning to various demands touching upon allegations against Mr. Coughlan. I find that, subjects touching upon the Westminer allegations aside, the preliminary prospectus of April 1990 only

raised concerns resolvable in a reasonable and expeditious way by OSC staff and Cavalier.

[160] The prospectus did not proceed expeditiously to final receipt. Later I shall discuss demands arising from the allegations and the settlement agreement. On this the OSC staff took a difficult stance and, at times, their approach seems unbusiness-like because the demands associated with the allegations kept changing and sometimes OSC staff made new demands not apparent in earlier comments. Also, by July 1990, Levesque had become cool to the offering. Attempts to find a co-lead were faltering and these attempts ended in failure about mid-September. In October, the preliminary prospectus was still under comment and other issues had arisen that would stall, then end the issue. The way in which the preliminary prospectus faired during the summer and fall of 1990 does not provide guidance as to how the 1988 preliminary prospectus might have faired without the allegations because the 1990 preliminary prospectus became bogged down in issues that were related to the allegations.

[161] In addition to the initial response to the 1988 preliminary prospectus and the progress of the 1990 preliminary prospectus, the present question must be answered in light of the diligence and expectations of the 1988 working group. Even before Wood Gundy became involved, the working group was made up of

experienced oil and gas experts in the fields of merchant banking, engineering, accounting and law, many of whom had often been involved in public issues of securities. Levesque and Cavalier's counsel had worked out a schedule for the working group and the schedule anticipated a final receipt less than a month and a half after closing of the purchase from Dome and the other shareholders. While the deadline may have been ambitious, I cannot find the tight schedule was unreasonable. It appears that the experts in the working group were prepared to work expeditiously, and that Mr. Byrne and Mr. Scott, much experienced merchant bankers, believed a quick turnaround was realistic. At the time the preliminary prospectus was filed, the schedule called for a final receipt in late August. The underwriting agreement was in production. The green sheet was being published. The road shows were being booked. I find that the underwriters and Cavalier would have finished the preliminary marketing and would have gathered information they required to complete the underwriting agreement within the schedule they had set for themselves, that is, during the second half of August, 1988. However, their schedule assumed completion of the process of comment and response with the regulators at the same time. Based upon the actual processes in 1988 and 1990, I think a period of one month too short for the process of comment and response that would have occurred

without the Westminer allegations. On the other hand, it took two and a half to three months for Cavalier and the regulators to settle the significant issues, other than the Westminer issues, in 1988 and in 1990, but that is too long a period for gauging the process that would have been. On both occasions, Cavalier was far less motivated to find a quick resolution to the non-Westminer issues than it was when the schedule was set in the summer of 1988, and on both occasions the regulators became bogged down with the Westminer issues. I am satisfied that the process of comment and response would have been completed and the regulators would have been satisfied by mid-September, 1988 had it not been for the Westminer allegations.

[162] I find that, but for the Westminer allegations, a final receipt would have been issued in mid-September 1988 assuming, of course, that Cavalier and the underwriters had settled the size of the offering and price per share. No investigation by the enforcement branch of the OSC could have impeded final receipt at that time. Mr. Groia and the investigative team were months away from reading a preliminary assessment and their interest would not become public until November, 1989. The suit and Westminer's public announcement were the impediments.

What Price Would the Cavalier Securities Have Commanded?

[163] It was never the subject of negotiations because the Westminer suit was made public the day it was produced, but the draft underwriting agreement supplied by Blake Cassels to their clients, Wood Gundy and Levesque, is the source for finding many of the terms the brokerage firms would have concluded with Cavalier. The draft, however, does not indicate the number of shares and debentures the firms were to purchase or the price to be paid for them. As I said before, Wood Gundy and Levesque had established a target of $30 million for the issue, and they forecast raising $20 million themselves, with the balance coming from Coughlan's followers. Given the four million shares referred to by Mr. Scott, the target would have been achieved at a price of $7.50 per share. It is not certain whether that is the price the underwriters would have agreed to pay, because the negotiation of price would have been finalized after the underwriters received information through the road shows and the road shows were cancelled because of the Westminer allegations. However, I do have sufficient information upon which to make a finding on a balance of probabilities. There is the evidence which led to my general finding, already stated, that the underwriters were enthusiastic, which not only suggests their willingness to purchase at the levels then under discussion but also indicates

something of the enthusiasm they would have passed on to others during the road shows. And, there is the evidence which led to my finding that Mr. Coughlan was an excellent promoter, which also says something for how the road shows would have gone. And, there is specific evidence as to what underwriters thought about price before the road shows were cancelled. Scott's memorandum to the Wood Gundy directors states a minimum of $24 million, which would lead to a price of six dollars a share. The evidence of Mr. Byrne and Mr. Coughlan suggests a minimum of $25 million for $6.25. These prices assume that the four million was to be in addition to the bonus shares issued to the initial investors. If not, the $7.50 would be $7.95, the $6.00 would be $6.36 and the $6.25 would be $6.62. In any case, both Mr. Scott and Mr. Byrne testified prices in the range of $7.00 to $8.00 were under consideration.

[164] As discussed earlier, there are recognized calculations that underwriters will take into account in determining whether to back an issue and in determining what price they would be willing to pay. These were explored in quite some detail with Mr. Byrne and Mr. Scott during their cross-examinations because it appears that the ratios deteriorated substantially as oil prices dropped during the spring and summer of 1988. This is a subject I must discuss in greater detail when I turn to the expert opinion offered on behalf of the defendants. For now, its

relevance is to finding the would-be price. I have already said that I accept the evidence of Byrne and Scott without qualification. In various ways they made the point that these ratios are important considerations, but should not be over-emphasized. There is some flux in the calculations themselves and, more to the point, they can never be determinative in the art and science of a merchant banker. Equity financing would be an easy business if simple ratios determined success. I have already discussed the consideration given to these calculations by the merchant bankers. Let us take another look, with a closer eye on possible prices. There is the ratio of the net asset value before taxes of junior oil and gas companies to the price at which their shares were trading at the time, and the comparison of those ratios with Cavalier's apparent net asset value and the amount then under consideration, twenty-four million. This calculation was first performed by one of Wood Gundy's specialists in Calgary when the firm was considering its involvement in the issue, and it appears Mr. Scott made some calculations of his own later in May 1988. The engineer's reports set out valuations of the company's oil and gas reserves and discounted figures of ten, twelve, fifteen, eighteen, twenty and twenty-five percent. One selects discounted figures, in the first instance it was 20%, and adjusts them according to the value of other assets and on account of certain liabilities, such as deferred

income tax and future tax on the income from the reserves. In the first instance, a figure of $30 million resulted, which compared favourably with trading at 65% to 75% of net asset value then current if the issue was to be $24 million. Mr. Scott made some calculations of his own later in May, arriving at a less favourable $27,400,000 at 20% discounting and a more encouraging $36,800,000 at 15%. Early in July, the second Coles report was distributed, and it indicated a significant drop in the value of reserves. Mr. Scott attributed this to declining oil prices, and I would infer that the value of reserves had dropped across the industry. Whether shares in junior oil and gas companies were trading above 75% of then net asset value is not revealed. They may have been. The investment decision may look to the longer term. In any case, the ratio was not of enough importance in that climate that the brokers recalculated Cavalier's net asset value, and it is the minds of the brokers on the subject of price that I am ascertaining. The other calculation is a multiple of projected net cash flow. Of course, projected net cash flow declined as did the value of the reserves. One is a function of the other. When the decision to support the issue was first made, Wood Gundy considered a projected annual cash flow of seven million dollars, and, using a multiple of four, easily justified an issue for Cavalier at twenty-four million. After the reduction in the value of reserves, someone at Wood Gundy

appears to have made some calculations justifying a price of $7.00 a share with a multiple of 5.3. The record of these calculations shows that the person making them found eight junior oil and gas companies for comparison and discovered their shares trading at a wide variety of cash flow multiples ranging from 5.3 to ten. In the climate for oil and gas of the 1988 summer and in the particular circumstances of the proposed Cavalier offering, it does not appear that these calculations were prominent for the brokers' decision-making. If anything, the calculation of a seven dollar price justified by a 5.3 multiple supports Mr. Scott's evidence of discussions in the seven to eight dollar range.

[165] I find the brokerage firms would have underwritten two thirds of the offering for seven dollars a share, at the least. I refer to my discussion respecting the initial investors, from whom Mr. Coughlan raised over fifteen million, in finding that he would have raised at least his share, ten million dollars. The underwriters would have obligated themselves to take the balance, so the issue would have produced at least $28 million for Cavalier, enough to retire all bank debt and to provide more than $3 million in working capital. The other major terms of the draft agreement, such as the fees and commissions, appear to have been settled, and nothing appears by which any condition would have impeded closing. I refer to the evidence of Mr. Scott and Mr. Byrne in holding that no material

change occurred and, except for the Westminer allegations, there were no changes in material facts as would justify termination under section 15(2) of the draft underwriting agreement. In particular, the continuing drop in oil prices would not have deterred the underwriters.

[166] To recapitulate. I have found that, but for the Westminer allegations, Wood Gundy and Levesque would have entered into an underwriting agreement if the securities regulators issued final receipts for the Cavalier prospectus and if the underwriters and Cavalier settled price. I have found that the OSC would have issued a final receipt about mid-September, 1988. I have found that the parties would have settled on seven dollars a share. One could say that these findings are determinative of the success of the IPO. Mr. Coughlan would have raised $10 million and the brokers would have bought the rest. However, these findings are not yet fully explained. They are reinforced by the likely prospects of the Cavalier shares in the immediate secondary market. Further, it is necessary to state findings in that regard for assessment of damages, which I am going to provide in any event of liability, and for determination of other issues.

How Well Would Cavalier Have Traded in the Public Markets?

[167] An expert opinion has been offered that the fortunes of Cavalier were unaffected by its inability to proceed with a public offering. It is said that Cavalier was purchased at such a high price in April 1988 that the public offering planned for later that year would have been entirely unsuccessful. The defendant's expert is Mr. George S. White. No competing opinion has been offered. Mr. White is a Chartered Accountant, a Certified Business Valuator and a Chartered Financial Analyst. His twenty year accounting career was served entirely with Price Waterhouse Coopers and one of its predecessors, Price Waterhouse. Mr. White has extensive experience providing accounting and valuation services in the oil and gas industry. The plaintiffs consented to his qualification as an expert witness capable of giving opinion evidence as to corporate accounting, corporate finance, valuation and prospects for an oil and gas public offering. No objections were made to the admissibility of the more important opinions he offered in this case.

[168] Mr. White valued Cavalier primarily by following the discounted cash flow approach. He also performed a valuation on the capitalized cash flow approach, which led him to increase the high end of the range established by his primary method. He then performed three tests, which he asserts as supportive of his findings based on the primary and secondary valuations.

[169] The discounted cash flow approach involves forecasting future cash flows and discounting them to the date under consideration. In the case of Cavalier, the bulk of this valuation comes from anticipated production out of proved and probable reserves of oil and gas. Mr. White arrived at a value for reserves of $10.4 million to $11.8 million and a total value for all assets of $13.2 million to $14.5 million, at the most crucial time, the time when the IPO was expected to be introduced, which he took to be August 31, 1988. Of course, forecasted prices for oil and gas are a major input in calculating cash flow from reserves. Mr. White used forecasted prices that were lower than those determined by Coles. He explained in his report, "the CNP price forecasts were significantly above those of other consulting firms" and he chose instead "the average consultant's pricing rather than the CNP pricing". Elsewhere in his report, Mr. White states "it is common to use pricing based on the average consultants' prices", but he does not explain why one should have confidence in this average or, even, how the average is established. Ultimately, the question is the value of Cavalier on the public markets. The prospectus, the primary source of information for the public, was to involve the prices forecast by Coles rather than "average consultants' prices". Coles participated in the due diligence process and the engineers had sufficient confidence in their assessments to

provide a consent and subject themselves to statutory liabilities at the time the preliminary prospectus was filed. In cross-examination, Mr. White said that Coles is one of only three firms that command superior respect as engineering consultants in the oil and gas field. While I accept that, generally, a business evaluator will have reference to an average of the opinions of various engineering firms when the evaluator is assessing oil and gas reserves, I do not accept that an average of anonymous opinions should outweigh the published opinion of a highly respected firm in the specific circumstances of a public offering for which the firm's opinion was given. In addition to forecasted price, the forecast of volumes of oil and gas is a major input in calculating cash flow from reserves. This usually involves counting proven reserves at 100%, counting probable reserves at 50% and ignoring possible reserves. And that is what Mr. White did. The preliminary prospectus emphasized cash flow calculations that did not discount the probable reserves. As we have already seen, securities regulators would insist on compliance with National Policy 2-B, and the prospectus to be shown to the public would have stated cash flow based upon a 50% discounting of probable reserves. However, the question is the attitude the markets would have had towards the value of Cavalier had it been in the markets during the summer or fall of 1988. It is evident that management

believed strongly that probable reserves had been showing a success rate much greater than 50% and Cavalier could be expected to continue to prove the probable reserves at a higher rate of success. Coles, Wood Gundy and Levesque had sufficient confidence in the probable reserves that Coles consented to and the brokerage houses certified a preliminary prospectus emphasizing undiscounted values. While securities regulators would require that the final prospectus emphasize figures based upon 50% discounting, Cavalier and the underwriters would have been entitled to continue expressing to the public the confidence they had in the probable reserves, and investment dealers and investors would have been entitled to draw their own conclusions as to whether the probable reserves were undervalued at a 50% discount. Apart from the importance of the subjective assessments of underwriters, investment dealers and investors, I should think that even an objective business valuation should give consideration to any evidence supporting an assertion by management that the corporation's probable reserves would prove at a rate greater than 50%, although that is the rate most usually selected for business valuations in this industry. One would think that if it was established that probable reserves were likely to prove at a higher or a lower rate, the business valuer would need to select the most likely rate rather than the most usual. Since the important time

is August 1988 or thereabouts, and since the important question is how investment dealers and investors would have valued Cavalier, the actual experiences with price and probable reserves after August 31, 1988 shed no important light. For what little value hindsight has for these questions, I note that oil and gas prices rose steadily after October 1988, and, for years after, generally remained at levels about one-third higher than the August 31, 1988 price, and I also note the increases in production realized by Cavalier in the years after acquisition. Because I reject the "average consultants' pricing" and because I have difficulty with a 50% discounting of probable reserves as an input for determining the assessments to be made by the markets, I do not accept Mr. White's opinion that Cavalier had a value of only $13.2 million to $14.5 million on the discounted cash flow approach.

[170] Mr. White's secondary method of valuation is the capitalized cash flow approach. One forecasts unlevered annual cash flow from operations to which one applies a multiple. Respecting the crucial August 31, 1988 valuation, Mr. White calculated unlevered cash flow from operations at $3.5 million for 1988. A figure of $3.7 million had been calculated by Cavalier's accountants in May 1988. A figure of $4 million appears to have been considered by the underwriters about the time of the preliminary prospectus. Mr. White refers to

the difference between his $3.5 million and the $4 million as “slight”, and his report attributes the difference to the following:

- Lower prices evident by August 31, 1988 compared to earlier in the year;

- The imputed income taxes payable resulting from the low income tax pool balances of Energy prior to its purchase by the Core Group and the elimination of interest expense inherent in evaluation Capital on a before-debt bases; and

- The increase in G&A costs needed to operate Energy without the benefit of access to Dome’s lower cost infrastructure.

He selected multiples of 4 and 4.25 to arrive at a range of value between $14.1 million and $15 million. As to appropriate multiples, he took these considerations into account:

- Normal standards for cash flow multiples prevalent in the industry, which have generally been in the range of 4 to 6 times;

- Analysis of market multiples for companies of comparable size and production to Energy as shown at Schedule D-8;

- The potential for production and reserve growth at Cavalier generally;

- The absence of a proven management team experienced in operating a public junior oil and gas exploration and development company;

- The short-term nature of the arrangements for the existing management team;
- The rate of growth in Capital's 1989 cash flow estimate compared to 1988 results; and
- Other factors related to Energy and its production.

Regarding the first of these points, the evidence is that multiples anywhere from four to six are selected when merchant bankers and others take this calculation into account. It will be remembered that Wood Gundy used a factor of four when it first studied the proposed issue in the spring of 1988 and that there is some evidence of higher factors being considered later, when oil prices decreased. I have difficulty with Mr. White's second point where he suggests financial information on comparable corporations is reflected in his choice of 4 to 4.25 multiples. His schedule identifies fourteen comparable corporations. Their shares were trading, on average, 6.2 times cash flow. Only three were trading at multiples below the 4X he selected for his opinion on Cavalier. Half of the corporations were trading above the 4X to 6X range. Further, Mr. White's assessment of management indicates a depressed multiple, where those involved in the issue had enthusiasm for management and for the concept that new management could realize upon opportunities that had been neglected under Dome. I doubt that, at the time of the planned 1988 offering, investment brokers and others would have forecast cash flow as low as Mr. White did in formulating his own opinion.

I reject his selection of four as the appropriate multiple in the circumstances of those times. Thus, I reject his opinion that the value of Cavalier as of August 31, 1988 was $14.1 million to $15 million on the capitalized cash flow approach.

[171] Mr. White performed three other calculations, which he refers to as tests. The first of these does not enlighten us much. It involves a calculation of the after-tax return upon liquidation of reserves, where the primary valuations treat the corporation as a going concern. It seems to me that all this calculation tells us is that Cavalier was, at that time, more valuable in business than in liquidation. And, if I understand correctly, this is the main point in making the calculation. Generally, the exercise becomes irrelevant when the calculation gives results lower than valuations of the business as a going concern. The other two tests are, I think, telling. Mr. White calculates two ratios which he can compare with benchmarks respecting the price of shares for junior oil and gas companies. However, in addition to the benchmarks, he is able to relate the ratios to similar ratios found in fourteen comparable junior oil and gas companies. I think these useful tests of whether his primary valuation may be too low, too high, or approximately right. The first is a ratio of net asset value to fair market value. Mr. White concludes the net asset value of Cavalier at August 31, 1988 was $17.9 million to $19.1 million, and he applies this to his $13 million to $15

million range of fair market value for results of 73% to 79%. At least his high end is near the benchmark sometimes considered in the industry, which is 80%. However, the comparison of this ratio with the ratios for the fourteen comparable corporations leads one to suspect that Mr. White's primary valuations are too low. He ascertained the share prices and total outstanding shares of each of the fourteen, and multiplied total shares by the price, sometimes called market capitalization. He was able to ascertain the net asset value of each comparable corporation so that he could compare the ratio driven by his valuation of Cavalier with the ratios for the fourteen comparable corporations driven by the actual trading price of their shares. The most striking thing about the ratios for the comparables is how desperate they are. The ratios range from 38.8% to 224.3%, which calls into question whether the benchmark had much meaning at that time. That observation aside, the average of the ratios is 89.3% when one excludes a company which had a negative net asset value and therefore a meaningless ratio of zero percent. It appears that shares in comparable corporations were trading well above what Mr. White's value for Cavalier would suggest, at least as far as the ratio of market capitalization to net asset value can show. The other ratio divides the reserves valuation into the total of Cavalier's barrels of oil, to be exact, into the barrels of oil equivalent for

its natural gas and crude oil holdings as calculated by Mr. White using the 50% discount for probable reserves. His valuation produces a ratio of $2.21 to $2.55 per barrel. He says "This range lies in the range of public company reserve values ...." It is quite a range. He is referring to the fourteen comparable companies. He ascertained the total barrels of each and divided that into the market capitalization of each. The range is $0.37 to $12.91. To say that Mr. White's valuation falls within such a wide range is no validation of his valuation. On the contrary, comparison suggests that Mr. White's value is too low. The average for the comparable corporations was $4.13 and the median was $3.48 per barrel, prices strikingly higher than the $2.21 to $2.55 indicated by Mr. White's for Cavalier.

[172] I do not accept Mr. White's opinion that Cavalier had a value of only $13 million to $15 million at the time of the planned offering. I reject his valuation by the discounted cash flow method as too low because I believe he selected forecasted oil prices that were too low and because I believe he should have given some consideration to a lower discount rate for probable reserves. I reject his valuation by the discounted cash flow approach because I believe he selected a multiple too low for the circumstances of Cavalier's management, for its opportunities and for the times, and because I believe his figure for net cash flow

may be too low. Further, my conclusion that he has undervalued Cavalier is also based upon the tests of net asset value to market capitalization and barrels of oil to market capitalization of comparable corporations at that time, which show that the shares of those corporations were, on average, trading at higher prices than Mr. White's valuation of Cavalier would suggest.

[173] Even if I did accept Mr. White's opinion of value, I would not follow him to his next step. Having ascertained a low value primarily by the discounted cash flow approach and secondarily by the capitalized cash flow approach, Mr. White argues that raising $24 million to $30 million from reasonably informed investors would not have been possible. He suggests that Cavalier would have recognized the values he now asserts and a write-down from accounting values would have had to have followed. He says the investors at the time of purchase faced a significant deficiency at the time of the proposed IPO and the offering would have been nothing but an attempt to shift the loss from old investors to new. This suggests that the methods of the expert business valuer are the last word on the value of stock to be traded in the markets. They are not. One need only refer to Mr. White's work on comparable junior oil and gas companies to see that there are wide variances between the trading price of stocks in this kind of companies. I think this is well explained through the evidence of Mr. Scott

and Mr. Byrne, who are sophisticated merchant bankers experienced in oil and gas. When they and others at Wood Gundy or Levesque were involved in studying any proposal to determine whether their firm should support it, they considered some calculations similar to those made by Mr. White. But these are factors that have to be weighed among others in the merchant banker's art of predicting share prices. With all of the sophistication of Wood Gundy and Levesque brought to bear through the rigors of their internal assessments and their full participation in the due diligence process, the firms were about to sign underwriting agreements premised on values double that reached by Mr. White. The differences? In the summer of 1988, the merchant bankers were aware of the acquisition premium and they were acutely aware of the difficulties the market presented for the offering. They may have had a more generous assessment than Mr. White of the value of probable reserves and the direction of oil and gas prices. However, the major differences are in the assessment of management and its ability to capitalize upon opportunities. The discounted cash flow approach treats the corporation as static. The capitalized cash flow approach is not static because it projects over a four to six year period. However, its major input, operating cash flow, is ascertained only for the current year and its focus is therefore on the short term. As presented by Mr. White,

neither approach allows much room for an increase in share value on account of a reasonable assessment that new management is peculiarly positioned to better realize upon opportunities than the corporation had done in the past. Yet, this was front and centre in the marketing effort Wood Gundy and Levesque were about to undertake. The description of corporate strategy that would have been given to the public is set out in the preliminary prospectus. It deserves to be quoted in full:

> Historically, the management and technical services for Cavalier were provided by Dome. Refer to "Management". As a subsidiary of Dome, Cavalier formed a minor part of Dome's total assets. As a result, the directors of the Corporation believe that the management of Dome, with its recent pressing considerations, was not able to concentrate its efforts on the potential for expanding the scope of Cavalier's operations. The directors of the Corporation intend to take an active role in Cavalier in order to realize its potential value by arranging financing, restructuring Cavalier and recruiting new management. Dome will continue to provide technical and administrative services to Cavalier until May 31, 1989. The directors of the Corporation are currently involved in forming a team of qualified individuals to provide technical and administrative services to Cavalier prior to and after the termination of Dome's management contract. This team is expected to consist of approximately four individuals in addition to independent contractors.
>
> Cavalier intends to conduct an active exploration and development program with an emphasis on increasing its cash flow by: (i) developing properties recently acquired in joint-ventures with Dome; (ii) further developing its current producing oil and gas properties; and (iii) acquiring additional producing oil and gas properties. The directors of the Corporation believe that upon completion of this offering, Cavalier will have sufficient cash reserves and cash flow to fund its current operations and exploration program. In addition, the Corporation has a line of credit of $10 million with a Canadian chartered bank which will be used to acquire producing assets should the opportunity arise. The directors of the Corporation also intend to proceed with additional financing for Western in the last quarter of 1988 while maintaining

> Energy's proportionate interest in Western. The proceeds of such financing will be used to acquire producing properties for Western should the opportunity arise.

