SUPREME COURT OF NOVA SCOTIA
Citation: Andrews v. Keybase Financial Group Inc., 2014 NSSC 31

Date: 20140204
Docket: Hfx. No. 339660
Registry: Halifax

Between:

Martin Douglas Andrews and the Estate of Sheila Rebecca Andrews (2010HfxNo339660)**, David Bateman and Sharleen Bateman** (2011HfxNo343599)**, John Cameron and John Cameron as Executor of the Estate of Linda Cameron** (HfxNo300385)**, Charles Raymond Michael Crowell and Darlene Joyce Crowell** (2011HfxNo343611), **Jeffrey H. Phillips and Denise Kowalski-Phillips** (2009HfxNo306313)**, Jared Raymond Phillips and Becky Lynn Waterfield** (2010HfxNo327381)**, James Edward Maxwell Ramsay and Lisa Elayne Matheson** (2010HfxNo343604)**, Wilma Lee Shane and Wilma Lee Shane as Administrator of the Estate of Ruth Shane** (2009HfxNo316695) **and Robert Andrew Verney and Janice C. Verney** (2010HfxNo327213)

Plaintiffs

-and-

Keybase Financial Group Inc. and Global Maxfin Investments Inc.

Defendants

Decision

Judge: The Honourable Justice Robert W. Wright

Heard: November 12-14, 18-21,25-28 and December 2, 2013 at Halifax, Nova Scotia

Written Decision: February 4, 2014

Counsel: Counsel for the Plaintiffs - Jamie MacGillivray
Counsel for the Defendants - Brian Awad and David Moorhouse

Wright, J.

INTRODUCTION

[1] Between 2008 and 2011, nine pairs of plaintiffs commenced separate actions against their former financial advisor, John Allen, as well as the mutual fund dealerships for whom he worked, and various lending institutions involved in a borrowing to invest scheme.

[2] The plaintiffs in each of the nine actions allege that Mr. Allen fraudulently implemented a leveraged investment strategy that was unsuitable for them, and caused them to incur heavy financial losses.

[3] As the