This statement of strategy describes the opportunity Mr. Coughlan saw when he purchased Cavalier from Dome and explains why he was prepared to pay full value. To him, the additional worth of the corporation was in this opportunity. Mr. White says he considered this strategy, but it is not mentioned anywhere in his 277 page report. Obviously, he did not consider it very important. Perhaps it is not very important in the accountant's valuation, because his work is so grounded in present financial information. The merchant bankers, on the other hand, were looking to the promotional opportunities. They allowed for the very difficult market and for the acquisition premium paid by Mr. Coughlan and his followers, and they made some calculations similar to some of those performed by Mr. White. They knew that there were factors seriously challenging the IPO, even as they became more and more committed to an offering at $24 million to $30 million.

[174] Common sense tells us that a business with positive cash flow would be in a better position to expand if it were fully financed by equity and junior debt owed to shareholders than if it were heavily financed by bank debt. This simple concept had a special meaning in the opportunity Mr. Coughlan identified. I accept his evidence about the general state of junior oil and gas businesses after

the crash of 1987. The saying was, "Cash is king." Money was tight. Particularly, the public markets, the primary sources of capital to develop natural resources, were cool. The very fact which, for Mr. White, severely depreciated the value of Cavalier, appreciated it for Mr. Coughlan. The junior oil and gas company with cash or greater flexibility for raising cash could realize upon new opportunities where cash-strapped competitors could not. The positive outlook for Cavalier's cash flow and the financial flexibility which would come with 100% shareholder financing, suggest to me an oil and gas business with better than average purchasing power or borrowing power. The investor of 1988 would have seen this as well, and some investors probably would have concluded that this gave Cavalier a significant competitive advantage in the circumstances of the 1988 oil and gas industry, that the purchasing power or borrowing power would be deployed by a management that was planning to be much more aggressive than the previous operator had been, and that other investors had already bought into the opportunity at very substantial levels and on terms similar to those being offered to new investors. These are points by which Cavalier could have been promoted as an appetizing and exceptional opportunity in the weak markets of later 1988. Mr. Coughlan, Mr. Byrne and Mr. Scott had solid evidence to back these promotional points and they had the

ability to get their points across to the investing public. I find the IPO would have been successful not only because Wood Gundy, Levesque and Mr. Coughlan's followers would have bought the entire offering at inception, but also because the shares and debentures would have traded well in the secondary market of later 1988.

[175] Mr. White also expresses opinions on the value of Cavalier at October 12, 1988 ($12 million to 14 million), December 31, 1988 ($11.5 million to 14 million), December 31, 1989 ($22 million to 26 million), July 31, 1990 ($16 million to 18.5 million), December 31, 1990 ($18.5 million to 22 million) and December 31, 1991 ($10 million to 12 million). These opinions treat of a corporation damaged. Unlike Mr. White, I am satisfied that there was value in the opportunity identified by Mr. Coughlan when he purchased Cavalier. I am satisfied the opportunity diminished or expired with the Westminer allegations. Mr. White does not treat of the difference because he does not recognize the value. His opinions about value after the damage are not of great assistance to me. These opinions are premised on his first opinion, that Cavalier was no worse off for being excluded from the public markets in later 1988. I do not accept that Cavalier was undamaged by the exclusion. Thus, Mr. White's opinions about value at later dates treat of a corporation damaged where, if

liability for the damage were established, my obligation would be to determine how the corporation would have fared, and, thus, how longer term investments in the corporation would have fared, if the corporation had not been damaged in later 1988. Having said that, there is a point made by Mr. White which I do accept. His low appraisal of management and opportunities as at August 31, 1988 is inconsistent with the appraisals of those who were going to market the issue at that time, and I have rejected Mr. White's appraisal and have found that the markets would have made appraisals more in line with what the merchant bankers had concluded and were about to advocate. As part of his justification for his low appraisal of management, Mr. White points out that the technical or operational management were hired away from Dome Petroleum. He says, and I accept, that one would have more confidence if some operational managers had had much experience in operating a junior oil and gas company, rather than experience based solely on the comforts of a large organization. As will be seen, the operational management of Cavalier turned out to be weak. The difficulty is that that fact could not have been known or predicted in 1988. A president had been selected with enthusiasm. He came from Dome, but that does not suggest he would implement a team of managers drawn exclusively from Dome. And, he was well regarded, especially in acquisitions, which would

be important for a corporation with an expansionary strategy. Other than having selected a president, Cavalier would not put an operational team into place until June 1989, when the transition from Dome would be complete. The high appraisal of corporate management and corporate opportunities in 1988 would not have diminished in the 1988 markets on account of serious weaknesses to appear in operational management much later on. It would have diminished when failures of operational management became apparent at later times.

Going Public Under Cloud of the Allegations: 1988 to 1990.

[176] I have already discussed Cavalier's dealings with securities commissions as it attempted to make public offerings after Wood Gundy withdrew and Levesque stipulated more stringent terms and a reduced offering. To recapitulate. Cavalier determined to go forward with the public offering after the allegations were made and Wood Gundy withdrew. ASC staff provided comments early on, but soon the effort became encumbered by demands of the securities commissions in reaction to the allegations. Although the intention to refinance through a public offering remained, the effort went dormant in early 1989, about the time the OSC decided to launch a formal investigation. That investigation did not lead to criminal charges, but a hearing was scheduled for the OSC to

restrict Mr. Coughlan's trading rights by removing exemptions. The issue was settled in March 1990, and an understanding was reached that the allegations would no longer constitute a reason for the OSC to refuse to issue a final receipt for a Cavalier prospectus. A new preliminary prospectus was filed and a final receipt was eventually issued. It remains to take a close look at the discussions between Cavalier and staff of the securities commissions regarding the allegations, and it remains for me to state my findings as to the events after the second preliminary prospectus became settled.

[177] By late September, 1988, two months after the preliminary prospectus had been filed, counsel for Cavalier was embroiled in discussions with staff of the ASC and the OSC to resolve demands the two commissions were making as a result of the allegations. Staff's position was stated by Cavalier's counsel, Susan Fraser, in a letter to them dated October 21, 1988 and this was the subject of further discussions, which led to amendments recorded in counsel's further letter of Halloween, 1988. The position of the securities commissions may be summarized as follows:

1) Mr. Coughlan and Mr. McCartney will resign as board members. Mr. Coughlan will resign as an officer. He will have no direct or indirect involvement in management, but could become a consultant after completion of the public offering.

2) The Board will be reconstituted to minimize participation of other defendants in the Westminer suit.

3) The prospectus will be updated and reviewed in the ordinary course. It will include disclosure of the Westminer suit.

4) Those who had been sued by Westminer will transfer their shares in trust, and the trustees will undertake to vote the shares only in the interests of the corporation.

Those sued by Westminer had invested millions in Cavalier and they were not prepared to agree to the voting trust without clarification. Except for Mr. McCartney, they were concerned for their own liquidity. Mr. Coughlan and the others needed to know whether the terms of the trust would impede transfer or hypothecation of the shares. At the direction of the Cavalier Board, Ms. Fraser addressed this question to staff of the securities commissions on November 2, 1988. The new year arrived, and still she had no reply. It does not appear that the required clarification was ever given. Correspondence resumed at the end of January, and ASC staff demanded Cavalier's acceptance or rejection of the demands, as is. On February 7, 1989, the Cavalier board rejected the proposal and resolved to seek a joint hearing of the ASC and the OSC. I believe the rejection was reasonable. It stemmed primarily from the demand for resignations and a restricted Board of Directors. The board considered these demands to have been unfair. I agree. To substantially alter the management of a company on mere allegations is unfair, not only to the managers but also to the corporation, the

prospects of which, as has already been demonstrated, hinged in good measure on the management. Further, these demands and the demand for trustees to vote shares imply prejudgment, a prejudgment that would have been published because of the various disclosures required in the contemplated prospectus. In any event, no appeal was taken. The OSC decided to launch a formal investigation, and Mr. Coughlan was interrogated not long after the Board decided to reject the demands.

[178] The OSC investigation led to a notice of hearing issued late in 1989, by which the enforcement branch of the OSC sought from the commission an order under s.124 of the *Securities Act* excluding Mr. Coughlan from some exemptions and, thus, restricting his trading activities. Mr. Coughlan settled the proceedings. He explained on the stand his reasons for doing so, and the primary reason was to clear the way for Cavalier to make a public offering. I accept his evidence. In addition to a formal settlement agreement between Mr. Coughlan and the enforcement branch, which was implemented by order of the Commission, there was an exchange of correspondence between Cavalier and the Commission. In negotiating the settlement on behalf of Mr. Coughlan, Mr. Pugsley had required, and Mr. Campbell accepted, that the "OSC give comfort to Cavalier" to the effect so long as Mr. Coughlan abides by the agreement any Cavalier prospectus "will be treated in the ordinary course". On March 5, 1990, Cavalier's counsel

wrote to the Executive Director of the OSC recording the Cavalier aspect of the settlement. She stated "the primary reason that staff ... would not recommend that a final receipt be issued ... was ... the ongoing investigation ...." And she recorded the understanding that had been reached "the matters giving rise [to the settlement agreement] will no longer, in themselves, be considered cause to refuse a receipt." The Executive Director responded, "Your letter reflects our mutual understanding."

[179] Once again, a working group was assembled and a preliminary prospectus was filed after about a month. An application was made concurrently to the Toronto Stock Exchange, and the long outstanding plan was implemented to amalgamate Cavalier Capital, which was not listed, with Cavalier Energy, which had been. The proposed issue was for a much smaller amount than had been attempted in July 1988. The experience after that had much altered and damaged the finances of Cavalier, as I shall discuss later. The purpose of the issue was to reduce bank debt and to finance capital expenditures, the latter actually being a cost cutting measure to avoid storage and transport charges Cavalier was paying to others. It was to offer equity units composed of common shares and share warrants, and flow-through units composed of flow-through common shares and flow-through warrants. The tax-relieving flow-throughs had not been a feature of the 1988

intended offering. Under the plan at that time, the corporation would have been free to offer flow-throughs in future to finance exploration and development. The amount expected to be raised was $13 million, compared with the 1988 target of $30 million. And so, the intended offering cannot be considered an attempt to reinstitute the plans of July 1988. That opportunity had been lost.

[180] Despite the agreement that had been recorded in the letters exchanged between Ms. Fraser and the Executive Director at the time Mr. Coughlan settled with the OSC, staff of the OSC responded to the new preliminary prospectus with this demand: "We will require Mr. Coughlan to resign as C.E.O. and Director." Counsel protested the demand for Coughlan's resignation, but it took Commission staff until July 13 to withdraw that demand despite its inconsistency with the Executive Director's agreement.

[181] Some of the initial comments seem to expand as the discussion continued. The comment demanding Mr. Coughlan's resignation included, "Please justify the constitution of the board of Directors given the allegations against various directors by Seabright Resources Inc. and in light of the Settlement Agreement reached with Mr. Coughlan." Cavalier responded by pointing out that there were seven directors, four of whom were not parties to the Westminer suit. It described the business backgrounds and qualifications of all seven. As to the

three who had been sued, it point out, " ... the allegations made against these gentlemen in the Ontario Action are and should be treated as such - allegations." The comment could also have been made that the Settlement Agreement accepted by the OSC contained Mr. Coughlan's specific denial of similar allegations made against him by the enforcement branch. Cavalier's response to the request for justification of the former Seabright directors provoked new demands from the OSC, demands which the OSC took a full month to communicate. On this topic it said:

> Please explain how the Board of Directors will operate in light of and in order to comply with the settlement agreement and the obligations thereunder. Please have all directors provide us with a letter describing their due diligence in regards to the prospectus, in particular their role in meeting the requirements under the settlement agreement. Please disclose the policies and procedures in place as required by the settlement agreement. Please also provide us with an opinion that the settlement agreement has been complied with.

At first opportunity after the settlement agreement, Cavalier had adopted policies and procedures in line with the agreement. However, these demands are curious because staff seems intent on expanding the terms of the settlement agreement. Only Mr. Coughlan was a party to the agreement with the OSC and to the proceedings before it. As part of the agreement he undertook to disclose his activities with any reporting issuer, to disclose the names of other directors and to ensure the reporting issuer

established policies and procedures for reporting material changes. These were his obligations, but the demand seems to extend obligation to all other directors, to Cavalier itself and, in one instance, to corporate counsel. One could conclude that the OSC staff were being difficult since a reasonable explanation provoked fresh and off-point demands, since the demands were inconsistent with the agreement between Cavalier and the executive director, and since these fresh demands were communicated a month after the response and two months after the filing. In frustration, the Cavalier Board determined to demand the director refuse to issue a receipt so Cavalier could appeal these and other demands to the Commission itself. On August 2, 1990, the OSC dropped all of these demands and substituted a request that Mr. Coughlan not serve on the material changes sub-committee of the Board, which was accepted.

[182] Another demand turned out to be related to the allegations although that did not become apparent for quite some time. Respecting the description of principal holders of common shares in the preliminary prospectus, the initial OSC staff comment said simply, "Please comply with O.S.C. Policy 5.9." Policy 5.9 dealt with occasions when the director will require an escrow or pooling agreement as a condition for issuing a final release. In response, Cavalier provided calculations showing the securities did not fall within the policy. The response was baffling for its want of reasons: "We will require an escrow." Eventually,

staff changed this demand to one for evidence that Mr. Coughlan was in compliance with the trading restriction provisions of the settlement agreement, a subject well off the original point as expressed by Commission staff.

[183] Further, Commission staff required disclosure of the settlement agreement and the Westminer suit in numerous parts of the prospectus, with a bold print warning on the second page. Later, it went so far as to require a special title for the bold forewarning: "Important Information Re: Directors and Officers". While it was Cavalier's position that the Westminer suit was immaterial to Cavalier, because of the denials and the intended vigorous defences and because the claims could not lead to any attachment of Cavalier's assets, it was prepared to make some disclosure and the communications from May through August concerned language. As to the warning on the second page, the parties settled on a statement in ordinary print under the heading: "Information Regarding Certain Directors and Officers".

[184] Major issues respecting the prospectus appear to have been settled in early August, and a letter from the Commission in early October indicates that only housekeeping issues were outstanding. I find the dialogue took longer than it should have and that it included positions adopted by the Commission that were sometimes unfair, as with the demands for resignations and reconstitution of the

Board, and that were sometimes unbusinesslike, as with the expanding or new demands that replaced original ones, and that were sometimes simply unreasonable, such as the stubborn insistence on a policy 5.9 escrow without any apparent reasons. This contrasts with the way the OSC staff dealt with more technical issues, as discussed earlier. The comments and responses now under consideration all relate to issues touching upon the Westminer allegations. I find the Westminer allegations caused OSC staff to take a hard position on the 1990 Cavalier prospectus.

[185] The prospectus may have cleared the OSC, but the Toronto Stock Exchange put up another hurdle. On October 4, 1990, the stock list committee of the TSE decided to approve the proposed listing only if Mr. Coughlan resigned as an officer and director and he placed his Cavalier shares in a non-voting trust. The Cavalier Board met the next day. Mr. Coughlan said he would resign, and it was noted the terms of the escrow had not been stated by the stock list committee and nothing had been said about whether Mr. Coughlan could act as a consultant to Cavalier. The Board decided any resignation should await appeals. The Board of Governors of the TSE upheld the stock list committee. [*Quote from decision.*] Cavalier appealed to the OSC, which has a statutory obligation of review over certain decisions of the Exchange. On March 11, 1991, the OSC

released its reasons for not interfering. The panel referred to its differential standard for review of Exchange decisions. It noted the settlement agreement, and the eventual issue of a final receipt for the prospectus. It accepted that the settlement agreement could not serve as proof of any of the allegations made against Mr. Coughlan and that Coughlan entered into the agreement

> ... for good, common sense reasons that were not connected with the possible truth of the allegations made against him --- for instance, that Mr. Coughlan wished to avoid a lengthy hearing which would further delay the issuance of a receipt for the Cavalier prospectus, that the payment of $40,000.00 towards the cost of the staff investigation would be less than the cost of such a hearing to Mr. Coughlan, and that the trading restrictions imposed upon Mr. Coughlan by the Commission were really of no consequence since he had no intention of so trading in any event.

And, the panel accepted that the Exchange had relied entirely "on the existence and terms of the settlement agreement, and upon the existence of the [Commission] staff's investigation which lead up to it ...." The panel was of the view that these were sufficient to provide some evidence upon which the Exchange could make the decision it did, and that the Exchange had acted reasonably in light of Cavalier's failure to provide evidence in contradiction of the allegations that had once been advanced by Commission staff.

[186] The offering might have gone forward without Coughlan as officer and director. Apparently, a final receipt had been issued. And, the TSE had approved the

listing, subject to the conditions. However, the brokers withdrew. Not long after the preliminary prospectus was filed in April 1990, Mr. Byrne left Levesque to form Byrne & Company and Mr. John MacKinnon took over the Cavalier account at Levesque. With Levesque's consent, Byrne & Co. accepted an assignment from Cavalier to find a larger national firm to co-lead the offering with Levesque. Mr. Byrne held discussions with a number of large brokerage houses. Some showed serious interest. Talks progressed. However, in each instance these houses eventually declined to become involved, and Mr. Byrne attributed this to the demands of OSC staff respecting the allegations. Mr. Byrne had thought that the settlement agreement set the allegations aside for any Cavalier issue, but, to him, the demands revealed the distrust the OSC still harboured. By the end of July 1990, Levesque had grown cool and Byrne was retained to assist Cavalier in dealing with Levesque "with a view to its remaining as an agent for Cavalier and obtaining satisfactory terms". The last prospect for a major co-lead, Richardson Greenshields, bowed out in mid-September. In a meeting held late in October of 1990, Mr. MacKinnon of Levesque expressed concerns about the TSE decision. Notwithstanding the assurance that Mr. Coughlan would resign if necessary, Levesque, J.D. Mack and Scotia Bond announced they were withdrawing. The TSE decision was not

the only concern Levesque harboured. A problem, which I shall discuss later, with water intrusion at some of the wells had emerged. Also, Levesque, while it had not settled its position on price for the offering, was expressing the view that it might consider a cash flow multiple as low as two. I find that Levesque withdrew and other large investment houses had become disinterested because they perceived the prospects for Cavalier had clearly deteriorated, and I find that the cloud over management apparent in the OSC demands and the TSE decision was the primary reason for that perception.

Financing Cavalier Without Access to the Public Markets: 1988 to 1990.

[187] The letters of credit, by which the $15 million loan with the National Bank was secured, had an expiry date of October 12, 1988. As the end of September arrived, no public offering was in sight, and the National Bank was making plans to collect the debt. It determined to demand upon Cavalier a week before the expiry date, and to call upon the issuing banks on October 6 if Cavalier failed to pay. Anticipating these actions, Cavalier issued a special rights offering to raise $15 million and pay the loan backed by the letters of credit. The offering memorandum provided that if a final receipt for the prospectus receipted in July 1988 was not issued by the end of the year, purchasers of the

special rights would receive one $1000 convertible debenture and sixty-two common shares for each unit of special rights at a subscription price of $1428 per unit. If the final receipt was issued, the special rights units would constitute subscriptions under the prospectus. The only market for the special rights units was among the initial investors, who faced being called upon by their banks after the letters of credit were honoured. In effect, the investor was offered the choice of paying to Cavalier the money the investor would otherwise have to pay to the bank. An investor could subscribe for the special rights units to the extent of the investor's contingent liability on account of the letter of credit issued by the investor's bank. Cavalier would advance the purchase price to the bank as a credit against the investor's contingent liability. The choice was between paying one's bank and acquiring a right of action against Cavalier or paying the same money to Cavalier and acquiring shares and convertible debentures. About the same time as the special rights offering memorandum was filed, the National Bank wrote to the investors advising that the letter of credit loan would soon mature and, if Cavalier did not pay it, the National Bank would "forthwith" call upon the issuing banks. On October 6, the bank demanded payment and shortly afterwards it called upon the issuing banks. In the meantime, Cavalier had written to the investors proposing the special rights

units, and Mr. Coughlan had contacted each individually. Some investors subscribed for the special rights units and terminated their liability to their banks before the bank actually paid up on the letter of credit. Some made similar arrangements outside the special rights offering, and acquired flow-through shares instead of special rights units. In a few cases, the issuing bank paid the National Bank and called upon the investor, who responded by paying the money through Cavalier and taking up the special rights units or making similar arrangements with Cavalier. Some investors secured extensions of their letters of credit, and eventually converted the contingent liability through the special rights offering or similar arrangements. A very few received special treatment through the efforts of Mr. Coughlan and Cavalier, a subject I shall deal with when discussing the claims of the various plaintiffs. The special rights offering raised $11,423,766 in 1988 and the loan was reduced to $2,225,000. Thus, Cavalier closed 1988 reporting $12,225,000 in bank debt made up of the $10 million demand loan and $2,225,000, the balance of the loan backed by letters of credit.

[188] In addition to the special rights offering, which from the company's perspective converted bank debt into even portions of equity and subordinated debt, the company raised some funds through private placements. A little over two

million was raised under an offering memorandum dated December 9, 1988. However, this involved flow-through shares and Cavalier was obliged to pass expense write-offs to the investors. Another offering was initiated in December and renewed in January 1989. The corporation attempted to raise up to $10 million from known or related parties under the sophisticated investor exemption. The proceeds were to reduce bank debt, and, again, units were offered in equal parts of shares and debentures. This efforts raised only $1,822,128.

[189] The consolidated balance sheet for the 1988 year end contrasted with the prospects for Cavalier as understood in the July 1988. No doubt, the balance sheet had been harmed by a substantial decline in oil prices, which reduced the value of reserves. As expected, oil production increased over that achieved under Dome's ownership. Production nearly doubled, and the company attributed this to new wells that were brought into production. However, oil prices had declined by nearly one-third and that off-set most of the revenue from the new wells, without providing relief in expenses. The loss from operations for seven months ending December 31, 1988 was $1,292,000, and this was entered as the deficit on the balance sheet, a deficit much higher and of a different kind than that anticipated in July. Bank debt of $12,225,000 compares

with nil on the pro forma balance sheet, where debt under convertible debentures had already reached $7,995,000 compared with the pro forma $15 million for issued, convertible debentures. Finally, share capital stood at $6,425,000 compared with the pro forma $15,590,000 made up of $590,000 attributable to the initial investment and $15 million to have been raised on the public markets. The year end balance sheet describes a company with substantial bank debt in contrast to the flexibility of being free of bank debt and having access to substantial credit, as planned at inception. It describes a company with combined bank and subordinated debt $5,220,000 more than planned. And, the character of the subordinated debt was not as planned. The actual state of the company made it much less appetizing for investors to convert subordinated debt to equity. There are also pro forma statements of operations in evidence, which give some insight into the income and expenses anticipated during the first months of operation and these show that a loss was anticipated in any case. However, the most striking contrast between the pro forma balance sheet in the preliminary prospectus and the 1988 year end balance sheet is in the level and the nature of the debt.

[190] The next year brought a rebound in oil prices, and Cavalier continued to increase production. Oil reserves increased substantially, and there was a slight increase

in natural gas reserves. Expenses increased. The company reported a net loss of $512,000, but depreciation was extraordinary and cash flow was positive. During 1989, the company raised money through private placements. An additional $800,000 was paid, ultimately to the National Bank, under the 1988 special rights offering. About six million was raised for flow-through shares under offerings initiated in 1989 by Cavalier Capital or Western Resources. One attempt was made to sell units of shares and debentures for reduction of bank debt, but only $550,000 was raised against the $6 million maximum for the issue. Mr Coughlan was finding it hard to market equity in the company. His contacts had been let down. Their investments were not liquidable. During cross-examination, Mr. Coughlan agreed that he had raised an amount comparable with the target for the IPO and he observed that this showed how well Cavalier might have done had it been marketed publicly. I think the observation has merit. The defendants argue that the total amounts raised are such that Cavalier achieved the financing it required from the IPO and the failure to go public did not damage it. This misses two points. I have already discussed the differences in debt structure and the reduced likelihood of debentures being converted to equity. The character of the company's financing was dramatically and adversely affected by its inability to proceed with the IPO.

Secondly, the plan was not to stop with the IPO and operate the company conservatively. The plan was to expand. In the long run, the company was to raise much more than the IPO target such that a companion of what was actually raised in total with the target figure for the IPO offers little insight into the impact upon Cavalier of Westminer's allegations.

[191] Cavalier closed 1989 reporting a reduced loss. The loss included extraordinary depreciation and, thus, the company showed positive cash flow. Production had continued to increase and this, combined with a rebound in oil prices, resulted in a good increase in revenues. However, the increasing production concealed a problem. Hampered by heavy debt, Cavalier could not take risks. It concentrated on exploiting existing wells and its efforts at exploration and development were much concentrated towards the latter. Without the flexibility to aggressively explore and develop new wells, the company would deplete its reserves. The balance sheet showed some of the constraint Cavalier was under as of the end of 1989. For obvious reasons, investors were not converting debentures to common shares. The subordinated debt stood at $7,696,000, down from $7,995,000 at the 1988 year end. The $10 million demand loan remained fully drawn and the loan backed by letters of credit had been reduced by $975,000, mainly under the special rights offering. Bank and subordinated

debt stood at $18,946,000 costing $2,528,000 in interest. There was a warrants issue in early 1990 involving $601,000 but, other than that, 1989 marked the last equity financing. I find the opportunities for private placement had dried up. There had been a slight improvement in the balance sheet, but the problem of depleting reserves could not be resolved without a large infusion of cash. It was not going to be raised from private placements, and, as we have already seen, Cavalier failed to access the public markets, the focus of Mr. Coughlan's efforts in 1990.

Desperate Measures: 1990 to 1992.

[192] After two years of operation, one under its own management, Cavalier recognized level of bank debt to be its greatest challenge. Reduction was to be the priority for 1991. Efforts were undertaken to reduce general and administrative expenses, a recuperating market for forward sales was exploited to bring cash in sooner, and some assets were put up for sale. Nevertheless, by mid-1992 the leveraged status of Cavalier was brought startlingly to the attention of the board. Contrary to instructions always to leave a cushion of $280,000 in the line of credit, operating management had drawn on the bank to the maximum of the line. The bank had become alarmed, and it had given

Cavalier sixty days to show progress on its plans for debt reduction. Although the measures referred to earlier were important to that plan, its primary component was to seek a merger with a more stable corporation.

[193] Unable to finance itself in the capital markets, Cavalier had determined to reduce its crippling bank debt by merging with a listed junior oil and gas company. A relationship had developed with an American investment fund called the Energy Recovery Fund, which was investing in Canadian oil and gas. The Fund was prepared to back a plan under which Cavalier would merge with a listed junior oil and gas company, and the shareholdings, as well as seats on the Board of Directors, would be apportioned according to value among the Fund, the Cavalier shareholders and the shareholders of the other company. This plan held the promise of new cash injected into both of the merged enterprises as well as a dilution of Cavalier's bank debt according to the financial position of the merger partner. Immediate relief from the bank debt was the primary motive. The first merger discussions were with Baca Resources Limited, which traded on the Toronto Stock Exchange. The Westminer suit was raised early in the discussions, and an assurance had to be given that former Seabright directors would not serve on the board of a merged corporation. The discussions were held during June 1991. By mid-month a deal seemed probable.

The Cavalier board approved of the negotiations in principle, and both Cavalier and Baca prepared for immediate due diligence, with public announcement expected toward the end of June. On June 20, Baca and Cavalier executed a letter of intent. Press releases were distributed. The Energy Recovery Fund was interested, and its only concern, that a new CEO should be found with Baca's CEO serving as Chief Operation Officer of the merged company, was readily accepted by Baca and its CEO. By June 24, due diligence was well underway. On July 12, Cavalier representatives were to meet with the Baca board. The representatives arrived. They were turned away. Baca had decided to back out. The stated reason was Cavalier's bank debt.

[194] Many attempts were made to merge with another junior oil and gas company. Numerous contacts produced a few sets of serious discussions. Each failed. The last of these involved a company called Sugar Creek Oil and Gas Inc., and by this time Cavalier had brought in a consultant who had built an oil and gas company of his own and was a very experienced oil and gas engineer. Mr. Donald Jepson so impressed Sugar Creek that a stipulation was made during the negotiations that Mr. Jepson would be the new CEO. These negotiations were carried out in September and October 1991. They led to agreement in principle and press releases. However, Cavalier announced failure on October 28, 1991.

According to Mr. Coughlan, his involvement with Cavalier and the allegations made against him were the reasons that the various merger discussions failed. I am satisfied that the size of Cavalier's bank debt, the very motive for merger, was a serious obstacle. I am also satisfied that the cloud over Mr. Coughlan's reputation particularly, and generally over Cavalier's board, which was composed of former Seabright directors and others associated with them, was a serious obstacle to mergers. In light of the fact that at least two sets of negotiations progressed very close to successful conclusion, I find that the debt and the clouds were related to the failed negotiations as causes and effect.

[195] The bank kept a close eye on the merger negotiations. The Arthur Anderson investigation had been conducted while these were ongoing. The report coincided with the announcement that negotiations with Sugar Creek had failed. That report held out almost no hope for a turn around. Just before the report was released, Cavalier considered bringing itself within the *Companies Creditors Arrangements Act*. On November 4, 1991, shortly after the Arthur Anderson report, the board instructed counsel to make an application under the CCAA with haste in the event the National Bank should call the loans. The Board met again on November 20, after discussions had been held with the bank, and it authorized a CCAA application. The Court of Queens Bench of Alberta granted

an order two days later bringing Cavalier within the Act and providing for a plan of arrangement no later than February 28, 1992. Of course, the National Bank dominated the class of secured creditors and its support was necessary for any plan to be adopted by that class and approved by the court. Quite an effort was made to find a compromise acceptable to the bank and the shareholders, but this failed. On May 13, 1992, the Alberta court issued a receivership order on motion of the bank, and the receiver was given powers for both management and liquidation. The receivership did not produce enough money to pay the bank debt.

The Causes of Cavalier's Failure.

[196] The fact finding on this subject goes to a variety of issues. In addition to causation and remoteness, this question touches upon the assessment of damages, which I will provide in any event of liability. I will state further findings when I turn to the assessment, but what follows will provide some of the relevant facts in that regard. My discussion of the causes of Cavalier's failure will begin with my findings about the immediate cause, then I will turn to the various difficulties Cavalier faced in its four year history from 1988 to 1992.

[197] As earlier stated, Arthur Anderson Inc. was retained by Cavalier at the insistence of the National Bank to study the financial affairs of Cavalier and make recommendations to the bank. The firm reported in October 1991 and the report is in evidence for truth of contents. The consultants noted an operating loss of $434,000 for the first half of 1991, an improvement over 1990 but a significant loss just the same. In part, the reduction was attributed to decreased production. As for cash, Arthur Anderson projected a small surplus after payment of bank interest in the coming months. However, the firm noted "in order to achieve this the Company is merely continuing to delay payments to trade creditors". The summary of Cavalier's financial position reads:

> The Company in its current form is operating at a loss and is at the top of its line of credit with the Bank. The Company's budget for 1991 indicates that it anticipates further losses. Cash flows from operations are only sufficient to pay current operating, G&A and Bank interest; the Company is unable to reduce Bank indebtedness or amounts owed to other creditors.

This describes an insolvent company, a condition Cavalier had to affirm when it sought protection under the *Companies Creditors Arrangement Act*, not long after the Arthur Anderson report. The receivership would demonstrate that the company was insolvent on the test of assets to liabilities. The consultant's observations of October 1991 demonstrate the company was also insolvent on the operational test. It could not meet

its liabilities generally as they came due. It hardly need be said that the insolvency was the immediate cause of the liquidation. What were the causes of the insolvency? Arthur Anderson noted the obvious, "The Company cannot continue to operate with continued losses." and it stated three theories by which Cavalier could achieve profitability, only to then demonstrate that none of them were practical. The possibilities were "increase reserves, increase margins or reduce costs". On cost reduction, the consultants determined that Cavalier's general and administrative costs were comparable to industry averages and it could only suggest a cost benefit analysis to see if a saving could be realized by contracting an oil and gas management company. The mere suggestion of contracted management is a severe criticism of the operating management, and the suggestion does not appear to have been put forward as a cure with much likelihood of success. As to increasing reserves, the consultants observed that oil and gas companies do not control prices. As to margin, the consultants said, "The Company is not engaging in any new activities and as operating costs such as processing fees, royalties, lease payments, etc. are basically fixed, no major economies or increased margins can be expected." This observation is the most enlightening for the immediate cause of Cavalier's insolvency. From inception, it had operated near or in excess of bank credit for operating expenses. Need for immediate cash had emphasized development of known reserves and had curtailed both exploration and

acquisition. Reserves were being exploited and not replaced. I find this financial constriction was the major immediate cause of the insolvency. It would be easy to link the financial constriction to the Westminer allegations: the allegations blocked the initial public offering and the public offering would have produced flexibility rather than constriction. In fact, it is difficult to trace the allegations of 1988 as cause to the receivership of 1992 as effect, as was ably pointed out in various ways on behalf of the defendants during arguments respecting foreseeability in negligence, causation in the various torts alleged against them and materiality in assessment of damages. However, the complexity of the task could be overstated. We are dealing with only three and a half years between inception of the company and insolvency. While the information is large, the story is more compact than with some failed businesses. Let us look closely at some of the other problems with Cavalier.

[198] Cavalier was plagued by accounting problems. Dome had agreed to manage the business for the first year, and the new owners immediately experienced difficulties getting adequate financial information. After a few months this seemed to be resolved. Monthly financial statements began to flow, and it appeared Dome had instituted proper controls and reporting. However, late in 1988 Amaco Canada Resources Limited, a subsidiary of the American purchaser of Dome, began to integrate its administration into the parents'. Apparently the

transition involved tremendous efforts and some of the duties owed to Cavalier under the management contract were not well attended to by Amaco. Statements were not produced for four months, and when statements were finally received in the spring of 1989, a huge deficit in Cavalier/Amaco accounts appeared. The company faced an unexpected demand against working capital of $2.5 million. By the fall of 1989, another large liability needed to be recognized because Amaco had credited Cavalier with 80% of reserves from farm-in wells after Cavalier recovered the agreed cost plus markup. Amaco should have been logging a 20% credit. This time the sudden demand was $1 million. These kinds of problems continued into 1990, and Cavalier was forced to hire consultants to sort out the state of accounts with Amaco, and the consultants identified four significant accounting errors. The consultants also reported upon Cavalier's internal accounting and reporting. They found the company's procedures did not meet industry standards for flow of information and they concluded "it would appear imperative that Cavalier visit the issue of its internal accounting and reporting capacities and procedures ...." After numerous difficulties and at least one dispute over a very substantial sum, Amaco and Cavalier were able to resolve the state of accounts in early 1991. It does not appear that Cavalier's poor accounting improved much over its life of

four years. On one occasion at least, senior management were caught by the surprise of being drawn well over the line of credit with the bank. Mr. Patrick Cashion, a business consultant, reported in March 1991 that Cavalier had no system for comparing actual reserves and expenditures to budget. Arthur Anderson, the consultants who reported to the bank not long before receivership, observed that Cavalier was not producing financial information on a timely basis and that its cash flow forecasts were not of sufficient detail. Except for the disputed amount, which was resolved favourably, none of the accounting problems with Amaco should have directly affected the Cavalier balance sheet. However, the state of the Amaco accounts particularly and the poor accounting practices generally had to have had a serious impact on Cavalier's fortunes. Mr. Coughlan pointed out that the problems with Amaco accounts affected Cavalier's understanding of its cash flow, and were a serious problem because Cavalier was so heavily in debt. Had it been financed more flexibly with equity and shareholder loans, cash would have been more available and news of a sudden drain on cash could have been handled more smoothly. That may be so. Certainly, a heavily leveraged business must watch its cash-on-hand very closely. However, it would be difficult for any business to flourish with stale

or misleading financial information. That describes Cavalier, and it introduces a broader defect in it.

[199] In the summer of 1988, Cavalier seemed to have good prospects for operational and corporate management. Mr. Coughlan brought his talents for promotion, and his ingenuity for corporate finance. His board included the very successful William S. McCartney and others experienced in business. They found a president who appeared to have talents and abilities suited to Cavalier and the strategy for expanding it. In July 1988, Wayne McGrath agreed to join Cavalier as president. He had spent his career with Dome, primarily working on acquisitions and development. In 1988, he was Dome's Director of Business Development and he was also general manager of Cavalier Energy. He had managed Cavalier Energy for three years. The investors in Cavalier had reason to be enthusiastic. Having managed the former Cavalier, Mr. McGrath had an intimate knowledge of the present operation and assets, and, with his background in acquisitions, he suited the business plan of the new owners. During the first year of operations, when Dome was providing technical and administrative services, one of Mr. McGrath's most pressing tasks was to put together a team of managers for accounting, engineering, geology and administration. This was done. As I said before, one of the reasons Mr. White,

the defendant's expert, gave little credit for management in his various valuations of Cavalier, is because many of the middle and senior managers had worked for Dome, those who were used to the support of a large corporation rather than those with experience in operating an independent junior oil and gas company. As stated earlier, I do not accept Mr. White's appraisal of management or the would-be public perception of management as of August 1988, but I do accept his point as it goes to the value and state of Cavalier after 1988. As things turned out, Cavalier was not well served by Mr. McGrath and some of those who worked under him. By 1990, Mr. Coughlan and board members were having misgivings about Mr. McGrath's performance. It appeared that he was not working full time, he had failed to resolve conflicts between departments, he had let some urgent problems slide and he was not communicating important information to Coughlan. Cavalier engaged management consultants, J.P. Cashion & Associates Inc., who carried out an extensive investigation, gave advice to the board and recorded their observations in a report to Mr. Coughlan in March, 1991. They reported on a conflict between the operations department and other departments and observed that communication "has been extremely poor for a long time." Of this the consultants said "It is inconceivable to us how the company could function

effectively under such circumstances." Poor communications were also evident between the president's office and the departments. Further, Mr. McGrath rarely held management meetings although the consultants regarded regular and frequent communication among senior personnel as characteristic of a successful oil and gas company. The consultants were also critical of Mr. McGrath's lack of leadership. He often evaded decisions within his responsibility and he did not pursue decision-making by those to whom responsibility had been delegated. In a similar vein, the consultants recorded that the president had failed to provide crucial information to the board. As for financial management, the consultants advised that the 1991 budget was late and that the company was not tracking budget and actual, a "serious omission". As for personnel, the report mentions some concerns, outstanding for a long time, that the accounting department may lack sufficient understanding of the oil and gas business. The report indicates senior personnel were being paid top dollar, but the operating results did not suggest top quality work. The consultants concluded "McGrath was not competent to serve as President of Cavalier". The board determined to dismiss Mr. McGrath for cause. On Cashion's advice, it also determined to dismiss the Vice-Presidents of Finance and of Operations with pay in lieu of notice. Replacements were found, with the Vice President of Finance being

replaced by a chief accountant. Cavalier did not last long enough to fully test the abilities of the new managers.

[200] Mr. Coughlan makes the point that Mr. McGrath's background was in mergers and acquisitions. His greatest talents and skills were never utilized because Cavalier was never able to pursue the expansionary approach originally conceived for it. I think it would be too simplistic for me to find that the serious problems that emerged with management were entirely attributable to the constraint which resulted from the failed 1988 IPO, but I think it also too simplistic to ignore the connection. On the one hand, it is probable that Mr. McGrath would have performed more effectively in an expanding business and that he became discouraged as Cavalier failed in its attempts to go public. On the other hand, managing a small oil and gas producer must involve times of set-back and disappointment, and the seriousness of the management problems, particularly the indecision and the deplorable state of accounting, are not indicative of sound managers in any mode. I am satisfied that the failure of the 1988 IPO made matters worse, but I also find that serious problems with management would have emerged sometime after June, 1989 in any case. I find that weak operational management was also a cause of the insolvency. In view of the magnitude of this problem, I find that poor management would have

damaged the company even if it had not been prevented from accessing the public markets and had not been so constrained in its ability to acquire replacement reserves. Operational management was made the weaker by that state of affairs, but the managers proved themselves not up to the task in any case. Perhaps the new management brought in during 1991 would have eventually turned around a company financed by shareholders rather than the bank, but I find that, access to the markets or not, Cavalier was in for severe challenge and serious financial loss because of its original operating managers.

[201] Another problem emphasized by the defendants is excessive water intrusion experienced in the latter half of 1990. One has to bear in mind there are two kinds of water problems experienced in oil production, one inevitable and the other less expected. The former could be called "watering in". Oil and natural gas are under pressure in nature. They are found with water in porous rock enclosed in impervious rock. The oil and underlying water are pressurized by natural forces. So, when the encasing rock is pierced, oil gushes out and the water level rises. An oil producer will install a shaft in the drill hole. The shaft may extend to the basement of the field. If one drew from there, one would get water. A plug is installed just above the water level so the shaft draws at that

point. Even with the first yields, there will be some water as well as oil. The product has to be sent to a separation facility. As more and more oil is extracted, the water level rises more and more, and one draws a greater and greater proportion of water to oil. Eventually there will be so much water that the cost of separating it exceeds the profit from the separated oil. Oil wells do not dry up. They water-in. So, an oil and gas producer that fails to find or acquire new wells will see its tired reserves becoming more and more costly to exploit. This was the immediate cause of Cavalier's collapse, and there is some evidence that the problem was beginning to manifest itself in 1990. The other kind of problems could be called "water intrusion", excessive amounts of water well beyond expected watering-in. The causes are various. The problem may be technological. The defendants argue that Cavalier suffered a serious water intrusion problem and it was one of various misfortunes unrelated to Westminer's allegations but related to the failure of Cavalier. I do not entirely agree. There was a water intrusion problem, which had nothing to do with the allegations, but the seriousness of that problem is eclipsed by the magnitude of the watering-in problem, which is linked to the allegations. The water intrusion began to manifest in the late summer of 1990. For July 1990, Cavalier reported a drop in production. A decline in one month is not considered serious because

production varies for any number of temporary reasons. August 1990 was another low month. Two months are not considered serious. The September figures showed a third consecutive month of poor production. In the industry, three months of reduced production are considered to be a sign of a serious problem. This was reported to Mr. Coughlan early in October. Company engineers set about studying the problem. On October 25, 1990, Cavalier filed a material change report and delivered a press release announcing it was experiencing higher water/oil ratios and a more rapid decline in production than had been projected by Coles. On October 25, it announced that staff were investigating the impact of this on reserves and cash flow. Another press release and material change report was issued on the first of November. It announced an expected decline of 200 barrels a day, about a 15% reduction from projections. During this time Mr. Coughlan and Mr. Byrne communicated with Levesque, which had pretty much given up on the 1990 IPO by then. Mr. Coughlan wrote to shareholders. The bank was advised. The board and its material change committee met. All of this shows the seriousness of the problem as it was perceived at the time. Perceptions changed. There were two discoveries. Firstly, the problem was narrowed down to fourteen wells at Grand Forks, some of which had recently become mainly an asset of Amaco and the

rest of which were about to go that way. Under the farm-in arrangements, Cavalier took 80% of the reserve from those wells until it had recovered cost plus profit, after which it would only receive 20%. All fourteen suspect wells had matured or were about to mature. Coles were retained to review the affected reserves, and based on their findings, Cavalier was able to issue a new press release and a new material change report on November 20, 1990. It said,

> Although the Corporation recognized a 200 barrel per day decline in production, the majority of the wells affected were encumbered by an 80% net profits interest. Consequently, the net effect of this decline is a reduction of approximately 3% in the projected pre-tax net present value of the Corporation's reserves, discounted at 15%, from that previously projected by the Corporation's independent engineering consultants.

I am invited by the defendants to find that a 3% reduction in projected net present value of reserves is equivalent to reduced production of 200 barrels per day. I am not equipped to make such a calculation. Given the invitation, I make these observations. Even if production was to be reduced by 200 barrels a day, it turned out that the profit from 160 of those barrels was already attributed to or about to be attributed to Amaco, not Cavalier. Evidence suggests that, at the time, Cavalier was projected to produce 1200 barrels a month. A reduction of 200 barrels is roughly 15%, and 20% of that is 3%. Further, a 3% reduction in net present value of reserves would not make much of

a difference in the kinds of calculation testified to by Mr. White, Mr. Scott and Mr. Byrne. I share the view taken by Cavalier's management at the time. An expected drop in Cavalier's own production of 200 barrels a day was a material change necessitating a report and a release. A drop of 3% in projected net present value of reserves was not material, and the discovery in that regard necessitated a report and a release only to correct the previous mis-information in the adverse material change reports. So, the first discovery much diminished the perceived problem. The second discovery concerned the cause of the problem. As I said, water intrusion could result from a technological problem or there could be other kinds of problems. This one turned out to be technological. The fourteen suspect wells were piped into a single water separation facility, so it was not possible at first to say how many were affected. The problem turned out to have been caused by a water level plug that had slipped in one of the largest wells. When this was repaired, a reduction remained appropriate, perhaps because of watering-in being higher than expected. I accept Mr. Coughlan's evidence that the impact of this entire episode was only a 2% reduction in the projected net present value of reserves. I attribute subsequent references to water problems, such as the bank's July 15, 1991 reference to "the higher water levels at Grand Forks", to watering-in. I find the water intrusion problem of 1990 did not have a significant impact on Cavalier and cannot have been a cause of its failure.

[202] In conclusion, on the causes of Cavalier's failure. I have found that Cavalier was insolvent by the fall of 1991, three and a half years after purchase and two and a half years after the new owners took over management. I have found that the most immediate cause of the insolvency was Cavalier's failure to replenish diminishing reserves. I am satisfied that the failure to replenish reserves resulted largely from Cavalier's inability to access public markets and establish flexible financing. Thus, exclusion from the capital markets was a cause of the failure. I have also found that a cause of the insolvency was weak operational management. These two causes are not discrete. The inability to raise capital would have affected the performance of operational management, but weak operational management would have damaged all efforts of the corporation, including acquisition and exploration. Finally, I have found that the water intrusion problem in later 1990 was not a cause of the insolvency.

WESTMINER AND CAVALIER

[203] When Mr. Wise met Mr. Coughlan for the first time, the former asked Mr. Coughlan what he would be doing now. According to Mr. Coughlan, he replied that, the former Seabright investors being liquid, he would probably start another public company. According to Mr. Wise's recollection, Mr. Coughlan said he would plow back the money he had earned into a resource company. I find that Mr. Wise was made aware that Mr. Coughlan probably would work at starting another public company, in the resource field, using his own cash from the Seabright sale and inviting the interest of other former shareholders.

[204] Mr. Lalor was a reader of the *Globe & Mail*. Oil and gas was a part of Westminer's business and I suppose highly placed managers, like Mr. Lalor, would take an interest in reports of business activities in that field. Late in April 1988, Mr. Lalor read an article in the *Globe* under the headline "Dome unloading assets before its sale to Amoco". The first four paragraphs read:

> Dome Petroleum Ltd. has started the process of selling off assets before it is sold to Amoco Canada Petroleum Co. Ltd.

> Dome, which will today start mailing shareholders an information circular regarding the $5.5-billion sale to Amoco, announced yesterday the sale of its 67.5 per cent share of tiny Cavalier Energy Ltd. to two Halifax businessmen.
>
> Terence Coughland and Fred Hanson will pay $9.25 a share for Dome's 1.7 million shares of Cavalier, which is traded on the Alberta Stock Exchange.
>
> Another 20.8 per cent of Cavalier's shares, held by Canpar Holdings Ltd., is also being sold to the two men through a private company, 380663 Alberta Ltd.

This was at the time when Mr. Coughlan was under investigation by Mr. Wise and Fasken & Calvin, without his being aware. I think it highly probable that information of this kind was considered important and was discussed internally. And, I find this knowledge of Mr. Coughlan's involvement in Cavalier was the source of this comment in Mr. Lalor's letter of late May asking Mr. Coughlan to resign: "You also seem to be fairly committed to other developments".

[205] Cavalier was of sufficient interest and focus that, by June 10, 1988, Mr. Braithwaite captioned a letter to Mr. Lalor simply "Cavalier Energy Limited". The letter was copied to Mr. Wise and Mr. Roy. It was not disclosed by Westminer to the plaintiffs in the Seabright action, and Justice Nunn did not have the advantage of the information it provides when he assessed the claim for losses on account of the failure of Cavalier. Stikeman, Elliott had been asked to look into assets of the former directors that could respond to a judgment. I

accept Mr. Braithwaite's evidence that this was the purpose of his inquiry into Cavalier and his firm's purpose in providing advice about the company. That purpose is consistent with the concluding sentence of his June 10th letter, with a further memorandum supplied by Mr. Braithwaite's associate and with various statements made at the Westminer board meeting at the end of June when suit was considered. Although no witness specifically said so, it seems clear that Stikeman, Elliott were instructed by Mr. Lalor, Mr. Wise or Mr. Roy to look into ownership of Cavalier as, at least, one source of recovery. As a result, Westminer became aware of much detail about the take-over of Cavalier Energy by Mr. Coughlan and others. The lock-up agreements had been signed by Dome and Canpar, a director's circular and a press release had been issued, shares had been tendered and compulsory acquisition of the balance of shares was in process. Stikeman, Elliott obtained the circular and the release. Mr. Braithwaite's letter enclosed the directors' circular including the attached take-over bid made by Cavalier Capital. Mr. Braithwaite wrote "Messrs. Coughlan, Hansen and McCartney are all apparently involved with Cavalier Capital Corporation." He drew to the readers' attention page 32 of the take-over bid "which indicates that the funds for the bid were apparently financed by a Canadian chartered bank and it would appear that the shares of Cavalier Energy

Limited acquired by Mr. Coughlan's company will secure the financing." Again, this indicates Mr. Braithwaite's attention was upon the shares as a source of recovery. However, the discussion under "Arrangements to Pay for Deposited Common Shares" on page 32 also informed the readers that Cavalier Capital intended to consider "equity financing" among the options available to it for retiring one of the two back loans committed for financing the bid and it also informed the readers that the loan was to be backed by "letters of credit". No information was provided as to whether the possible equity financing was to be raised publicly or privately. And, no information was provided about who might be putting up the letters of credit. Indeed, under "Purpose of the Offer and Plans for the Company" we see no reference to any public offering. Rather, "the Offeror will be able to integrate or reorganize the Company in whatever manner it considers desirable". This part suggests that amalgamation with Cavalier Capital is likely, and it is consistent with the actual plan to take Cavalier Energy private. I find the take-over bid did not suggest to any representative of Westminer that going public or an initial public offering was in the near future for Cavalier.

[206] It took six years for this case to come to trial after suit was commenced. With stops and starts, the trial extended from April 2000 to November 2000.

Argument was heard in December. Further submissions were provided in writing into February 2001. Then, I was advised of another relevant document, previously undisclosed. With Westminer's consent and without it admitting that the document was of sufficient weight to meet the test for re-opening a trial, the trial was re-opened so the document could be entered along with, by consent, certain answers to interrogatories sworn by Mr. Wise. The document most lately produced is a memorandum forwarded by Simon Romans to Mr. Wise at Westminer on June 23, 1988 when Mr. Wise was reporting to Mr. Morgan about the case against the former directors and when they were preparing for the board meeting. Mr. Romans was an associate of Mr. Braithwaite's at Stikeman, Elliott and he acted as recording secretary for Westminer Canada and Westminer Canada Holdings in July 1988. The memorandum makes it clear that Westminer had requested further information on Cavalier Capital and Cavalier Energy: what exchanges Energy traded on and what equity investment had been made by Capital. Mr. Romans appears only to have reviewed the take-over bid. He concluded that Cavalier Energy trades on the Alberta exchange and the size of the equity investment "cannot be determined at this time." During his direct examination Mr. Wise stated that he paid no attention to the copy of the take-over bid delivered with Mr. Braithwaite's letter. He was interested in the

bottom-line as to whether shares in Cavalier would provide a basis for recovery. In cross-examination, it was made clear that Mr. Wise could take no bottom-line from the Braithwaite letter. The discovery of the later memorandum is consistent with Mr. Wise's testimony that he was looking for a bottom-line and did not read the bid. The later memorandum makes it clear that Mr. Wise asked for the bottom-line, and the answer derived entirely from the bid. It is true that this adds nothing to our understanding of the body of knowledge Westminer had obtained on Cavalier and the memorandum, including the requests, tends to confirm that Westminer's interest in Cavalier concerned the ability of some former directors to respond to a judgment. However, this evidence also shows how present Cavalier was in the minds of Westminer representatives as they moved towards suit, public announcement and complaint to the OSC.

[207] It will be recalled that the June 29th Westminer board meeting was presented with Mr. Wise's report and that the Ontario statement of claim included claims for an accounting and tracing of proceeds. The report included a reference to Cavalier in a part titled "Tracing of Profits":

> A company controlled by Coughlan and Hansen (previously Vice President and Secretary-Treasurer and a director of Seabright) acquired majority ownership and control of Cavalier Energy Limited, a publicly listed company on the Alberta Stock

> Exchange in April/May 1988. McCartney (previously a director of Seabright) also holds shares in Cavalier. They will soon move to 100% ownership of Cavalier.
>
> The purchase price for 100% is approximately C$25 million and has been funded in part by loan from a Canadian chartered bank. Cavalier has oil and gas reserves and production in Alberta, Canada.

This part of the report concludes with estimates of the profits realized by Coughlan, Hansen and McCartney from the sale of Seabright stock, which total $9,363,000. This is consistent with other references by Mr. Wise to potential recovery of $10 million and the state of information on Cavalier is also consistent with Mr. Morgan's advice to the board that judgments may not be recoverable in whole or in part.

[208] Cavalier was mentioned at the first meeting with Mr. Groia. No one who gave evidence recalled the discussion. No mention is made of it in Mr. Braithwaite's memorandum. Early in Mr. Groia's seven pages of notes appears "Seabright Resources" and below it Mr. Coughlan's name and the word "promoter". Positioned and written in such a way as to cause me to conclude that it was written later are the words "Cavalier Energy". I am satisfied that one or several of Mr. Roy, Mr. Braithwaite or Mr. Wise, brought up Cavalier and told Mr. Groia of Coughlan's involvement in it. To Mr. Braithwaite's knowledge, Cavalier Capital was in the process of taking Cavalier Energy private. And, Cavalier Energy had not traded on the TSE. To mention Cavalier to an official

of the OSC in the context of a discussion concerning protection of the integrity of the capital markets in Ontario suggests that the Westminer representatives foresaw some likelihood that Mr. Coughlan would seek to promote Cavalier in Ontario to the extent that it would need to become a reporting issuer under the OSC, as Seabright had been. The subject of Cavalier became of interest to the enforcement branch once the decision was made in 1989 to bring administrative proceedings. Mr. Groia explained that they were seeking to restrict Mr. Coughlan's activities in any public company in Ontario and Cavalier was the only company they specifically had in mind. Indeed, Cavalier was prominent in the discussions leading up to the settlement agreement which included the requirement that the OSC should indicate that it would treat Cavalier "in the ordinary course" notwithstanding Mr. Coughlan's involvement. That Westminer continued to refer to Cavalier in communications with the enforcement branch is made clear by a letter of Mr. Roy's to Mr. Wise reporting a conversation with Mr. Campbell shortly before the OSC hearing: "... he is cognizant or aware of Cavalier and clearly wants to shut Coughlan out of any involvement in any company that is publicly traded 'for a period of time'." Of course, that is not what the agreements provided.

[209] The preliminary prospectus for the Cavalier initial public offering was filed with the OSC on July 22, 1988, nine days after the meeting with Mr. Groia, seven days before the suit and twelve days before Westminer's public announcement. The IPO was reported in the OSC Bulletin published on August 5. Stikeman, Elliott receive the bulletin. Mr. Braithwaite reads portions of it regularly to keep abreast of securities law. He does not make a habit of going through the lists of new filings in this lengthy book. I accept his evidence that he did not do so with the August 5, 1988 publication, and that he learned about the Cavalier IPO much later.

[210] I find that, through Mr. Wise, Westminer knew of Mr. Coughlan's intentions for his next line of work to this extent: he intended to promote a publicly traded, junior resource company involving his investment and that of those former Seabright shareholders who were loyal to him. I find that, through the *Globe & Mail*, Westminer learned that Mr. Coughlan's plan had fixed upon Cavalier Energy, which he and Mr. Hansen were purchasing. By June 1988, Mr. Braithwaite, Mr. Roy, Mr. Lalor and Mr. Wise had all of the detail available from the Cavalier Energy directors' circular. From this, Westminer was aware that the purchase had been financed by two bank loans, one of which was backed by letters of credit and was likely to be retired through equity financing.

It also concluded that Coughlan, Hansen and McCartney had probably committed sizeable investments in Cavalier. On the information Westminer had about Mr. Coughlan's following of investors, which came not only from Mr. Coughlan's discussion of his plans with Mr. Wise but also from Westminer's entire knowledge of Seabright and its dealings with fellow shareholders in Seabrex, I find that Westminer must have known it was likely that followers of Mr. Coughlan would invest in Cavalier. Westminer had no way of knowing who or how much. It also understood that Cavalier Energy would likely amalgamate with Cavalier Capital, and it soon knew that Cavalier Energy was being taken private. The agents of Westminer involved in this subject did not, at the time of the press announcement or before, have reason to believe that equity financing would be sought from the public markets in the immediate future. On the contrary, based upon the take-over bid and information Cavalier Energy was going private, I find that the indication was that the immediate financing would likely have been private, whether through shareholder-backed bank debt or through direct investment. However, based upon the reference to Cavalier in the earliest discussion with representatives of the OSC and based upon the knowledge the Westminer agents had of financing junior resource companies, I find that Westminer knew that an attempt at an initial public

offering was likely in the offing, in the near future though not the immediate future. I do not find Westminer was made aware of the initial public offering at the time of the filing of the preliminary prospectus or in the months following. However, in light of the reference to Cavalier in the discussion with Mr. Campbell in early 1990 and in light of the intensity of effort that Westminer brought to bear on all of the issues surrounding the Seabright affair, I have difficulty believing Westminer did not pick up on this at some point, early 1990 at the latest.

“REASONABLENESS” OF WESTMINER’S ACTIONS IN LIGHT OF *PEZIM*

[211] The decision of the Supreme Court of Canada in *Superintendent of Brokers* v. *Pezim and others* (1994), 168 N.R. 321 (S.C.C.) is often referred to for the standard of review on a challenge to a decision of a specialized tribunal where there is a statutory right of appeal as opposed to a statutory prohibition against interference. The Supreme Court reversed a decision of the British Columbia Court of Appeal setting aside orders of the British Columbia Securities Commission and it did so on the basis that the courts owe deference to decisions of securities commissions within their field of their expertise and responsibility notwithstanding a statutory right of appeal (para. 85). However, the court went further than to hold that the issues before the commission were subject to deference and the commission’s decision was within the ambit precluding interference. The court went so far as to agree with the commission’s findings: paras. 87, 90, 93, 96 and 100. This agreement with the commission’s reasons

founds the defendants' argument that *Pezim* necessitates a re-evaluation of Justice Nunn's findings towards the conclusion that Westminer's investigation and the allegations it made were reasonable. The court agreed with the commission that undisclosed drilling results can constitute a material change (para. 90) and that the duty to disclose "as soon as practicable", as provided in the British Columbia statute, must be discharged before the issuer engages in a securities transaction (para. 91). As to the second point, about the timing of the disclosure, both the commission and the court had to confront an unusual circumstance. For good reason, senior management in that case had been shielded from learning of drill results until they became public. Nevertheless, the commission had concluded that management had a duty to make inquiries before causing an issuer to engage in securities transactions. The court not only found that this interpretation was within the jurisdiction of the commission, to which the courts owe deference. The court agreed with the interpretation. Justice Iacobucci wrote for the court. At para. 93, he said:

> In any event, I find that it was well within the Commission's jurisdiction to interpret s. 67 in the manner it did, and I fully agree with its position on this point. Although a duty to inquire is not expressly stated in s. 67, such an interpretation contextualizes the general obligation to disclose material changes and guarantees the fairness of the market, which is the underlying goal of the Act.

The defendants say that this duty casts the activities of Mr. Coughlan and the other Seabright directors in a new light, tending to show that Westminer behaved reasonably when it made allegations following the investigation carried out under Mr. Wise's direction: In light of *Pezim*, Mr. Coughlan and the others had a duty to disclose the assay results from the Beaver Dam exploration before the entire exploration was complete and, in light of *Pezim*, Justice Nunn was wrong if he found that senior management could rely on the interpretations of technical management or others to the exclusion of management's own inquiries into the continuing assay results. (In fact, Justice Nunn was referred to the British Columbia Court of Appeal decision and he decided against following it on the only point for which it was referred to him.) This argument requires a close look at the facts of *Pezim*.

[212] Prime Resources Group Inc. or its wholly owned subsidiaries had interests in and managed about fifty junior resource companies. Mr. Pezim was chairman of Prime's board, and he was a major shareholder. One of the fifty or so operating companies was Calpine Resources Inc., a reporting issuer under the British Columbia Securities Commission whose shares were listed for trading on the Vancouver Stock Exchange. Calpine had a one-half interest in a mining property. This was its only significant asset, and exploration and development of the property was its only business. It commenced a drilling program in 1988

and it announced the assay of each drill hole when the results were in hand. By the spring of 1989, it was able to announce a strike in what was called zone 21 to have been established over 1500 feet with one end and the extent of depth still open. It started a new program of drilling, using two drills. One worked continuously on in-filling the established strike, and the other worked in a fresh area, called zone 21B. For some reason, Calpine stopped its habit of immediately releasing assay results, and started reporting them in batches about two weeks apart. The controversy arose mainly because of one drill hole, hole 109. Apparently, the geology was such that a single rich hole can be very significant. Gold was visible when 109 was drilled. The assay results that came in later were described as “spectacular” and “staggering”. This single result could double the reserves. A press release eventually referred to the visible gold, but the assay results were not released for three weeks after they were in hand. In the meantime, Calpine was the subject of various securities transactions, including a large sale of shares to Prime. The British Columbia Securities Commission dismissed insider trading charges against Mr. Pezim and other officers of Prime. Calpine had taken steps to prevent Prime from learning results of the drilling program before the results were made public. However, that did not relieve the officers of their responsibility for continuous disclosure.

The Commission found that visual inspection of the core from hole 109 constituted a material change for Calpine, and the assay results constituted a material change for Prime also. The continuous disclosure provisions of the British Columbia *Securities Act*, S.B.C. 1985, c. 83 as amended by S.B.C. 1988, c. 58 and S.B.C. 1989, c. 78 provided for a press release "as soon as practicable" after a material change occurs: s. 67(1), which compares with "forthwith" in the Ontario *Securities Act* of that time: s. 75(1). The British Columbia Securities Commission found that the securities transactions were such that "as soon as practicable" meant sooner than otherwise might have been. Failure to disclose the visual inspection and the assay results when the transactions were occurring constituted offences under s. 67(1). The Commission also found two "no material change" certificates were false. It imposed trading restrictions upon Mr. Pezim and others. Mr. Pezim did not know what his technical staff knew. Nevertheless, he was personally responsible.

[213] Justice Iacobucci did not say that undisclosed drill results necessarily constitute a material change. At issue was the proposition that "undisclosed drilling results can constitute a material change" (para. 86). The situation at zone 21B in 1989 was not akin to the situation at Beaver Dam in 1987. Zone 21B reserves had not been established and it was undergoing surface exploration, where the Beaver

Dam reserves had been established by surface exploration and a single program of underground exploration was being conducted within parameters already set. The objects of the underground exploration were to determine mineability and to confirm the reserves, objects which could not possibly be achieved by reference to isolated assay results, let alone by reference to the assay of a single drill hole. Further, the geology of the two places does not appear to be comparable. The evidence in this case suggests that, even in surface exploration, it would be wrong to attach significance to a single drill hole. Indeed, an error alleged against MPH concerned its finding continuity by matching rich drill holes which turned out to be unrelated to one another. The essential difference between *Pezim* and this case is in the complexity of technical assessments. In *Pezim*, a single drill hole was obviously significant for all concerned. In this case, massive testing required technical interpretation. In *Pezim*, information of obvious significance was withheld. In Seabright, the significance of information had to be determined by experts, both on staff and outside. In Seabright, the company's understanding of technical advice, including advice as to the reliability and significance of interim assays before completion of the entire bulk sample, where crucial to determining material change. That issue was confronted by Justice Nunn. Nothing like it arose in

Pezim and the Supreme Court of Canada's approval of the British Columbia Securities Commission findings could not have provided great assistance to Justice Nunn, let alone persuaded him to re-cast his findings.

[214] Even if I had concluded that the Seabright directors failed to disclose a material change, I would not find that Westminer acted reasonably. It alleged fraud and Westminer broadcast that allegation to the OSC, to the business world and to the public. The allegation was baseless. It nearly destroyed reputations. And, it was made out of the wrongful motive I have described.

LIABILITY

Conspiracy

[215] The development of conspiracy as one of the intentional torts and the present state of Canadian law governing it were discussed extensively by the Court of Appeal in the Seabright case. Readers of Dean Klar are referred to that decision "[f]or a good review of the authorities and the elements of the action for conspiracy": Lewis N. Klar, *Tort Law* 2nd ed. (Carswell, 1996). The discussion of conspiracy extends from para. 76 to para. 110 of *Coughlan* v. *Westminer Canada Ltd.* (1994), 127 N.S.R. (2d) 241 (C.A.). Apart from the present case having arisen from the same circumstances, this is the decision that provides authoritative guidance as to the law governing the decision I have to make. The plaintiffs referred me to *Canada Cement LaFarge Ltd.* v. *B.C. Lightweight Aggregate Ltd.* (1983), 145 D.L.R. (3d) 385 (S.C.C.) and *Hunt* v. *Carey Canada Inc.* (1990), 74 D.L.R. (4th) 321 (S.C.C.), which were discussed and applied by Justice Nunn as indicated in para. 77, 81, 82, 104 and 110 of the appellate decision. At page 398 of *Canada Cement*, Estey J., who delivered the judgment of the court, observed that "the scope of the tort of conspiracy is far from clear." He said that, in situations where tort law does not hold an individual liable for injury caused by individual action, "the law of tort does recognize a claim

against them in combination as the tort of conspiracy." The tort may be established if:

> (1) whether the means used by the defendants are lawful or unlawful, the predominant purpose of the defendants' conduct is to cause injury to the plaintiff; or,
>
> (2) where the conduct of the defendants is unlawful, the conduct is directed towards the plaintiff (alone or together with others), and the defendants should know in the circumstances that injury to the plaintiff is likely to and does result. [p. 398 - 399]

Justice Nunn discussed *Hunt* v. *Carey Canada Inc.* at para. 634 of *Coughlan et al.* v. *Westminer Canada Ltd. et al.* (1993), 120 N.S.R. (2d) 91 (Nunn J.) and the Court of Appeal's further discussion may be found at para. 78 to 80 of that decision. Justice Nunn referred to the following from Justice Wilson's judgment in *Hunt*:

> As Fridman has noted in **The Law of Torts in Canada**, vol. 2, at p. 265:
>
> > "The difference between the English and Canadian formulations of the tort of conspiracy lies in the way the intent of the defendants is expressed. The language of Lord Diplock seems to indicate that the necessary intent should be actual. That of Estey, J., suggests that it may be possible for a court to infer an intent to injure from the circumstances even if the defendants deny they acted with any such intent."
>
> Fridman goes on to observe at pp. 265 - 266:

> "In modern Canada, therefore, conspiracy as a tort comprehends three distinct situations. In the first place there will be an actionable conspiracy if two or more persons agree and combine to act unlawfully with the predominating purpose of injuring the plaintiff. Second, there will be an actionable conspiracy if the defendants combine to act lawfully with the predominating purpose of injuring the plaintiff. Third, an actionable conspiracy will exist if defendants combine to act unlawfully, their conduct is directed towards the plaintiff (or the plaintiff and others), and the likelihood of injury to the plaintiff is known to the defendants or should have been known to them in the circumstances."

At para. 78 and 79 of the decision of the Court of Appeal, the court noted Justice Wilson's reservations concerning Fridman's first ground and the court said: "Earlier she had stated the law with respect to the situation when lawful means are used is not in doubt." And, the Court of Appeal repeated this passage from Justice Wilson's judgment, with the emphasis indicated:

> "If A and B agree to commit acts which would be lawful if done by either of them alone but which are done in combination and cause damage to C, no tortious conspiracy actionable at the suit of C exists unless the predominant purpose of A and B in making the agreement and carrying out the acts which case the damage is to injure C and not to protect the lawful commercial interests of A and B."

At para. 80, the Court of Appeal discussed the decision of the House of Lords in *Lonrho Plc.* v. *Fayed,* [1992] 1 A.C. 448 and said of it:

> ... Lord Bridge of Harwich held for the House of Lords that it was not fatal if the purpose to injury was not the predominant purpose of the conspiracy so long as it was one of the purposes. This has the effect of broadening the scope of the tort of conspiracy in Fridman's first description, while predominant purpose remains the test in the second description which the trial judge applied in the present appeal.

[216] Counsel for the plaintiffs point out that the decision in the Seabright case involved findings of both lawful and unlawful acts. Justice Nunn based liability in conspiracy upon lawful conduct having injury as its predominant purpose (see para. 633 and 636), and this was the ground focused upon by the Court of Appeal in reviewing Justice Nunn's findings, as the quotation set out above makes clear (see also, the discussion of conspiracy based on lawful means and conspiracy based on unlawful means at para. 103). The most serious acts committed by Westminer where the institution of the Ontario action and the amendment to claim fraud against the outside directors (see Court of Appeal, para. 109). In the Court of Appeal, Westminer argued that, because of immunities afforded by law, tortious conspiracy cannot be based exclusively upon the commencement or prosecution of a civil action. In the course of deciding that issue, the court pointed out that the conspiratorial purpose had crystallized in various acts "lawful and unlawful" (para. 107) and it identified at least one act as having been unlawful: "The manoeuvre to deprive the Seabright directors of an insured defence to the Ontario action, for example, was sufficient to fulfil all the requirements for civil conspiracy by an unlawful

act"(para. 109). In addition to the Ontario suit, lawful acts in furtherance of the conspiracy included reporting Coughlan and Garnett to the Ontario Securities Commission (para. 107) and issuing the public announcement "calling attention to the allegations" (para. 108).

[217] I am unable to find unlawful conduct on the part of the defendants in the present action, as would found liability to the present plaintiffs in conspiracy. I have reached the same conclusion as had Justice Nunn: the defendant corporations employed means that may have been lawful but they were deployed with the predominating purpose of injuring the former directors in order to conceal from public scrutiny the carelessness of Westminer and its senior management. The means for achieving this purpose included the suit and the public announcement, and I attach much significance to the latter because it went far beyond announcing the suit. I am mindful also of the approaches made to the OSC, allowing the insurance policy to lapse and the amendment alleging fraud.

[218] The purpose of the defendants' conduct was not to injure the present plaintiffs and the conduct was not directed towards them. These findings are based on the detailed findings I set out earlier. The present plaintiffs were outside the motive that informed Westminer's purpose and the direction of its actions.

The motive was to cast blame on others so as to deflect scrutiny of Westminer's own actions and judgments. The intent, the purpose and the direction of the actions taken because of this motive were to inflict injury on others who could suffer the blame. Those others were the former directors of Seabright, those who could be blamed, and not the subsequent investors in Cavalier, whose interests were scarcely known to Westminer and who, more to the point, could not logically have been and were not in fact among those upon whom it was casting blame. No purpose, predominant or otherwise, to do harm to the present plaintiffs has been established. It has not been established that the defendants' conduct was directed towards the present plaintiffs. Whether the means were lawful or unlawful, the claim in conspiracy must fail.

[219] The plaintiffs referred me to *American Reserve Energy Corp.* v. *McDorman*, [1999] N.J. No. 198 (Nfld. S.C.), where Justice Adams found unlawful conduct and he found the unlawful conduct had been directed against the plaintiff. In support of that finding of fact, the court said the conspirators had been "wilfully blind to the injury likely to be caused to the plaintiff" (para. 191). I will discuss the proximity of the defendants' conduct and harm to persons in the position of the defendants later when I deal with the claim in negligence. The plaintiffs referred me also to authorities on constructive intent in tort law generally,

including *Hall-Chem Inc.* v. *Vulcan Packaging Inc.*, [1994] O.J. No. 817 (Gen. Div.) and *Reach M.D. Inc.* v. *Pharmaceutical Manufacturers Assn. of Canada*, [1999] O.J. No. 2853 (S.C.). I do not think, and I do not take the plaintiffs to say, that constructive intent applies to the tort of conspiracy in such a way that knowledge of the unlawfulness of an act alleviates the need to prove that the act was directed against the plaintiffs. Where unlawfulness is proven, it may be that constructive intent comes into play in relieving the plaintiff of the need to prove predominating purpose, but the plaintiffs must still establish that the unlawful acts were directed at the plaintiffs or that injury to the plaintiffs was among the purposes. I do not think that foreseeablility of injury can, on its own, establish this element. Foresight of injury relates to the other element referred to in *Canada Cement LaFarge*, "the defendants should know in the circumstances that injury to the plaintiff is likely to ... result." Again, it appears that proof of foreseeability of injury is an element that replaces the requirement for proof of predominating purpose where unlawfulness is established, but, if foreseeability is established, directedness remains to be proved. I find some support for these views in a discussion found at para. 42 of *Cheticamp Fisheries Co-operative Ltd. et al.* v. *Canada* (1995), 139 N.S.R. (3d) 224 (C.A.), to which I shall refer in the next section. Although the relationship may

meet the requirement for proximity in negligence, the defendants' actions and the plaintiffs' injuries were far too distant from one another for any finding of directedness in the circumstances of this case. None of this is to say that wilful blindness is irrelevant to a finding of intent. The blindness is, after all, "wilful". Defendants may close their eyes to the natural consequences of their actions, but they can expect still to be found to have intended those consequences. It is in that vein that I understand the finding of fact in *American Reserve Energy Corp.* v. *McDorman*. While I accept that the directedness required for conspiracy based on unlawful act may be inferred where the conspirators turn a blind eye to those persons standing in the range of the consequences of the unlawful act, this is not a case for that kind of finding. Firstly, I would characterize most of the acts in question as lawful: the dealings with the OSC, the suit, the public announcement and the amendment. In respect of those acts at least, the plaintiffs would have had to prove their interests were within the predominating purpose, which they were not. As regards the manoeuvres that may have deprived the directors of coverage for their expenses in the Ontario suit, I think the interests of the present plaintiffs were far removed. But even if all of the efforts had been unlawful, the interests of the present plaintiffs were so distant from the conspiracy, both its motive and

its immediate consequences, that I would not find recklessness or infer directedness.

<u>*Interference with Economic Relations*</u>.

[220] This recently established intentional tort was the subject of early recognition in *Volkswagen Canada Limited* v. *Spicer* (1978), 91 D.L.R. (3d) 42 (N.S.S.C., A.D.). In *Cheticamp Fisheries Co-operative Ltd.* v. *Canada* (1994), 134 W.S.R. (2d) 13 (S.C.), reversed on other grounds (1995), 139 N.S.R. (2d) 224 (C.A.), Justice Tidman said, at para. 47, that the tort is composed of three elements and he characterized them this way: "1) There must be conduct by the [defendant] which is unlawful; 2) The conduct must be deliberate and done with the intention of causing damage to the business of the plaintiffs; and 3) The conduct must have caused damage to the business of the plaintiffs." The decision of the Court of Appeal was delivered by Chipman J.A. who noted that counsel had not placed this characterization of the elements in dispute (para. 24). The appeal concerned findings in respect of the second element and the appellate court disagreed with the trial judge's determination of intent by reference to the defendant's knowledge of or recklessness towards the unlawfulness of the act charged against it. Justice Chipman introduced the

discussion by saying, at para. 28, "The intention to cause injury is an essential element of this tort." He reviewed various decisions in Great Britain and other Commonwealth countries and said, at para. 35, that they support the conclusion that "there is a requirement that the purpose or intention of the unlawful conduct at issue must be to inflict injury upon the plaintiff." At para. 40, he reached the same conclusion in reference to a decision of the Manitoba Court of Appeal: *Gerrard et al.* v. *Manitoba et al.* (1992), 98 D.L.R. (4th) 167 (C.A.). In reference to recklessness as a basis for a finding of intent to injure, Justice Chipman said at para. 42:

> The courts have stopped short of substituting for an intention to cause damage to the plaintiff a mere foreseeability that such damage may result from the unlawful conduct. A constructive intent to injure or foreseeable injury may have a place in the tort of conspiracy but not in my opinion in the tort of interference with economic relations.

And, after authorities including *Canada Cement LaFarge* were citied in reference to that last comment, the discussion continued: "I think that recklessness is more akin to foreseeability than it is to intention. If any lesser standard of intention were required, it still seems clear that the offending conduct must be 'directed at' the plaintiff." Justice Chipman's "directed at" clearly refers to the element of the tort conspiracy where, if the plaintiff establishes an unlawful act, the plaintiff may go on to establish

liability by proving that the act was directed at the plaintiff. I have been referred to many authorities, but *Cheticamp Fisheries Co-operative Ltd. et al.* v. *Canada* is binding on me for the proposition that the tort now under discussion requires proof of an actual intention to do harm to the present plaintiffs. As indicated in respect of civil conspiracy, I cannot make that finding.

Negligence and the Rule in Foss *v.* Harbottle.

[221] In addition to the intentional torts of conspiracy and interference with economic relations, the plaintiffs claim in negligence. The defendants submitted that this claim is precluded by the rule in *Foss* v. *Harbottle.* The plaintiffs submitted that their present claims are sufficiently personal and sufficiently distinct from the corporate losses of Cavalier that the rule does not apply. I am inclined to the position taken by the plaintiffs.

[222] *Hercules Management Ltd. et al.* v. *Ernst & Young et al.* (1997), 146 D.L.R. (4th) 577 (S.C.C.) concerned liability of an independent auditor to shareholders for allegedly negligent audits of a company in which the plaintiffs hold shares. An order for summary dismissal was affirmed by the Manitoba Court of Appeal and by the Supreme Court of Canada. The Supreme Court dismissed the appeal on two distinct grounds. No duty of care was owed to the shareholders as such.

And, the rule in *Foss* v. *Harbottle* applied. The discussion of that rule is found at para. 58 to 63. At para. 59, Justice LaForest, who wrote for the court, stated the rule this way: "... individual shareholders have no cause of action in law for any wrongs done to the corporation and ... if an action is to be brought in respect of such losses, it must be brought either by the corporation itself (through management) or by way of a derivative action." With one additional comment, Justice LaForest accepted the description of the rationale behind the rule given by the English Court of Appeal in *Prudential Assurance Co.* v. *Newman Industries Ltd. (No. 2)*, [1982] 1 All E.R. 354 (C.A.). I should repeat the passage. It appears at p. 367:

> The rule ... is the consequence of the fact that a corporation is a separate legal entity. Other consequences are limited liability and limited rights. The company is liable for its contracts and torts; the shareholder has no such liability. The company acquires causes of action for breaches of contract and for torts which damage the company. No cause of action vests in the shareholder. When the shareholder acquires a share he accepts the fact that the value of his investment follows the fortunes of the company and that he can only exercise his influence over the fortunes of the company by the exercise of his voting rights in general meeting. The law confers on him the right to ensure that the company observes the limitations of its memorandum of association and the right to ensure that other shareholders observe the rule, imposed on them by the articles of association. If it is right that the law has conferred or should in certain restricted circumstances confer further rights on a shareholder the scope and consequences of such further rights require careful consideration.

The additional comment provided by Justice LaForest reads "... the rule is also sound from a policy perspective, inasmuch as it avoids the procedural hassle of a multiplicity of actions" (para. 59). After discussing the rule and its rationale in the context of auditor's negligence and concluding that the rule precluded the shareholders' action, Justice LaForest made it clear that the rule does not preclude actions that are personal to a shareholder even though the corporation may have its own cause of action on the same facts:

> One final point should be made here. Referring to the case of *Goldex Mines Ltd. v. Revill* (1974), 7 O.R. (2d) 216 (C.A.), the appellants submit that where a shareholder has been directly and individually harmed, that shareholder may have a personal cause of action even though the corporation may also have a separate and distinct cause of action. Nothing in the foregoing paragraphs should be understood to detract from this principle. In finding that claims in respect of losses stemming from an alleged inability to oversee or supervise management are really derivative and not personal in nature, I have found only that shareholders cannot raise individual claims in respect of a wrong done *to the corporation*. Indeed, this is the limit of the rule in *Foss v. Harbottle*. Where, however, a separate and distinct claim (say, in tort) can be raised with respect to a wrong done to a shareholder *qua* individual, a personal action may well lie, assuming that all the requisite elements of a cause of action can be made out. [para. 62]

Goldex Mines Ltd. v. *Revill* involved an allegedly false and misleading annual report circulated by a director of a corporation in connection with a proxy solicitation.

[223] In *Hoskin* v. *Price Waterhouse Ltd.* (1982), 37 O.R. (2d) 464 (Div. Ct.), the Divisional Court reviewed the refusal of a motion to dismiss an action on the

basis that it was substantially derivative. The statement of claim set up numerous causes in reference to the losses of the plaintiff's company. The court recognized that some paragraphs of the statement of claim described personal claims:

> Those paragraphs relate to claims asserted by the plaintiff as to damage to his reputation and credit, as well as claims that the plaintiff has been exposed to potentially larger claims under guarantees he signed than would have been the case were it not for the alleged wrongful acts of the defendants. Those claims are not derivative; they are personal. I observe, however, that the pleaded contention that the defendants' wrongful actions or omissions have exposed the plaintiff to an increased loss under guarantees he has signed represents a loss that the plaintiff has not yet incurred. The plaintiff has not paid anything under those guarantees. The plaintiff has not claimed an entitlement to a declaration as to the validity of the bank guarantees or indemnity from the defendants on the Unit Step trade creditor guarantees. [p. 466 - 467]

The action was dismissed because "the statement of claim was so saturated by derivative claims" (p. 467).

[224] The passage set out above from *Hoskin* v. *Price Waterhouse* was emphasized in *Martin* v. *Goldfarb et al.* (1998), 41 O.R. (3d) 161 (O.C.A.), where an award of damages for breach of fiduciary obligation was set aside because it intermingled derivative claims with personal claims. There is reference in *Martin* v. *Goldfarb* to the situation of a guarantor advancing a personal claim on account of having had to honour a guarantee of company debt:

> It is true that as a guarantor of some of the corporate mortgages, Martin was exposed to personal liability on those mortgages. Had he paid the amounts owing on them, he would have been entitled to claim against the corporations for indemnity and would become a creditor himself. [p. 180]

Because the trial judge had failed to distinguish between personal losses and those of the company, and because evidence had not been sufficiently led to enable the appeal court to make an assessment, a new trial was ordered. The Ontario Court of Appeal suggested that an appropriate avenue of inquiry at the new trial would be the plaintiff's "exposure on these guarantees or to what extent he was called upon to respond to them" (p. 190). Also, the trial court might inquire into "fresh infusions of his personal resources to shore up his corporate operations" (p. 191).

[225] In *Alfano* v. *KPMG Inc.* (2000), 17 C.B.R. (4th) 1 (O.S.C.J.) a motion had been made to strike a statement of claim on the basis of *Foss* v. *Harbottle*. Justice Lane referred to *Hercules* and other authorities and she then provided this commentary on *Goldex* at para. 27 and 28:

> In *Goldex* the directors were alleged to have sent misleading information to the shareholders in a proxy solicitation, an act which the Court of Appeal said, at page 224, injured the shareholders, apart altogether from any breach of duty owed to the company itself. At pages 222-3, the Court discussed the line of demarcation between a derivative action and a personal one. It referred to the California case of *Jones v. H. F. Ahmanson & Co.*, 460 P. 2d 464 (U.S. Cal. C.A. 1969) where the Court said:

> The individual wrong necessary to support a suit by a shareholder need not be unique to that plaintiff. The same injury may affect a substantial number of shareholders. If the injury is not incidental to an injury to the corporation, an individual cause of action exists.

The Court of Appeal then explained the last portion of the above quotation as follows:

> What limitation on the general principle is intended by words in the last sentence: "...bit incidental to an injury to the corporation"?
>
> In the context of the whole judgement, we believe Traynor CJ., meant by this phrase: "...not arising simply because the corporation has been damaged, and as a consequence of the damage to it, its shareholders have been injured."

In *Alfano*, the statement of claim was struck because "The possible personal claims are so intertwined with the derivative claims..." (para. 33).

[226] The rule in *Foss* v. *Harbottle* did not apply in *Pizzo* v. *Crory et al.* (1986), 71 N.S.R. (2d) 419 (S.C., T.D.), where Justice Richard referred to *Goldex* and found the plaintiff's action was based on a shareholders' agreement. The rule was applied by Justice Nunn in *Brown* v. *Barrow et al.* (1983), unreported SH42762 (S.C., T.D.), a brief oral decision referred to by Justice Richard in *Pizzo*. I have not been referred to further authority in this province.

[227] Following the lines of demarcation indicated by *Goldex*, that the alleged injury to shareholders does "not arise simply because the corporation has been

damaged" and that the injury is not simply "as a consequence of the damage to it", I would not dispose of this case on the basis of the rule in *Foss* v. *Harbottle*. The plaintiffs invested as creditors as much as they invested in Cavalier as present and prospective shareholders. This is seen both in their initial status as contingent creditors on account of the letters of credit and in their status as holders of debt instruments that were, albeit, near-equity, the debentures convertible to shares. In these aspects of their investment the present plaintiffs may be similar to a guarantor of corporate debt who might be able to claim personal losses on account of the same wrong as was done to the corporation. I have some difficulty with this as a basis for distinguishing *Foss* v. *Harbottle* because the contingent liabilities and the debt instruments were so bound up with the equity investment, but that indicates caution in keeping purely corporate losses separate in assessing damages rather than preclusion of the claims. There are some substantial distinctions between the corporate losses of Cavalier on account of the disability of Mr. Coughlan and the personal losses of the plaintiffs on that same account. Cavalier lost the ability to raise the financing necessary to its plans for development as described at the time of the attempted initial public offering, July 1988. However, the injury to the investors was both more immediate and more complicated than the impact the

failure to go public had upon anticipated shareholders' equity in Cavalier. The failure to go public was, as my earlier findings indicate, the cause of Cavalier's failure to retire the bank debt for which the investors had partial and contingent liabilities. The immediate impact on the investors was that they had to respond to demands from their bankers, in some cases actual demands, but, in most cases, demands anticipated with certainty. As I shall attempt to explain when I provide an assessment of damages in the alternative, it would be artificial to consider this injury and the requirement to make good on the letters of credit in isolation from the purposes for which the investors put up the letters of credit. They generally intended to invest in the company when it went public and most intended to invest at levels consistent with the limit of the letter of credit delivered on behalf of each. In effect, each intended to replace liability under the letter of credit partially or totally with the cost of shares and debentures publicly traded. Viewed this way, the investors still lost opportunities distinct from the injuries to the corporation. They lost the trading value of the shares issued to them as compensation for their exposure under the letters of credit, which would be a loss identical to the injury to the corporation, but they also lost the reasonably anticipated liquidity of the shares, and they lost the opportunity to convert their exposure under the letters of credit into

investment at whatever level they might choose. Though factually related to any claim that Cavalier might have advanced, the claims of the present plaintiffs are personal rather than corporate.

Negligence: Duty of Care

[228] Allowing that their position is new or untested, plaintiffs' counsel contend one owes a duty of care to others foreseeably harmed where one intentionally wrongs another in a position such as Mr. Coughlan and in a manner such as that found by Justice Nunn. In effect, secondary liability to third parties in negligence is grafted upon the primary liability to Mr. Coughlan for the intentional wrongs. This duty of care is advocated on the basic principles articulated in *Anns* v. *Merton London Borough Council*, [1978] A.C. 728 and in light of the Canadian approach to recovery for pure economic loss. It is opposed by the defendants upon the same basic principles and by reference to many authorities on pure economic loss. Much informed by the references supplied and the arguments made by counsel, I will attempt to explain my understanding of the law by referring to authorities that seem to me most pertinent before attempting to explain my opinion that there was no duty of care owed by the defendants to the plaintiffs in this case.

[229] It is established law in Canada that the two part test described at p. 751-752 in *Anns* is to be applied in determining the existence of a duty of care: *Hercules Managements Ltd. et al.* v. *Freed et al*. (1997), 146 D.L.R. (4th) 577 (S.C.C.) at para. 19. Special considerations will apply in cases where recovery for pure economic loss is sought, but *Anns* supplies the framework for determining duty of care even in cases of pure economic loss: *Hercules*, para. 21. The *Anns* test was restated by Justice Wilson in *City of Kamloops* v. *Nielsen et al.* (1984), 10 D.L.R. (4th) 641 (S.C.C.) at p. 662-663:

> ... in order to decide whether or not a private law duty of care existed, two questions must be asked:
>
> (1) is there a sufficiently close relationship between the parties (the local authority and the person who has suffered the damage) so that, in the reasonable contemplation of the authority, carelessness on its part might cause damage to that person? If so,
>
> (2) are there any considerations which ought to negative or limit (a) the scope of the duty and (b) the class of persons to whom it is owed or (c) the damages to which a breach of it may give rise?

See also, *Hercules* at para. 20. As I said when discussing the rule in *Foss* v. *Harbottle*, *Hercules* raised the question of liability of corporate auditors to shareholders in negligence where audit reports were alleged to have been carelessly

prepared. After discussing *Anns*, its subsequent rejection by the House of Lords and its application in Canada and New Zealand, including to cases of pure economic loss, Justice LaForest concluded his discussion with this:

> Whether the respondents owe the appellants a duty of care for their allegedly negligent preparation of the 1980-82 audit reports, then, will depend on (a) whether a *prima facie* duty of care is owed, and (b) whether that duty, if it exists, is negatived or limited by policy considerations. [para. 21]

In cases of allegedly negligent misrepresentations, even the *prima facie* duty of care determined at the first step of *Anns* is not established in exactly the same way as the *prima facie* duty of care in cases of injury to the person or to tangible property. In cases of harm to person or property, the inquiry "will always be conducted under the assumption that the plaintiff's expectations of the defendant are reasonable." (para. 25), but recovery for pure economic loss on account of a representation demands an inquiry, at the first level of the *Anns* test, into reasonable reliance (para. 24, see also para. 41). However, enquiries for the purpose of determining the existence of a duty of care into, "(a) the defendant's knowledge of the plaintiff (or the class of plaintiffs) and (b) the use to which the statements are put" (para. 30) are proper to the second branch of the test, not the first (see also, para. 37). The court in *Hercules* found a *prima facie* duty of care, but rejected duty of care on the second branch of *Anns*

because of indeterminate liability. On the facts of that case, the auditor knew the identities of the shareholders, but shareholders' use of the audit report was not within the purpose or transaction for which it was prepared. The "use of the defendant's statement for a purpose or transaction other than that for which it was prepared could still lead to indeterminate liability" (para. 46).

[230] *Martell Building Ltd.* v. *Canada*, [2000] 2 S.C.R. 860 raised the issue of a duty of care owed by parties in negotiation of a commercial contract. The Department of Public Works was a tenant, and its lease was coming up for renewal. The government entered into negotiations with the landlord. However, the government eventually put its requirements for space out to tenders and it rejected the landlord's bid even though it may have been the lowest. The trial judge had dismissed claims of the landlord in contract, which claims were premised on an implied term said to have arisen in the lease that had come up for renewal and on an alleged collateral contract. She also rejected an argument that Canadian law recognizes an obligation to conduct negotiations in good faith. However, she found that the relationship between the parties was sufficiently proximate to give rise to a duty of care, and she found the government had breached the duty by the manner in which it had conducted the negotiations. She found that the landlord had failed to establish

causation, and she dismissed the action. The Federal Court of Appeal disagreed with the trial judge on causation, and it found negligence not only in the conduct of the negotiations, but also in the government's conduct of the tender. These two grounds of negligence framed the issues before the Supreme Court of Canada (para. 31). The court rejected both. In respect of the first, the court considered "Does the tort of negligence extend to damages for pure economic loss arising out of the conduct of pre-contractual negotiations?" (para. 31). The decision of the court in *Martel* was delivered jointly by Justices Iacobucci and Major. At para. 35 they said,

> As a cause of action, claims concerning the recovery of economic loss are identical to any other claim in negligence in that the plaintiff must establish a duty, a breach, damage and causation. Nevertheless, as a result of the common law's historical treatment of economic loss, the threshold question of whether or not to recognize a duty of care receives added scrutiny relative to other claims in negligence.

They referred to the early common law position which "did not allow recovery of economic loss where a plaintiff had suffered neither physical harm nor property damage." (para. 36) and they observed at para. 37,

> Over time, the traditional rule was reconsidered. In *Rivtow* and subsequent cases it has been recognized that in limited circumstances damages for economic loss absent physical or proprietary harm may be recovered. The circumstances in which such

> damages have been awarded to date are few. To a large extent, this caution derives from the same policy rationale that supported the traditional approach not to recognize the claim at all. First, economic interests are viewed as less compelling of protection than bodily security or proprietary interests. Second, an unbridled recognition of economic loss raises the spectre of indeterminate liability. Third, economic losses often arise in a commercial context, where they are often an inherent business risk best guarded against by the party on whom they fall through such means as insurance. Finally, allowing the recovery of economic loss through tort has been seen to encourage a multiplicity of inappropriate lawsuits.

Following LaForest J. in *Canadian National Railway Co.* v. *Norsk Pacific Steamship Co.* (1992), 91 D.L.R. (4th) 289 (S.C.C.), Justices Iacobucci and Major recognized five categories of cases that have given rise to "potentially compensable economic loss: 1 The Independent Liability of Statutory Public Authorities; 2 Negligent Misrepresentations; 3 Negligent Performance of a Service; 4 Negligent Supply of Shoddy Goods or Structures; 5 Relational Economic Loss" (para. 38). There is a presumptive exclusionary rule in relation to one type of relational economic loss, contractual relational economic loss (para. 41), which involves "a plaintiff's contractual relationship with a third party to whom the defendant is already liable for property damages..." (para. 41). This subcategory receives "unique treatment" (para. 43) and has, thus far, been restricted to cases where the claimant had a property interest in damaged property, general average cases in shipping and cases where the claimant and the property owner were in a joint venture (para. 44). Otherwise, the categorization of cases in which pure economic losses have been recovered assists in

"grouping together cases that raise similar policy concerns" but, at that, the categories are "merely analytical tools" (para. 45). New cases are to be decided according to "the flexible two-stage analysis of *Anns* ..." (para. 46). The court was satisfied that the first level of *Anns* established a *prima facie* duty of care in the circumstances of *Martel* (para. 53). However, "Notwithstanding our finding of proximity above, there are compelling policy reasons to conclude that one commercial party should not have to be mindful of another commercial party's legitimate interests in an arm's length negotiation." (para. 55) Unlike *Hercules*, indeterminancy of liability was not the primary consideration in *Martel.* However, Justices Iacobucci and Major did observe "The scope of indeterminate liability remains a significant concern underlying any analysis of whether to extend the sphere of recovery for economic loss." (para. 57)

[231] The categories referred to by the Supreme Court are not of much assistance for determining the issue of a duty of care in this case. Perhaps, the position put by counsel for the plaintiffs would logically fit within the general category of relational economic losses but such would involve an extension to cases where the third party's reputation is damaged. The situation is outside the physical injury to property in *CNR* v. *Norsk*, which was not a case of contractual relational economic losses, and it is outside the reference to physical injury to property made by Justices Iacobucci and Major in defining contractual

relational economic losses. I do not understand the defendants to have submitted that the asserted duty of care raises the presumption against recovery in cases of contractual relational economic loss, and the plaintiffs have submitted for a determination based upon *Anns*.

[232] In 1988, Westminer knew Mr. Coughlan to have a following of investors with cash. Except for Mr. Hansen and Mr. McCartney, the identity of these investors and the amounts they had for investment were unknown. Westminer was aware that Mr. Coughlan's initial plans involved establishing a publicly traded, junior resource company with the financial assistance of his following of investors. That knowledge became altered and refined when Westminer learned of the acquisition of Cavalier Energy and when it received the detail of information found in the circular issued by the then directors of Cavalier Energy following the take-over bid and when it learned that Cavalier Energy was being taken private. It knew that the acquisition had been financed by two bank loans and that there were letters of credit issued in respect of one of them. It knew the cost of acquisition to have been $25 million and it knew that some money had been put up or put at risk by Coughlan, Hansen and McCartney, which it estimated at $10 million. While I find that Westminer knew it to be likely that others in Mr. Coughlan's following either had invested or would be

given an opportunity to invest in something associated with the business of Cavalier Energy, in July or August 1988, Westminer did not know whether other investors had already put money into or put money at risk for the private corporation or whether they would be invited to do so at a later time or whether they would be invited to invest at a time when the corporation would seek to go public. One in the position of Westminer would know it was possible others had invested already, but other possibilities would equally present themselves. As to the nature of the business, Westminer knew Mr. Coughlan to be interested in junior resource ventures, it knew Cavalier Energy to be a junior oil and gas corporation and it knew certain details of the corporation's present operations and status as disclosed through the directors' circular. However, it also knew that there was a parent corporation. It did not know whether Cavalier Energy was the only business involved or whether other businesses had been founded or acquired under the parent. And, it did not know the immediate plans or activities of the parent, whether it would continue the business of Cavalier Energy as it then appeared or whether it was seeking to expand the business through significant purchases of assets, through acquisitions or through mergers. A person in the position of Westminer would know it was possible that some of Mr. Coughlan's followers had invested in the business of Cavalier

Energy as such or in combination with other like businesses, but the possibility would equally appear that the investors were to be given an opportunity to invest in future. As regards foreseeable risk, Westminer had information that Mr. Coughlan was promoting a junior oil and gas business, it must have known Mr. Coughlan would also be involved in the management of the business, and it had to know that access to the public markets would be in the offing. The initiation of a junior oil and gas venture, either as a continuation of Cavalier Energy without the financial resources and management style of a large corporation like Dome or as a new business of which Cavalier Energy was to be a stepping stone, would be vulnerable to the health and reputation of its main promoter and manager. A person in the position of Westminer would see that serious damage to the business reputation of Mr. Coughlan could result in damage to whatever venture he was promoting, not only by damaging whatever corporations he was leading but also by damaging the opportunities of any investors to realize on their investments through the public markets. It was reasonably foreseeable that private investors had put up money or had put money at risk in a junior oil and gas business being initiated by Mr. Coughlan, and it was reasonably foreseeable that serious damage to Mr. Coughlan's business reputation would cause loss to those investors. In my opinion, there

was a sufficiently close relationship between the Westminer companies and the Cavalier investors that, in the reasonable contemplation of Westminer, carelessness in making serious allegations against Mr. Coughlan would cause damage to the investors. While a duty of care is indicated *prima facie* at the first level of the *Anns* test, the second level is, in my opinion, preclusive of a duty of care.

[233] The potential for indeterminate liability excludes the kind of duty asserted on behalf of the plaintiffs. If that element of public policy was not determinative of the present case then other policy considerations would require exploration. I will briefly mention these other concerns before turning to indeterminate liability. They involve, firstly, a diffuse concern that the asserted duty of care would amend the laws of economic torts by grafting onto what are intentional torts an additional liability in negligence and, secondly, specific concerns that the asserted duty of care conflicts with some well established legal policies. As to the first, note that the plaintiffs frame the duty in a narrow way. It is not asserted that one in a position like that of Westminer bringing an action in fraud against a person in a position like that of Mr. Coughlan owes a duty to third parties in positions like those of the plaintiffs. Nor is such asserted in respect of complaints to securities regulators or publication of fraud allegations or

otherwise. The plaintiffs recognize that a duty along these lines would be too broad. Rather, they say there is a duty upon those who sue in fraud, complain to securities regulators, *et cetera*, in order to do harm to persons in positions like that of Mr. Coughlan. The assertion contains this: those who set about to commit civil conspiracy or to interfere with economic relations must take care not to harm third parties who would forseeably suffer loss along with the intended victim of the intentional tort. Defamation, conspiracy, unlawful interference with economic relations and other intentional torts all carry their own limits of liability. Perhaps those limits should be expanded in some cases, perhaps not. But, it seems to me that the questions of policy that would arise should be confronted directly in light of the law surrounding an applicable intentional tort rather than indirectly by grafting negligence onto an intentional tort. As for the second area of concern, these arise depending on which of Westminer's efforts are emphasized and the concerns involve access to the civil justice system, candid reports to investigative authorities and freedom of speech. As the Court of Appeal said in the Seabright case, the most serious accusations against Westminer concerned the institution of proceedings in Ontario and the amendment of the statement of claim to allege fraud against the outside directors. As indicated by Justice Nunn at para. 633 of his decision and

by the discussion of immunity beginning at para. 85 of the decision of the Court of Appeal, concerns respecting access to the system of civil justice have been expressed even in reference to intentional torts grounded on the malicious institution of a civil action. The policy in favour of access indicates caution, if not preclusion, where the institution of civil proceedings grounds a claim in negligence. I have found that the approaches made to the OSC and, for the purposes of the present action, permitting directors' and officers' insurance to lapse, were indicative of Westminer's animus against the former directors, but they were not the cause of any loss to the present plaintiffs. If the approaches to the OSC were more prominent for the present issue, I would suggest that the laws of defamation providing absolute privilege for certain reports to public authorities indicate one policy reason that may preclude a duty of care in making such reports. Further, the freedom of expression, as limited by the law of defamation, should be considered to the extent that Westminer's public announcement grounds the present claim in negligence. I am not concluding that any of these concerns preclude the asserted duty of care. Brief mention of them is enough because I think the asserted duty is precluded by the policy so frequently at issue where a duty of care would lead to recovery for pure economic loss, indeterminate liability.

[234] As I said, Westminer did not know the identity of the present plaintiffs or of the others who invested in Cavalier by putting their money at risk through bank letters of credit with personal recourse. Nor did it know much of the class of these investors. It knew someone put up letters of credit and that Cavalier was considering equity financing to retire some bank debt and that Mr. Coughlan had a following of investors, but it did not know if the investments had been made by way of equity or credit. As I said, Westminer did not know whether any investment was present or reserved for the near future and it did not know the extent of any investment, whether it involved part of the purchase price for Cavalier Energy, all of the price or some broader business being established then or some broader business to be established using Cavalier Energy as a stepping stone. The actual extent of persons and amounts encompassed by a duty of care of the kind proposed would be indeterminate. The proposed duty of care would be owed on account of actions taken against the CEO and intended promoter of a private corporation with plans to go public in the offing. Though the number of shareholders in the private company would be limited by the securities laws of several provinces, the duty encompasses creditors and , I would say, it cannot logically be contained to creditors who invest with a view to taking shares, but would have to extend to those who invest as senior

creditors by way of loans as well as junior creditors whose loans are nearer to equity. Similarly, the extent of investment encompassed by the proposed duty of care is indeterminate. While the business was that of a junior oil and gas company, the extent of the business was not fixed and investment, by equity or loan, may have been becoming greater than the Cavalier Energy purchase price could describe.

[235] In conclusion, the plaintiffs seek recovery of pure economic loss and the duty of care they propose attracts the "added scrutiny" referred to in *Martel*. The known categories for recovery of pure economic loss do not assist. The new duty proposed by the plaintiffs does not pass the second level of the *Anns* test because a duty of that kind would lead to indeterminate liability.

ALTERNATIVE FINDINGS

Additional Findings of Fact

[236] I have found against the plaintiffs as regards the issues of liability. In case I have erred in that regard, I will provide my findings and reasons respecting the issues that would have arisen had I found liability. Those issues concern causation, parties, mitigation and damages. Factual findings already stated are relevant to these subjects, but it is necessary to supplement what has already been said, especially with regard to the particular investments, actions and losses of each plaintiff.

[237] The context of this discussion includes the approaches made by Mr. Coughlan or others to potential investors in the spring of 1988, the subscription agreements and the amendments in July 1988. To recapitulate. Investors were approached by various means and many of the plaintiffs attended a meeting held in Halifax during the spring of 1988 at which they learned about Cavalier and the then conceived plan for financing of the take-over to be followed by more permanent financing in what was then planned to be a combination of private placement and public offering. All potential investors appear to have received the document prepared by Mr. Coughlan describing two stages of

financing and the plan that Cavalier should be the cornerstone of a much larger enterprise to be developed through expansion. Various investors, including all of the plaintiffs, signed subscription agreements by which one of the bank loans required for the purchase of Cavalier was backed by letters of credit in limited amounts issued by each investor's bank to the National Bank. The letters were to terminate in July 1988, but Cavalier could cause them to be automatically extended to October if the second phase of financing could not be completed by July. The compensation under the subscription agreements was common shares in Cavalier according to the amount of the investor's letter of credit and doubling if the letter was extended to October. After sufficient amounts had been raised through the two bank loans and take-over was assured, investors met again with Mr. Coughlan and others in May 1988. They were informed of progress made towards retention of underwriters and they were advised that the IPO would be launched during the summer. In July 1988 all investors were asked to execute amended subscription agreements and all did so. The major amendment was to release rights to double common shares upon extension of the letters of credit. The amended subscription agreements also involved Cavalier's express promise to proceed with the IPO and they showed that there

would be no second private placement. Investors were asked to indicate how much they planned to invest under the IPO.

[238] On August 10, 1988 many of the investors gathered at Halifax to discuss the impact of the Westminer suit upon them. It was generally seen that prospects for the IPO were grim, at least in the short term. Mr. Coughlan chaired the meeting but, at a point, he and other former Seabright directors left the room. The plaintiff, Mr. Sumner Fraser, took over as chair and the topic was whether the investors should accept Mr. Coughlan's offer to withdraw from management of Cavalier. The decision was unanimous that he should remain. Generally, investors remained confident in Mr. Coughlan and saw his involvement as necessary to a successful public offering. Many investors had invested because of Mr. Coughlan's perceived ability to make a success of an oil and gas enterprise founded on the business and assets of Cavalier. They felt they had invested more in Mr. Coughlan than in the present business and physical assets. At the meeting, Cavalier's solicitors provided an opinion that any judgment recovered by Westminer could not be enforced directly against assets of Cavalier. This provided little comfort. The investors had been expecting an IPO that would immediately relieve their liabilities in connection with the letters of credit. To the extent they had intended to make more

permanent investments in Cavalier, investors would have relied more on Mr. Coughlan and future business rather than the present physical assets of Cavalier.

[239] Another meeting was held in early September 1988, where, among other things, Mr. McGrath was introduced. Investors may have been made aware of Levesque's offer of a best efforts arrangement with the reduced target and various stipulations. In any case, investors did not seek to intervene in management's decision to reject such an offer. A number of the plaintiffs recalled indications that the IPO would be put off for almost six months, a decision consistent with the recommendation made by Wood Gundy at the time. The National Bank issued its letters of late September advising of its intent to call on the letters of credit in October. The investors also reviewed a letter from Mr. Coughlan respecting the special rights offering. No one decided to take action against Cavalier or to encourage the board to liquidate Cavalier assets to pay debt. In one way or another, all plaintiffs took shares or debentures in replacement of some or all of that liability. And, some made substantial additional investments in Cavalier.

[240] The parties have agreed on much as to the quantification of each plaintiff's loss for the purpose of assessing damages. Outstanding issues include whether a

calculated loss on the July 1988 shares should be included. For those who made additional investments in Cavalier, the inclusion of losses on those investments is in contest. In some cases, the defendants assert a plaintiff could have achieved a better tax treatment of losses and they argue the difference should be deducted from the calculation. In some cases the investment was made on behalf of or was transferred to a corporation related to a plaintiff or was transferred to an RRSP account, and there are issues as to whether the plaintiff in his or her own right suffered the loss. It is also argued that some plaintiffs could have better mitigated their losses by investing in flow-through shares rather than paying the balance of a letter of credit in cash. In two cases, there is a dispute respecting calculation of the loss. Finally, there was an issue respecting the *Survival of Actions Act* with respect to the two investors who are deceased, but I understand the estates have conceded they cannot claim under the heads brought into issue on that score. The circumstances of each plaintiff need to be examined.

[241] Michael Bradshaw is in his mid-fifties. He is a resident of Antigonish and a business man who has owned and operated a general insurance agency for many years. He invested in Seabright and Seabrex from the earliest stages and realized a profit of several hundred thousands. He heard of the opportunity to

invest in Mr. Coughlan's oil and gas venture from Colin MacDonald. Mr. Bradshaw attended the first meeting of potential investors, which I earlier described. Although "Stage 2" in the document provided at the meeting calls firstly for a private placement to be followed by a public offering, Mr. Bradshaw affirmed that at that first meeting it was made clear that the letters of credit were to be replaced through a public offering. Based on the information he received, he believed a public offering was imminent and he considered the proposed interim financing to be a good investment. He executed a subscription agreement and arranged a letter of credit from the Canadian Imperial Bank of Commerce for $150,000. He executed an amending agreement in July 1988, giving up his right to double the common shares to which he was entitled on account of the automatic extension of the letters of credit. In part of this document providing "the undersigned intends to subscribe to $____ Canadian of the Public Offering", Mr. Bradshaw entered "N/A". On the stand he said, and I accept, that he had not then made up his mind as to his participation in the public offering. Mr. Bradshaw attended the August 10, 1988 meeting and supported the decision that Mr. Coughlan should continue as CEO and promoter. He also attended the September 7, 1988 core group meeting. He received a call from his bankers who told him the National Bank

had called on the letter of credit and his bank would honour the call. He paid $150,000 under the special rights offering and Cavalier caused this money to be applied to the National Bank debt, thus causing the CIBC letter of credit to be released. He did not make inquiries of Cavalier concerning its reducing his exposure to other means. He chose the special rights offering and did not believe that Cavalier otherwise had the ability to respond to any demand he might have made for the $150,000 it owed to him on account of its failure to retire the National Bank debt. In addition to the shares and debentures Mr. Bradshaw obtained through the special rights offering, Mr. Bradshaw invested $25,000 in flow-through shares under the offering memorandum of December 1988. He did so because of the tax advantages and because he thought it positive that Cavalier should proceed with explorations. I accept Mr. Bradshaw's evidence on all matters of importance. His claim was quantified at $113,600 exclusive of interest and gross-up for income tax. As far this quantification is concerned, I understand the defendants take issue only with the inclusion of losses on account of the flow-through shares, the inclusion of a claim for the after-tax value of the so-called bonus shares and the absence of an adjustment for the possibility Mr. Bradshaw may use remaining loss carryovers of $16,109 in future.

[242] Brayman Enterprises Limited is a holding company that was owned by William Hardman before he did an estate freeze. Mr. Hardman is a Halifax businessman who has been involved in commercial real estate for many years. He did not invest in Seabright. He was introduced to the Cavalier investment by Robert Hemming and he invested after meeting with a few people including Mr. Coughlan. Mr. Hardman explained that he makes investment decisions based upon the people in the corporation, "I invest in people", and he said he invested in Mr. Coughlan. Brayman subscribed for $200,000 by way of letter of credit and this was provided by the Royal Bank of Canada. Mr. Hardman attended the May 31, 1988 meeting of investors. On behalf of his company, Mr. Hardman executed an amending agreement in July 1988 and he indicated that the company would subscribe for a minimum of $50,000 in the public offering, subject to his examination of the final prospectus. On the stand, he said he planned to do $50,000 as a more permanent investment but he wanted to study the prospectus before making a final decision on the amount. Brayman did not pay the Royal Bank on account of the letter of credit. The obligation was reduced by Cavalier under the special rights offering in which Brayman invested $107,000, and Mr. Hardman was successful in negotiating with Cavalier for it to pay off the balance. I accept Mr. Hardman's evidence.

Brayman's claim is quantified at $68,482 and, as far as quantification goes, I understand the defendants only to take issue with the inclusion of the after-tax value of bonus shares.

[243] Dr. James Collins is a physician, who has been in practice at Port Hawksbury for over twenty years. He invested large sums in Seabright, and was assisted by Mr. Coughlan to liquidate some of his investments when Dr. Collins faced financial difficulties as a result of the October 1987 stock market crash. He attended all four meetings in the spring and summer of 1988 and he attended the February and May 1992 meetings. His rather precise recollection has been of assistance in the findings I have made regarding the content of meetings. Although he was somewhat irritable and argumentative during cross-examination, I accept Dr. Collins' evidence. Dr. Collins signed a letter of confidentiality and attended the first meeting. He understood he was being asked to back bridge financing to purchase Cavalier, which was intending to proceed with an equity issue. Dr. Collins signed a subscription agreement for $700,000 and the CIBC put up a letter of credit backed by his liability. He attended the May 1988 meeting, where detail was provided as to how Cavalier was going public, including the involvement of both Levesque and Wood Gundy, information consistent with the planned $27 million to $30 million

offering and advice of an IPO during the summer. In July 1988, Dr. Collins signed amended subscription agreements totalling $700,000 and he chose to arrange a cash payment in exchange for a promissory note rather than to continue with the letter of credit. He attended the August and September 1988 meetings, and he took $700,000 in shares and debentures under the special rights offering in exchange for Cavalier's promissory note. He took the special rights offering rather than making a demand on the note. Those involved were trying to hold together and to get an IPO launched. For Dr. Collins, it would have been "crazy" to make demands on Cavalier. Dr. Collins or the trustee of his RRSP invested a further $249,900 under the January 1989 offering memorandum, $127,000 under the May 1989 offering memorandum and a further $50,000 in 1990. He said he did so in order to help the company. The defendants argue that Dr. Collins cannot claim for losses on account of shares held by the trustee of his RRSP. It is necessary to set out some details regarding the involvement of his RRSP. Dr. Collins wanted to invest under the January 1989 offering memorandum by way of his RRSP. The difficulty was that the RRSP could hold shares but not debentures, at least according to Dr. Collins' understanding. So, Dr. Collins took the debentures in his name. The RRSP paid the entire investment of $249,900 but it only received about

$75,000 in shares. To make up the difference, Dr. Collins transferred shares he had acquired under the initial subscription agreement or under the special rights offering at a book value of about $175,000. I accept the evidence of Dr. Collins but I do not necessarily accept his opinions or calculations. His loss has been calculated at $711,073 and the outstanding issues concerned inclusion of an amount for losses on the bonus shares, inclusion of losses on the additional investments, the possibility Dr. Collins miscalculated his loss on flow-through shares by entering the tax cost of Canadian Exploration Incentive Program grants in two places, his failure to use loss carryovers in 1995 when he realized a capital gain, and, the involvement of his RRSP. Based on post-trial submissions, it appears that the CEIP issue has been resolved. If I have misunderstood, I am open to providing supplementary reasons.

[244] Dr. Michael Cook is a surgeon who lives in Truro. He invested in Seabright and made something under $100,000. He became interested in Cavalier through Mr. Coughlan or an investment adviser. He signed a subscription agreement and the CIBC issued a letter of credit on his behalf in the amount of $350,000. He said this was to be a short term investment and Cavalier was to go public. The investment looked favourable, especially with Mr. Coughlan being involved. Dr. Cook agreed to the amendment to the subscription

agreement and, on that document, he noted that he would probably invest $100,000 to $200,000 more permanently through the public offering. He wrote that the decision would depend on the final prospectus. On the stand, he said he would be interested in seeing the share price. He was interested in quick liquidity and if he thought the price was too high he would not invest as much. He attended the August 1988 meeting. He said the investors felt it would be inappropriate for Mr. Coughlan to resign and the meeting fully supported him. He invested $150,000 in the special rights offering and most of the balance of his letter of credit was retired through further investments in Cavalier. The CIBC extended his letter of credit from time to time, but the bank eventually set off $33,334 from his account to retire the balance. The first investment of $150,000 is consistent with the indication on the amended subscription agreement that Dr. Cook was prepared to invest $100,000 to $200,000 more permanently. In addition to investments used to pay down the obligation under the letter of credit, Dr. Cook made an investment of $50,000 in Cavalier but he did not seek to have this applied to release the letter of credit. Dr. Cook used some of his capital losses in Cavalier to reduce income tax in past years but he still has $74,000 available. I accept the evidence given by Dr. Cook. His loss is quantified at $272,304. In issue are the capital loss carryforwards, the

additional investment, the bonus shares and the failure to have the bank liability extinguished when the last investment was made.

[245] Gloria Coughlan is Mr. Coughlan's sister-in-law. She works in health records administration and was an investor in Seabright for about $75,000. She did not attend the first meeting of prospective investors for Cavalier. She was likely out of town at the time and authorized her husband to sign a subscription for her. She read the document distributed in the beginning to prospective investors and she understood Cavalier was to go public. Her husband signed subscriptions for her and for himself, $50,000 each. Instead of a letter of credit, they dealt directly with the National Bank, who took guarantees and a pledge of guaranteed investment certificates. The guarantees came due in October 1988 and the bank took the GICs, retiring the obligation. She participated in the special rights offering. She made an additional $50,000 investment in September 1990. She has capital loss carryforwards respecting her losses in Cavalier. I accept her evidence. Her claim is quantified at $52,802 with the defendants submitting for adjustments on account of the capital loss carryforward, the amount attributable to the additional investment and the inclusion of a loss on bonus shares. There is also a question as to whether she ought to have claimed a capital loss in 1990.

[246] James Coughlan manages his family's retail monument business. He is the brother of Terry and the husband of Gloria. Mr. Coughlan invested in Seabright and realized a profit of about $100,000. His brother introduced him to the Cavalier investment, he attended the first meeting and his understanding was that Cavalier was to go public after the initial financing. As I said, Mr. Coughlan signed a subscription agreement for himself as well as one for his wife. They participated in the special rights offering rather than to make demands on Cavalier, and their GICs were used to pay the bank. Mr. Coughlan said he took the special rights offering because Cavalier did not have the money to repay the investors and the obligations had to be turned into long term debt in order for the company to survive. As with Ms. Coughlan, Mr. Coughlan made an additional investment of $50,000. He said he did so because Cavalier needed money, because the notes issued under that particular offering bore a 16% return and he regarded it then as a safe investment. I accept Mr. Coughlan's testimony on these subjects, and I have also relied on it in making my findings as to what transpired at the various meetings he attended. Mr. Coughlan's claim was quantified at $50,467. The outstanding issues are the same as with Gloria Coughlan's claim.

[247] Gerald Coyle has been an investment dealer for over forty years. He works with Wood Gundy and lives in Halifax. He invested in Seabright from the time of its earliest offerings and made a profit of about $400,000 after tax when he sold to Westminer. He affirmed that Cavalier was supposed to go public after the initial investment and the purchase. He executed a subscription agreement and the CIBC put up a letter of credit on his behalf for $150,000. He also signed an amended subscription in July 1988 and he chose the option of putting up cash in exchange for a company note. At that time he indicated that he intended to invest the same amount, $150,000, in the public offering. I accept Mr. Coyle's testimony. His loss has been calculated at $87,249 and the only issue concerns the inclusion of an after-tax value for the bonus shares.

[248] Mr. Alan Dand lives in Calgary at this time, although he has lived in twenty-six different cities on account of his background in retail trade. He invested in Seabright and decided to invest in Cavalier after attending the first meeting. He subscribed for $500,000 initially but soon decided to increase his investment to $700,000. The CIBC issued a letter of credit on his behalf. He signed an amended subscription agreement and indicated his intention to invest $400,000 more permanently when the public offering would become available. He took $400,000 under the special rights offering and he also took $201,600 under the

December 1988 offering memorandum, which also went in reduction of his letter of credit. The letter was extended from time to time, but eventually Mr. Dand paid cash to retire the balance of $98,400. He felt he had no other option but to invest in Cavalier to try to recoup his investment. He did not take action against the company because there were not sufficient funds in the company. I accept his evidence. His claim was quantified at $396,091 and there are issues concerning the timing of his tax treatment of losses and the inclusion of an amount attributed to the bonus shares. Also, it is argued that he ought to have realized tax benefits by purchasing flow-through shares rather than paying the balance of the letter of credit directly.

[249] We regretted the death of Mr. Robert Dauphinee early in the trial. He did not have the opportunity to testify. However, a transcript of his discovery testimony, his answers to some interrogatories and some documents relevant to his claim are before me. Mr. Dauphinee ran a security firm in Halifax for many years. He invested in Seabright and realized a small gain. An investment adviser told him of Cavalier. It does not appear he attended the first or second meeting of investors, but he was present for the August 1988 meeting concerning the Westminer suit. He subscribed for $250,000 and the Royal Bank of Canada put up the letter of credit. His amended subscription

agreement includes a question mark in the place where the investor was requested to indicate how much he might put into the public offering. Mr. Dauphinee owned a holding company called Armcrescent Holdings Limited. That company put up $166,666 to reduce Mr. Dauphinee's liability to the Royal Bank by way of the special rights offering. It appears the balance, $83,334, was paid personally by him through an April 1990 investment and that he invested an additional $50,200 through the December 1988 and May 1989 private offerings. The claim has been quantified at $173,380 of which $96,635 is attributable to the Armcrescent Holdings payment. The outstanding issues are recovery for the additional investments, inclusion of losses on the bonus shares and the involvement of Armcrescent Holdings. An issue concerning the *Survival of Actions Act* appears to have been resolved.

[250] Mr. Murray Edwards lives in Wolfville and he is semi-retired after selling his interest in a fast food business. He made a small investment in Seabrex and he became interested in Cavalier through a friend. He attended the first meeting and affirmed that the discussion was consistent with the document provided by Mr. Coughlan at the time. He signed a subscription agreement for $100,000 and the Bank of Montreal put up a letter of credit for him. His amended subscription agreement indicates he intended only to invest $20,000 in the

public offering. He testified that that was all he felt he could afford for the longer term investment. Mr. Edwards attended the August 1988 meeting and agreed with the consensus that Mr. Coughlan should remain. He said that Mr. Coughlan was the reason he had invested in the first place. Mr. Edwards invested $50,000 in the special rights offering and $50,000 under the December 1988 offering memorandum. Of course, Cavalier directed these funds in reduction of that portion of the National Bank debt secured by Mr. Edward's letter of credit. I accept his evidence. His claim has been quantified at $49,084 and the only issue is the inclusion of an amount in respect of the bonus shares.

[251] Mr. Sumner Fraser testified for several days. As earlier stated, he became a director of Cavalier in 1989 and part of the reason for this was that he had no involvement in the Seabright suits or the events giving rise to them. My acceptance of his evidence reflects in some findings I have made concerning the course of Cavalier's business after the take-over, especially towards the end when Mr. Coughlan was more involved in the Seabright suit and Mr. Fraser shouldered much of the duties of management. Mr. Fraser is a businessman who lives in Moncton. He operated a sizeable retail chain selling Goodyear tires and he became a director of Goodyear's Canadian subsidiary. He explained that most of his investment decisions are based on people. In

Cavalier, he saw that Mr. Coughlan would be putting in a great deal of his own time and money, and yet was inviting others into the investment on the same terms as applied to him. Also, the company was to go public and Mr. Fraser's investment was to become liquid. Further, he believed the company had assets to be realized and it would have the capacity to realize on opportunities quickly because, in the oil and gas field, cash and absence of debt are positive. He signed a subscription agreement for $300,000, and the CIBC put up his letter of credit. Mr. Fraser takes exception to "bonus" in "bonus shares". These were to be his compensation for providing the letter of credit, and bonus suggests something secondary or voluntary. His amended subscription agreement indicates he was prepared to invest $228,000 in the public offering. He attended the August 1988 meeting and chaired part of it, and my findings in that regard are based on his evidence and that of others. At the end of September, the National Bank advised Mr. Fraser of its intention to call on the letters of credit. His investment company, Sumner Capital Corporation, put $300,000 into the special rights offering. The subscription agreement, the amended subscription agreement and the letter of credit refer to Mr. Fraser rather than Sumner Capital. However, Mr. Fraser testified that he always intended to put the investment through his company. Late in November 1989

Mr. Fraser caused the "bonus" shares that had been issued in his name to be transferred to Sumner Capital. The nature of the relationship between the investment and Sumner Capital was the subject of detailed inquiry during Mr. Fraser's cross-examination, including references to his evidence on discovery. I take Mr. Fraser to have said that the investment was supposed to have been in Sumner Capital and that ultimate liability under the letter of credit was to be for the account of Sumner Capital. He was acting as agent. Sumner Capital made additional investments in Cavalier in 1988, 1989 and 1990 totalling $504,984. Another company, Willoughby Investments Limited, invested $175,340 in 1989. Mr. Fraser is an officer and the manager of this holding company, his mother is the sole voting shareholder and various family members hold non-voting shares. Sumner Capital invested heavily in real estate and it got into trouble during the last recession. It made a proposal in bankruptcy in 1996 and Mr. Fraser said the proposal was successful. Clause 21 of the proposal provided:

> That the other investments of Sumner Capital Limited, including but not limited to the investments in Millville Investments, Holiday Property bond, Seiger and Ferlander and CRRL Ltd., will be disposed of by Sumner Capital Limited at values to be agreed with the Trustee, and any funds derived therefrom shall be paid to the Trustee for distribution in accordance with the terms of this proposal.

Clause 25 provided that Sumner Capital would cease financing certain suits including the action initiated against "Westminer Canada Limited et al". Mr. Fraser has always been the first plaintiff in this action, and Sumner Capital or Willoughby have never been parties. At discovery, Mr. Fraser affirmed that no claim was being advanced by Sumner Capital, and his counsel added that no claim was advanced by Willoughby either. Lately, Mr. Fraser obtained an assignment of the Sumner Capital claim from the trustee under the proposal, but Mr. Fraser testified that the proposal had been successful and I have not seen an assignment from Sumner Capital. Sumner Capital's loss has been quantified at $553,561 and Willoughby's at $99,528. The issues involve Mr. Fraser's interest in the claim, applicability of the small business tax rate in the Sumner Capital calculation, loss on account of the so-called bonus shares, capital or income treatment in the Willoughby calculation, and the inclusion of losses on the additional investments.

[252] Mr. James Hartling is a contractor who lives in Fall River. He made a large investment in Seabright and learned of Cavalier from his investment dealer. Mr. Hartling attended the early meetings on Cavalier and his rather precise recollection assisted my findings in that regard. He saw that there was an opportunity for Cavalier to quickly expand, and he described the plan as having been to use Cavalier as a stepping stone to something much larger, through the

acquisition of other companies and through expanded exploration. The initial investment was to be replaced by a $30 million public issue, which would give Mr. Hartling an opportunity to reduce his investment. He subscribed $300,000 and the Royal Bank of Canada put up the letter of credit. In the space in the amended subscription agreement calling for the investor's intended participation in the public offering, Mr. Hartling wrote "subject to receiving prospectus". He said on the stand that it would be prudent to study the prospectus before he committed even in principle, but his plan was to reduce his investment to $100,000. Mr. Hartling attended the August 1988 meeting. He felt quite threatened because he had not invested in the present business of Cavalier, he had invested in the future. He saw clearly that the allegation of fraud against Mr. Coughlan was going to make it difficult to take Cavalier forward. In time, he saw that the National Bank was going to call on the letters of credit. So, he invested $100,000 in the special rights offering, $100,800 under the December 1988 offering memorandum and $100,800 in Western. I accept his evidence. His loss has been calculated at $160,178. The defendants argue for adjustments based on the inclusion of a loss attributed to the bonus shares, the possibility Mr. Hartling will be able to take advantage of his

remaining loss carryforwards and questions raised as to the best timing for tax purposes of a resource claim and a loss claim.

[253] Mr. Hector Jacques was a founder of an engineering firm in the early 1970s, which has expanded much since then in the fields of geological and environmental engineering. His firm worked for Seabright and he invested in it. Mr. Coughlan introduced him to the Cavalier investment. He subscribed for $200,000 and the Royal Bank put up his letter of credit. His amended subscription agreement provided "Amount to be determined" in the space indicating his planned participation in the public offering. He explained that he had no view at the time on this subject. He had to see the business plan. Mr. Jacques did not believe he had any reasonable option to have Cavalier pay on the liability if his letter of credit were called. He invested $150,000 in the special rights offering and $156,240 under the September 1989 offering memorandum. I accept his evidence. His loss has been calculated at $124,690. The outstanding issues on quantification involve the inclusion of a loss on the bonus shares, the remaining availability of some loss carryforwards and the possibility Mr. Jacques ought to have pursued better tax treatment by claiming an allowable business investment loss rather than a capital loss and by making the claim in a different year.

[254] Mr. Harry Kennedy lives in Fredericton. He owned and operated a fast food franchise for twenty years. An investment adviser told him about Cavalier, he received the document prepared by Mr. Coughlan about the time of the first meeting, and he subscribed for $500,000. His letter of credit was provided by the Bank of Montreal. He spoke with Mr. Coughlan in July 1988, and signed an amended subscription agreement. He did not indicate the amount for investment in the public offering but wrote "undecided, pending review of final prospectus." He explained during his testimony that he regarded the letter of credit investment as providing a good return for a very short term without tying up his cash. Investment in the public offering would involve different considerations. As regards the question of Mr. Coughlan resigning, which was raised at the August 1988 meeting, Mr. Kennedy was of the opinion that Mr. Coughlan was the lynchpin of the whole deal and it would not work without him. In cross-examination, he said that, as of August 1988, his primary concern was to get out of the problem, but he did not believe there was any way Cavalier could cover him without all investors being covered. As to the prospect of a best efforts arrangement with Levesque, he described this as "a very poor option" and one which would not have solved the problem if only because of the subsequent difficulties with regulatory approvals. Although his

bank never formally made demands, Mr. Kennedy's letter of credit was extended several times and he understood demands would be made if he did not extinguish the liability. Mr. Kennedy or his company invested $504,000 under the December 1988 offering memorandum as a way of mitigating the loss by taking advantage of the tax relief associated with flow-through shares. This investment was financed by Hamilton-Kennedy Inc., Mr. Kennedy's company. Company records show that $100,800 was offset against his shareholder account, and $403,200 was deducted from company accounts, with the equivalent amount of shares being set up as a company asset at cost. Mr. Kennedy made additional investments in Cavalier under the May 1989 and September 1989 offering memoranda and these totalled $202,600. His wife invested $75,600 under the September 1989 offering memorandum. He said that the investments in excess of the letter of credit were made for tax reasons and, also, to assist the company. I accept Mr. Kennedy's evidence. Losses have been calculated at $302,763 with $10,209 attributable to Ms. Kennedy and $157,509 attributable to the payment made by Hamilton-Kennedy. At issue are the inclusion of the calculated loss on the bonus shares, the losses that may be attributable to Mr. Kennedy's company and his wife, and the inclusion of losses on the additional investments.

[255] Mr. William Kitchen lives in Halifax and has owned and operated businesses in retailing and manufacturing of furniture. He is 76. Mr. Kitchen invested in Seabright and has known Mr. Coughlan, Mr. Hemming and Mr. Colin MacDonald for many years. He signed a subscription agreement for the Cavalier purchase and the Royal Bank put up a $500,000 letter of credit. He indicated on his amended subscription agreement that he intended to subscribe for $400,000 in the public offering including "shares earned with letter of credit", which I take to mean that his intended cash investment in the pubic offering was $362,500. He invested $500,000 in the special rights offering and Cavalier used the money to cover the portion of the National Bank debt secured by the letter of credit issued for Mr. Kitchen. I accept the evidence given by Mr. Kitchen. His loss has been calculated at $362,349 and the issues are whether a loss attributable to bonus shares should be included and whether an adjustment should be made for loss carryforwards that Mr. Kitchen may be able to claim in future.

[256] Mr. Roland MacDonald lives in Pictou where he operates a trucking business. He made about $100,000 on Seabright and learned of the opportunity with Cavalier from his accountant. He does not recall attending the early meetings, but he signed a subscription agreement for $100,000 and the Bank of Nova

Scotia put up a letter of credit. He attended the meeting held on August 10, 1988 at which all agreed that Mr. Coughlan should stay on. Mr. MacDonald was of the opinion that Cavalier probably would not survive without Mr. Coughlan. He was contacted by someone to pay on his letter of credit, and he invested $100,000 under the special rights offering. He invested an additional $25,000 in flow-through shares under the May 1989 offering memorandum because Cavalier needed the money for exploration and Mr. MacDonald felt the company had a chance of becoming successful even though it had failed to go public. Also, he made the additional investment because not all of it was at risk due to the tax savings. I accept the evidence given by Mr. MacDonald. His loss has been calculated at $67,742 subject to issues regarding inclusion of losses attributed to the bonus shares and the additional investment.

[257] Mr. Douglas McCallum lives in Halifax where he has been associated with the printing business for over twenty years. He did not invest in Seabright, but he had funds in need of investment at the time of the Cavalier purchase and an investment advisor told him of the prospect. He attended the first meeting, came to understand the plan for Cavalier along the lines stated in the document prepared by Mr. Coughlan and he saw that the company was to go public soon after purchase. Mr. McCallum signed a subscription agreement for $100,000

and he secured a letter of credit in that amount. His amended subscription agreement indicates that he intended to invest a like amount in the public offering. He said he had intended to invest in Cavalier for five years or more. He was asked to honour his obligations in respect of the letter of credit and did so by investing $100,000 in the special rights offering because he was out that amount and hoped the company could still succeed in going public. For him, the shares and debentures acquired under the offering were something rather than nothing. I accept Mr. McCallum's evidence. His loss has been quantified at $64,720 with the outstanding issues being inclusion of a loss on his bonus shares and the possibility he could have realized a better tax treatment of his loss by applying it in later years rather than carrying it back to 1989.

[258] Mr. Gerald McCarvill lives in Toronto and he is the chairman of a merchant banking firm. At the time of the Cavalier purchase he was Vice-President and Director of Retail Sales with Wood Gundy. His colleague, Mr. John Panneton, recommended Cavalier. Mr. McCarvill signed a subscription agreement and the Royal Bank put up a letter of credit for $100,000. He agreed to the amendment and indicated at that time that he intended to invest the same amount in the public offering. Mr. McCarvill learned of the Westminer suit and allegations by reading the August 4, 1988 Globe & Mail. He felt the

allegations could have severe implications for Cavalier and he said that allegations of that kind against management would have grave implications in marketing an issue. In years to come, he would attempt to assist Cavalier as it tried to raise funds and as it attempted to arrange a merger. Not long after the Westminer suit, Mr. McCarvill received a letter from the National Bank indicating that the loan was maturing and the letters of credit would be called in if the loan was not paid by Cavalier. He paid $100,000 under the special rights offering. He was unaware of the Seabright actions until after they were tried. I accept Mr. McCarvill's evidence. His loss has been calculated at $56,928. The only issue concerns the inclusion of an amount for losses on the bonus shares.

[259] Mr. William Mundle was long associated with Seabright, which was a customer of the drilling company he has operated for many years out of Colchester County. He invested in Seabright, invested in Cavalier and became a director of it in 1989. His investment in Cavalier was large and deliberate. He saw it as a route to retirement and intended only to dispose of his investment over a four to eight year period. I accept Mr. Mundle's evidence. He learned of the Cavalier investment from Mr. Coughlan and it was clear to him that the initial purchase was to be followed by a public offering. Mr. Mundle subscribed for

$1 million and caused the Bank of Nova Scotia to issue a letter of credit. As for his intentions to invest in the public offering, Mr. Mundle's amended subscription agreement provides, "The amount will be determined upon receipt of the Prospectus." Early in August 1988 Mr. Coughlan was able to reach Mr. Mundle, who was on a boat. He attended the meeting to discuss the Westminer suit and its impact on Cavalier and, both then and later as a director, he was opposed to Mr. Coughlan resigning. In his view, an initial public offering could not succeed without Mr. Coughlan. Mr. Mundle recalled discussion of a possible best efforts agreement for the underwriting at the time of the August 1988 meeting and he attended the September meeting as well. His recollection is that the issue was tabled. There is a big difference between an underwritten and a best efforts deal, and Mr. Coughlan's credibility had been damaged at a time when market conditions were poor. Mr. Mundle's letter of credit was called upon, his bank paid the National, and he said he has been paying on his liability ever since, with the balance about cleared at the time of trial. He raised the full $1 million to invest in the special rights offering and he invested a further $351,200 in flow-through shares under the December 1988 and May 1989 offering memoranda. He said he invested in the flow-through shares because they provided tax relief, because the investment provided support to

the company and because he regarded Cavalier still to be a good investment. As I said, Mr. Mundle served on the Cavalier board; my acceptance of his evidence is reflected in some of the findings I made concerning its operation after 1988. His loss has been calculated at $761,333 which includes calculated losses on bonus shares and on the additional investments, matters in issue as far as the calculation of Mr. Mundle's damages are concerned. Also in issue is the possibility he may claim loss carryforwards in years to come.

[260] Mr. John Panneton's career was in investment dealing and merchant banking at Montreal and Toronto. He became the president and chief executive officer of CIBC Investment Management Corporation and he was head of retail sales for Wood Gundy at the time of the Cavalier purchase. In that capacity he was required to give his opinion on the proposal and his opinion was that Wood Gundy would easily sell the portion it was considering. Mr. Panneton had invested in Seabright but he sold before the take-over. He learned of Cavalier from several sources and he understood in the beginning that the corporation was to be private at first and could remain private for a time or move to a combination of private and public financing, but he understood it would probably be taken public. Mr. Panneton subscribed for $100,000, which led to a letter of credit from Lloyd's Bank. His amended subscription agreement

recorded his intention to invest a like amount in the public offering. Lloyd's Bank was called upon by the National, Mr. Panneton borrowed money to cover the liability and he took $50,000 of the special rights offering and $50,400 under the December 1988 offering memorandum. As regards the suggestion that Mr. Coughlan might have resigned in order to make going public easier, Mr. Panneton said that Mr. Coughlan was "absolutely vital" to his decision to invest. He said he relies on management in making investments and Mr. Coughlan was well qualified. As regards the legal opinion given at the August 1988 meeting to the effect that any judgment recovered by Westminer could not be enforced directly against Cavalier assets, Mr. Panneton observed that a good portion of a company's real assets are "human assets". Mr. Panneton's losses have been calculated at $49,521 and the only issue taken with that is the inclusion of a calculated loss on bonus shares. I accept his evidence.

[261] Mr. Robert Peters has been a stock broker in Halifax since 1969. He was with Levesque at the times that concern this case, and he had been involved with Seabright, both as an investment dealer and as an investor in his own right. I accept the evidence he gave. He affirmed that the intention was to invest privately in Cavalier at its purchase, then finance it on the public markets. The letters of credit were to provide bridge financing and the compensation was to

be the so-called bonus shares. Mr. Peters subscribed for $100,000 and his amended subscription agreement indicates that he would decide how much to invest in the public offering "upon review of final prospectus". Mr. Peters reduced his exposure on the letter of credit by investing $50,000 in the special rights offering, he managed to convince Cavalier to contribute another $25,000 against his portion of the National Bank debt and he paid the balance of $50,000 directly. His loss has been calculated at $38,607 subject to arguments that losses attributed to bonus shares should be excluded and that the cash payment constituted a failure to mitigate where tax benefits could have been realized if the money had been used to purchase flow-through shares.

[262] We regretted the death of Reginald Prest during trial. Fortunately, he did testify. Mr. Prest's career was in marketing and publishing. A company belonging to him invested in Seabright and it sold to Westminer at a loss. He learned of Cavalier from his accountant, Mr. Hemming, and subscribed for $100,000. The Bank of Nova Scotia put up the agreed letter of credit. Mr. Prest was definite in his assertion that the plan was to take Cavalier public. His amended subscription agreement referenced only $5,000 for investment in the public offering but he said he could not recall what he had planned to do with the other $95,000 he had temporarily put at risk. Mr. Prest's letter of credit was

not called upon initially. He invested $25,000 in the special rights offering, and the amount of his letter of credit was reduced accordingly. The letter of credit was extended at various times and bank documents show it was reduced by $50,000 at the time of an extension granted in March 1987. The source for this reduction is not entirely clear, but Mr. Prest excludes it from his claim. A further $25,000 appears to have been retired through further Cavalier investments. Fifteen hundred shares were transferred from treasury to Mr. Prest in July 1988 pursuant to the subscription agreement. A further 1,159 shares were transferred from treasury to Mr. Prest in 1989. Mr. Prest transferred the shares to his holding company, Bilby Holdings Limited, and then the company transferred them to Mr. Prest's RRSPs, which were administered by RBC Dominion Securities. I accept the evidence given by the late Mr. Prest. His loss has been calculated at $43,207 and the outstanding issues concern the portion of the loss attributable to bonus shares, the contribution of shares to his RRSPs and the best tax treatment of a 1989 loss carry back. I believe that the *Survival of Actions Act* question has been resolved.

[263] Mr. Andrew Saulnier is a businessman in the building supplies trade and he lives in New Minas. Formerly, he worked with Mr. Edwards in his fast food business. Mr. Saulnier did not invest in Seabright. He was introduced to the

Cavalier opportunity by Mr. Edwards. He decided to put up a letter of credit for $100,000 until Cavalier went public. He signed a subscription agreement and arranged for a letter of credit from the Bank of Montreal to the National Bank. Mr. Saulnier crossed out the part of his amended subscription agreement in which he was asked to indicate how much he would invest in the public offering. He explained on the stand that he was waiting to see what would happen and his decision would depend on the markets. Mr. Saulnier invested $50,000 in the special rights offering and he invested $50,400 under the December 1988 offering memorandum, and Cavalier caused the National Bank debt to be reduced to the extent that the Bank of Montreal letter of credit was released. I accept Mr. Saulnier's evidence. The amount of his loss has been calculated at $68,552 and the outstanding issues are inclusion of a loss on the bonus shares, the possibility that Mr. Saulnier could have further reduced his taxes by better tax treatment of the Cavalier loss and the possibility he may be able to reduce taxes in future through use of the balance of his loss carryovers.

[264] Dr. Allistair Thompson is a retired dentist who lives in Ontario. He was introduced to the Cavalier opportunity by his friend and neighbour, Mr. Panneton, and he made his decision based entirely on what Mr. Panneton said. Dr. Thompson understood that it would be an excellent investment. The notion

of a public offering was not drawn to his attention at the time. He signed a subscription agreement for $100,000 and arranged for a letter of credit from the Bank of Nova Scotia. His amended subscription agreement indicates he intended to invest a like amount in the public offering. As with other investors, he received a letter from Blair Prowse dated September 30, 1988 in which Mr. Prowse said that, if Cavalier did not pay the National Bank letter of credit loan maturing on October 5, the National Bank would call for payment under the letters of credit "forthwith". Rather than wait for that to happen, he invested $100,000 in the special rights offering. He invested another $100,800 under the October 1988 offering memorandum and he said he did so because Cavalier needed cash. At the time he had sufficient positive information on Cavalier to justify the investment. As with most other investors, Dr. Thompson did not treat the bonus shares for tax purposes in 1988. He said they were not included in his adjusted cost base because he did not consider them as capital on income at the time of his 1988 filing. As with all plaintiffs except Dr. Collins he relied entirely on his accountants for preparation of income tax returns and he agreed that the accountants relied on him to provide pertinent information. I accept the evidence given by Dr. Thompson. His loss has been calculated at $93,317 and

the outstanding issues concern inclusion of a loss on the bonus shares and possible better tax treatment of his Cavalier losses.

Proper Parties.

[265] With respect to Mr. Dauphinee and Mr. Kennedy, the defendants argue that any loss may be claimed only by their companies, because the companies put up the money to invest in Cavalier and thereby clear their personal liabilities in respect of the letters of credit. Where the companies are singly owned holding vehicles, I would not expect transactions of this kind to be recorded with the kind of detail that would be required if any interests mattered other than those of the sole shareholder. In the absence of evidence to the contrary, I would presume that the express or implied arrangement was that the companies would have recourse if it ever mattered. In effect, I accept the argument advanced by Mr. James that these were merely methods of financing the individual's payment of his liability.

[266] With respect to the transfers of shares by Dr. Collins and Mr. Prest, there is the additional complication of an RRSP trustee, which makes the transfers unamenable to an implication of recourse. The argument is that the shares were transferred at value, and the loss was extinguished. I think this artificial.

Nothing occurred that would change who ultimately would suffer the loss because the individuals were the sole beneficiaries of the RRSPs. If the argument is reduced to the proposition that someone else had to claim the loss on his behalf, I do not see why I would not order that person to be joined as a plaintiff.

[267] The situation with Mr. Fraser is different. Although the documentation makes it seem as though the liability was undertaken by him personally, the evidence he gave makes it clear that he signed the subscription agreement on behalf of Sumner Capital. (I will dispose of Willoughby's losses in finding that losses on additional investments are not recoverable.) As between Mr. Fraser and Sumner Capital, it is clear that the latter undertook the liability and beneficially acquired the bonus shares. The loss was to Sumner Capital, not Mr. Fraser. The trustee under the proposal did not acquire the right to advance the claim and recover the loss. That would have happened if the proposal had failed and the trustee automatically became the trustee in bankruptcy of Sumner Capital. But, the proposal was a success and, under the terms of the *Bankruptcy and Insolvency Act* as well as the terms of the proposal, the cause of action remains with Sumner Capital. It may still be possible to join it as a plaintiff.

Causation.

[268] Assuming that the allegations made by Westminer against the Seabright directors and published by Westminer in various ways constituted a tortious wrong against the plaintiffs in this action, the plaintiffs bore the onus of establishing that that wrong was causally connected to injuries they suffered. I refer to my findings under the title "Cavalier" in holding that, but for the allegations, the plaintiffs would not have been compelled (whether legally or merely practically) to honour their liabilities to their banks in respect of the letters of credit. The contingent liabilities would not have become actual because the primary debtor would have paid the debt. That finding covers all plaintiffs except Dr. Collins and Mr. Coyle, who took the option of investing cash in July 1988. In those cases, I find that, but for the allegations, the liability of Cavalier to these two plaintiffs would have been paid out of an October 1988 public offering. I also find that, but for the allegations, the shares distributed to all plaintiffs in compensation for the risks they undertook in raising the letters of credit before July 1988 would have become liquidable in October 1988 for at least the face value, five dollars a share.

Mitigation.

[269] On behalf of the defendants, it was submitted that all plaintiffs failed to mitigate their losses by failing to take measures in two respects: they failed to cause Cavalier to take up the Levesque proposal for a best efforts offering, and they chose to subscribe for Cavalier securities rather than to pursue payment by Cavalier. These failures are said to vitiate the whole of each defendant's claim; reasonable mitigation would have avoided the entire losses. In addition, the defendants submit that some plaintiffs failed to mitigate part of their losses by filing tax returns that did not treat the losses at maximum tax advantage or by failing to subscribe for flow-through shares rather than to pay part of their liability directly to their bank.

[270] The burden on these issues is upon the defendants. In a passage quoted at para. 76 of *Collins Barrow* v. *18740000 Nova Scotia Ltd. and Shannon* (1997), 159 N.S.R. (2d) 260 (C.A.), *McGregor on Damages* sets out three principles in respect of mitigation, the first of which reads:

> (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.

In my assessment, the plaintiffs acted reasonably in respect of the Levesque proposal and the choice not to make demands upon Cavalier. Also, where it is said that some

plaintiffs could have better reduced their individual taxes by better treatment of their losses or by purchasing Cavalier flow-through shares, I am not satisfied that a failure to mitigate has been established.

[271] I have found that Wood Gundy, Levesque and Cavalier would have entered into an underwritten deal had the Westminer allegations not been made, and I have found that the agreement would have been to raise $30 million with Wood Gundy and Levesque underwriting $10 million each and Mr. Coughlan's group to put up the balance of $10 million. As discussed, Wood Gundy withdrew because of the Westminer allegations and it recommended Cavalier stay out of the markets for at least six months. As discussed, Levesque was not prepared to enter into an underwritten deal and, at the end of August 1988, the management of Cavalier rejected Levesque's suggestion of a best efforts deal with a probable target of $15 million and an option for Levesque to act as sole lead on future Cavalier offerings. I have also discussed at length the difficulties Cavalier faced in attempts to get regulatory approval for an IPO and the significance of the Westminer allegations in those difficulties. The defendants' argument on this point would involve findings that the present plaintiffs could have and should have influenced Cavalier management not to reject the Levesque position and that accepting Levesque's terms would have put the

plaintiffs in a position of liquidity. The evidence does not support those findings. On the contrary, management's decision was a reasonable one. Levesque's position was in contradiction of the business plan set out in the preliminary prospectus itself because the target would have been halved, with the core group bearing the burden of taking up most of the offer. Further, Cavalier was not prepared to encumber future offerings with an option for sole lead in Levesque's favour. The defendants argue, contrary to management's position as explained by Mr. Coughlan, that this demand was not onerous, that Levesque could have been displaced by the production of an offer from another firm providing terms Levesque would not choose to match. Obviously, there are sound business reasons for negotiating with investment houses on an equal footing, and knowledge that the terms would have to be presented to another house could be expected to dampen the negotiations. Further, the option would have had an impact on any hope of reviving Wood Gundy's interest as co-lead. I have discussed the relative positions of Levesque and Wood Gundy in the industry west of Quebec. It was not unreasonable for management to reject the Levesque position. Further, a rush to accept Levesque's terms with a view to an October offering was not indicated by the climate Westminer's allegations had created for Cavalier in the markets and with the regulators. As regards the

markets, I refer to Wood Gundy's own reasons for withdrawal and its recommendation that Cavalier stay out of the markets for the time being. As regards the regulators, I am invited by the defendants to find that approval would have to come swiftly if Mr. Coughlan and the board had accepted the suggestion of a non-voting trust and if Mr. Coughlan had resigned as an officer but remained as financial consultant. I refer to my discussion of Cavalier's dealings with the regulators in 1988 and 1989 and to my discussion of decisions made by the Cavalier board, and I find that regulatory approval was uncertain and board decisions were businesslike at the material times. I find the plaintiffs did not act unreasonably in failing to attempt to have management accept the Levesque terms and attempt a public offering in 1988.

[272] I also find that the plaintiffs acted reasonably in choosing to convert Cavalier's liabilities to them into investments in Cavalier. Two of the plaintiffs, Dr. Collins and Mr. Coyle, had chosen in July 1988 to put up cash in exchange for promissory notes rather than to continue the letters of credit. They clearly had rights of action against Cavalier as of October 1988. However, I do not see a substantial difference between their positions and the rest as regards the present issue. The others clearly had rights of indemnification against Cavalier whenever the National Bank called upon their banks and their banks, in turn,

called upon them. The situation was known to all by October 1988 and generally they choose further investment over demand. I agree with Dr. Collins. To do otherwise would have been foolish. Without the IPO, Cavalier was facing $15 million in senior debt secured against its assets. On its terms, the senior debt instrument would fall into default just as the IPO failed. For a significant number of unsecured creditors to have taken action would have risked a liquidation of the Cavalier assets at forced sale prices. The risk of forced sale would have been substantial. The risk that forced sale prices would produce little or nothing for junior creditors would also have been substantial. To try to make a go of the company, even as it was disabled from pursuing the plan that had attracted the investors, may well have been prudent. It was certainly not unreasonable. It is true that some investors, including some plaintiffs, were able to get some relief from Cavalier. The dollars were not large compared with the total claims of the core group and the reasons were various. The fact that some relief was sought and received does not indicate that sizeable demands from more investors would have been honoured. On the contrary, had the core group not generally stuck together and remained as investors, the odds for forced sale would have been very high. A more subtle argument is made to the effect that, instead of turning to remedies, the plaintiffs

could have influenced the board to cause an orderly liquidation of Cavalier's assets, which might have avoided forced sale prices. It will be remembered that the $30 million contemplated by Wood Gundy, Levesque and Cavalier was premised on assessments that included high appraisals of management as it would have been seen in the 1988 markets. I do not take Mr. Scott and Mr. Byrne to have disagreed with the defendant's expert, Mr. White, that the value of hard assets went down significantly after the purchase price was established, in light of the decline in oil prices and the July 1988 Coles report. Even Mr. White established that Cavalier was worth more as a going concern than in liquidation. I refer to my discussion of those subjects and find that the decision to try to make a go of Cavalier was a business decision made in light of conditions known at the time. The duty to mitigate does not demand clairvoyance and compliance with the duty is not measured according to what would have been a second guess at the time. I find that neither the choice against turning to remedies nor the disinclination to influence Cavalier towards liquidation constituted a failure to mitigate. That leaves the questions of cutting losses by taking better advantage of the tax laws.

[273] Mr. Richard G. Ormston, C.A. is of the opinion that about a half dozen of the twenty-four plaintiffs could have paid less tax by treating their Cavalier losses

differently or by investing in flow-through shares rather than paying their banks directly. Mr. Ormston testified as an expert for the defendants, and I accept his opinions as to the availability of better treatments and the tax saving in the case of two plaintiffs who might have invested in flow-through shares. Mr. Ormston and his firm engaged in a very extensive study of the plaintiffs' calculations of losses, which led to numerous agreements right up to the time argument was made. Outstanding issues do not reflect the extent of the work done. As for the questions I am now concerned with, the most common adjustments were summarized in Mr. Ormston's report as follows:

- if a deduction such as a loss carryover or a Canadian exploration expense could have been used in another year against income in a higher tax bracket, this was done;

- if a Plaintiff did not claim the full amount of the loss, this was done;

- if a capital loss was claimed and a greater benefit could have been enjoyed through BIL treatment, the latter was used;

- in two cases where a cash payment was made to settle a Plaintiff's obligation under the letter of credit versus the purchase of flow-through shares for a like amount, the latter is included in the analysis as the more reasonable option.

As for adjustments of the kind described in the first three sections, I do not agree that these errors or failures in judgment amount to a breach of the duty to mitigate. The returns were filed years ago. In each applicable case, the return was prepared by an accountant upon whom the plaintiff relied for tax advice. I am asked by the defendants to infer that the plaintiff in each of these instances must have failed to provide his or her accountant with pertinent information. If Mr. Ormston and his firm recognized that a loss carryover could have better been used in a different tax year, or that the loss was not fully calculated, or that business investment loss would have been better treatment where a capital loss was claimed, then the plaintiff's accountant would have recognized the same unless the client failed to provide relevant information to the professional. I do not make the suggested inference. I conceive that a tax professional questions and challenges the client. On the facts, the client's failure to provide relevant information, a difference in judgment between the professional and Mr. Ormston, or a lapse on the part of the professional are equally possible. The onus is on the defendants and it has not been met.

[274] Mr. Ormston's fourth point concerns the argument that three plaintiffs unreasonably failed to mitigate their damages by carrying a balance on their liability to their banks on account of the letters of credit issued for them. As earlier stated, the balance of Mr. Dand's letter of credit was extended at various

times until $98,400 was paid to the bank in 1991. Similarly, Mr. Peters paid his balance of $50,000 to the bank in 1991. Dr. Cook paid $33,334 although he might have had his last investment applied to wipe out the liability. The defendants submit that these balances should have been invested in flow-through shares, in which case the balances would have been offset. Mr. Ormston has recalculated these plaintiffs' losses by assuming flow-through shares were purchased in 1988 and by showing the consequential effects on cash flow in ensuing years. Mr. Peters, for example, would have stood to gain $5794 had he purchased $50,000 in additional flow-through shares in 1988 rather than paying the $50,000 in cash in 1991. The argument that the failure to purchase flow-through shares amounted to a failure to mitigate must be addressed from the perspective of these plaintiffs' positions as at 1988, rather than with the hindsight of 1991 or years later. None of these plaintiffs was able to offer much by way of explanation as to why they choose to continue extending their letters of credit rather than to invest and take the tax advantages. They had the financial ability to make the investment. Obviously, each decided to keep their options open. In Mr. Dand's case that approach did not pay. In Mr. Peter's case it probably did pay. It must be kept in mind that Mr. Peters got his letter of credit liability reduced by $25,000 by investing that much under the

December 1988 offering memorandum and that, some time afterwards, he was able to negotiate a payment by Cavalier of another $25,000 against his letter of credit liability. Mr. Ormston's calculation would have Mr. Peters investing only an additional $50,000 in 1988, in effect charging him with foresight that he could negotiate $25,000 out of Cavalier, no more and no less. This requires too much foresight to support a finding of a failure to mitigate. If Mr. Peters had not kept his options open he would have invested $100,000, not $75,000, and he would have enjoyed the tax benefits of $100,000 invested under the December 1988 offering memorandum, but his overall loss would have been much greater. Although these plaintiffs were unable to offer detail, their choices were made in light of however they assessed their financial circumstances and the prospects for Cavalier at the time choices were made. It has not been established that their particular choices to partially maintain the status quo were unreasonable and, in Mr. Peter's case, the choice appears to have kept the losses down. The defendants have not met the onus of establishing a failure on the part of Mr. Dand or Mr. Peters in their duties to mitigate their losses. Dr. Cook on the other hand made further investments without having his liability reduced and I find the defendants have made out a

case to offset the tax benefits that could have been realized had he required Cavalier to reduce his bank liability by $33,334.

[275] All plaintiffs who invested beyond the amount of their liabilities on account of letters of credit seek to recover their losses on the additional liabilities on the basis that the additional investments were efforts to mitigate the losses on the initial investment. The second and third principles stated in *McGregor on Damages* as quoted in *Collins Barrow* read:

> (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.

The plaintiffs rely on the second of these principles. The decision in *Collins Barrow* was concerned with the third principle (para. 80). Mr. Shannon had relied on audited financial statements prepared by accountants, Collins Barrow, when purchasing a company. The auditors had been negligent, and the statements much overstated the financial health of the company. Rather than to cut his losses early and ascertain the amount, Mr. Shannon worked hard for a number of years to make the company into something profitable. It would have been reasonable for him to have liquidated the

company, but he went on with it because of pride and reputation (para. 93). He succeeded, and Collins Barrow sought an offset of the profits. Chipman J.A., for the court, discussed the second principle taken from *McGregor* at para. 81 to 91. At para. 90, he concluded that discussion:

> 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.

The rule appears to be that the defendant must establish the steps taken by the plaintiff were not completely collateral to the wrong (para. 83). The difficulties in applying such a rule may be alleviated by the observation that "The subsequent transaction ... must be one arising out of the consequences of the breach and in the ordinary course of business" (see quotation and authorities referred to at para. 88) and by reference to a test sometimes employed: "whether the plaintiff could, even in the absence of wrong, have made the disputed profit" (see para. 89). In the case of Mr. Shannon, the successful turnaround was a collateral event and, at that, an event outside the chain of causation arising from the accountant's negligence.

[276] Of course, the plaintiffs' claim on the basis of the second principle set out in *McGregor*, that a plaintiff who takes reasonable steps to mitigate the loss

recovers for loss sustained in doing so. Counsel for the defendants refer to a passage in *Collins Barrow* to help frame their argument on this point:

> 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. [para. 94]

At the end of this passage, Justice Chipman refers the reader to *Haida Inn Partnership et al.* v. *Touche Ross & Co. et al.* (1989), 64 D.L.R. (4th) 305 (B.C.S.C.), where there was no recovery for losses following a decision to continue a business after an accountant's negligence had been discovered.

[277] In my assessment, the additional investments were not intended to be and were not in fact steps taken to mitigate the losses occasioned by Westminer. Some plaintiffs referred to a desire to assist the company with exploration expenses and replenishing reserves. I have accepted their testimony, and accept that those who spoke that way had such a desire among their motives. However, an interest in assisting a company in which one already has an investment is not necessarily an indication of an effort to overcome damage caused to the company or the investment by others. On the contrary, these were investment decisions. A prominent motive for all was to take advantage of very sizeable

tax benefits. Other factors had to include the faith the investors had in Mr. Coughlan, the upbeat reports he was able to make despite the difficulties in going public, and the optimism that Cavalier would eventually launch an IPO. And, for those who invested after 1988, the rebound in oil prices must have been a consideration. Further, as discussed in reference to Westminer's allegation of abuse of process, the plaintiffs did not fully appreciate their loss until 1994 and only in 1994 did they seriously turn their minds to the proposition that they had been actionably wronged by Westminer. The investment decisions involved considerations other than any attempt to achieve liquidity, which was the subject at the heart of the loss caused to the plaintiffs by any wrong that may have been committed by Westminer. By analogy to the rule that applies in application of the third principle in *McGregor*, these investment decisions were completely collateral to the conduct of Westminer. They were not directed at, nor did they have for their purpose, alleviation of harm caused by Westminer.

Damages.

[278] The plaintiffs claim for losses on account of their having to honour commitments to their banks in respect of the letters of credit or, in the case of the Coughlans, losses on account of the calls on their guarantees, or, in the case of Dr. Collins and Mr. Coyle, their losses on account of Cavalier's inability to pay on the promissory notes issued to them. These losses have been calculated by taking the amounts actually invested by each plaintiff in Cavalier to enable it to retire the National Bank loan that was backed by the letters of credit, adding any amounts paid directly to banks and subtracting the tax benefits realized to date, interest paid by Cavalier on the convertible debentures and settlements received when trust funds arising from the compulsory acquisition were distributed. In general, the defendants have accepted that method of calculating damages. I have already dealt with most issues raised by the defendants that touch upon the calculations. The remaining issues are whether to discount the losses for a negative contingency that the investors would have suffered a loss in any case, whether to make provision for the balance of loss carryovers some investors may be able to claim if they declare capital gains in future years, and whether and how to recognize tax consequences of the award.

[279] In addition, the plaintiffs claim the after-tax value of losses in respect of the common shares issued to them in exchange for the letters of credit they caused

to be put up as security for the $10 million National Bank loan. The defendants submit that this is not an appropriate head of recovery. Also, the questions of a negative contingency, loss carryovers and recognizing tax consequences may affect the calculation of an award of damages on account of the bonus shares.

[280] Further, the plaintiffs claim punitive and exemplary damages, Mr. Fraser and Mr. Mundle claim general damages in connection with their service on the Cavalier board of directors, and all plaintiffs except the estates claim general damages in connection with their efforts to deal with liabilities respecting the letters of credit and to deal with their deteriorating investments by attending meetings of Cavalier.

[281] Of course, the purpose in compensating the plaintiffs for their losses in connection with the letters of credit is to return them to the position they would have been in had they not been wronged, and the defendants cannot be burdened with putting them in a better position than would have been the case. Establishing loss according to the position a party would have occupied often involves the court in answering hypothetical questions, which take us outside the usual civil standard and into an assessment of relative likelihoods, such that "A future or hypothetical possibility will be taken into consideration as long as it is a real and substantial possibility and not mere speculation": *Athey* v.

Leonati, [1996], 3 S.C.R. 458 at para. 27. All agree that Cavalier was a speculative investment. Except in one respect, it would only be speculation to conclude that the plaintiffs would have realized profits on the investments they intended to make in Cavalier or that the plaintiffs were bound to experience losses.

[282] In my opinion, the assessment of these damages cannot stop at the calculation of the after-tax amounts paid to extinguish liability in connection with a letter of credit. The putting up of a letter of credit was inextricably tied to an intention to invest for a longer term. For one thing, investment by the plaintiffs and their fellow "core group" members was essential to the success of the public offering by which the loan secured by the letters of credit was to be extinguished. As a group, they had to purchase shares and debentures at a very substantial level, $10 million was approximated. Further, each of the plaintiffs did intend to invest in the public offering that would relieve their liabilities, and many had decided to invest at the exact same level as the letter of credit. Furthermore, they had followed Mr. Coughlan's lead and, like him, most intended to remain for the longer term. In these circumstances, a real and substantial possibility of a loss on account of the intended investment should lead to a reduction in damages calculated according to the actual loss on the

actual liability. I am referring, of course, to the deficiencies in operational management that inhered in Cavalier, a subject I have discussed in reference to the causes of Cavalier's failure. Those deficiencies were unknown to anyone, including the markets, in 1988, as discussed in connection with the price at which the Cavalier shares would have traded. However, Mr. McGrath had been selected before the loss arose and, while he may have preformed better in a healthy Cavalier, the company was to be served by him and by staff he selected. Cavalier was in for serious internal difficulties where it was served by operational management who could permit the kinds of failures discussed earlier. I think it probable that liabilities in connection with the letters of credit and corporate liability on the promissory notes of Dr. Collins and Mr. Coyle and liability on the guarantees of the Coughlans would have been converted into units of shares and debentures on the public offering. I think it less probable, but still more than speculation, that debentures would have been converted to shares. It is probable that deficiencies in operational management would have manifest themselves in such a way as to substantially reduce the trading value of Cavalier shares. I cannot state a precise amount, but it would have to have been substantial for a time. Taking all of that into account and allowing that the drop in value could have been temporary, I would apply a

20% reduction except where it cannot be said that an investor would have continued to invest at the level of the letter of credit, note or guarantee.

[283] I find that those who indicated on the July 1988 subscriptions that they would invest in the public offering at the same level as their letter of credit, note or guarantee would have done so. Given their attitudes towards Cavalier and the positions of the plaintiffs as a whole on the value of Cavalier but for the Westminer allegations, I am satisfied, with one exception, that those who took no position in July 1988 would have invested at the level of their letters of credit in October 1988. The exception is Mr. Hartling, and, based on his testimony, I find it is most likely he would have invested $100,000. Although the late Mr. Prest wrote that he would invest only $5000, he was unable to explain when he testified and I believe the figure does not reflect what he must have intended. It was probably a mistake. Although Mr. Dand and Mr. Kitchen made reference to their bonus shares in connection with the round figure that was stated on their July 1988 agreements, I think they would have been persuaded to invest the round figure. Mr. Hardman had made a decision to invest $50,000 and had stated that as a "minimum". His situation is therefore different from those who indicated no position in July 1988 and, in light of his testimony, I cannot say he would have invested more. The exceptional

plaintiffs and the negative contingencies applicable to them are: Mr. Hardman's Bryman Enterprises (5%), Dr. Cook (11%), Mr. Dand (11%), Mr. Edwards (4%), Mr. Fraser (15%), Mr. Hartling (7%) and Mr. Kitchen (16%).

[284] As for those plaintiffs with loss carryovers still available to them, I accept the argument made by Mr. James. That is, I do not have sufficient evidence for a finding that these plaintiffs will ever have an opportunity to use the loss carryovers. Further, even if I could determine that these plaintiffs will experience gains and when, I am not satisfied that they could continue to carry the losses after a party was ordered to pay the loss. In view of the later consideration, I decline the defendants' submission for a negative contingency.

[285] As for recognizing the tax consequences of the award, the claim advanced by the plaintiffs became complicated when counsel was unable to submit how Revenue might treat the award. It appears more probable that Revenue would accept that the award would not be taxable. Counsel for the plaintiffs suggested that I might make an order subject to revision after the plaintiffs deal with Revenue. I have some discomfort doing that unless all parties agree because the case is closed and I doubt that the law permits damages to be re-assessed in future. Since this is a hypothetical assessment, my determination of this issue may not matter greatly. If it matters and if counsel wish to supply either

authorities on ordering damages subject to re-assessment or detailed references to the *Income Tax Act*, I am prepared to give supplementary reasons before an order is taken out.

[286] The defendants argue that the losses on the bonus shares are subsumed in the losses on account of liabilities in connection with the letters of credit. They argue that this is a lost investment opportunity which is to be compensated by way of prejudgment interest. They point out that the value of the shares were compared with return on investment when the subscription agreements were first solicited, and they point out that most plaintiffs did not treat the shares for tax purposes for the 1988 tax year. They rely on *Collins Barrow* at para. 75. I do not agree that this is a claim for lost opportunity. The damage caused to the shares is related to the fact that they would have become liquidable but for the actions of the defendants. Nor were the shares paid in the nature of interest. They were compensation for putting one's money at risk but such compensation is not necessarily interest. The rights represented by the shares could have been traded but for Westminer's conduct. I think such a loss both personal and recoverable. The plaintiffs choose to measure the loss by taking the face value of the shares, which is comparable to the value I have found the shares would have had in the October 1988 markets, and discounting for tax benefits. Given

the failure of Cavalier and Westminer's contribution to that failure, I accept this as a correct measurement of the loss on account of the shares not being tradeable, subject, of course, to the same negative contingencies as with the losses in connection with the letters of credit, guarantees and notes.

[287] The claims for general damages rely upon *Collins Barrow*. At para. 68 to 71, Justice Chipman discussed awarding Mr. Shannon compensation for the extra effort he put into turning around the newly purchased company, which he had been misled into purchasing by the negligently prepared financial statements. Following *Esso Petroleum Co.* v. *Marden*, [1976] 1 Q.B. 801 (C.A.), Chipman J.A. decided the effort should be compensated according to a "rough and ready" estimate. Such an award was "extremely difficult to estimate" (para. 71). In the circumstances, an award of $50,000 was allowed "for disruption and inconvenience". The plaintiffs propose $5,000 each with an additional $50,000 for Mr. Fraser and $35,000 for Mr. Mundle. Mr. Fraser and Mr. Mundle joined the Cavalier board in 1989 at a time when it was apparent that the company needed directors independent from the former Seabright directors and distanced from the Westminer allegations, in order to get regulatory approval for an IPO. The tasks undertaken in 1989 increased unpredictably, especially for Mr. Fraser, as Cavalier's misfortunes mounted and as the CEO became more and

more consumed with trial preparation in the Seabright case. In the case of Mr. Shannon, the effort followed directly from the negligence and it was made by the known shareholder. I think the efforts now under discussion too remote for recovery. One in the position of the tortfeasor would not envision, even in a general way, that the actions taken against Mr. Coughlan and the others would lead some members of an undisclosed body of passive investors to become active managers. The efforts of some plaintiffs in attending meetings and reading correspondence do not appear to me to have been onerous compared with what they might have expected in any case as substantial backers of a junior oil and gas company. I think the difference too insubstantial.

[288] Punitive and exemplary damages are very rarely ordered for negligence. A hypothetical inquiry into these heads on my part would be very artificial given my findings in respect of the intentional torts. My finding is that Westminer’s actions were not directed towards the present plaintiffs, and, in the circumstances, that precludes discussions of punishment or compensation for aggravated injury. So, on that, I should say no more.

CONCLUSIONS

[289] I will dismiss the action. I have provided an alternative assessment of damages and the parties are free to address me on any subjects that may remain outstanding. During the trial, I indicated my preference for later submissions on prejudgment interest and costs. If an alternative opinion on prejudgment interest is desired, I shall provide it. And, the parties may make arrangements to address me on costs.

J.

Halifax, Nova Scotia
9 November 2001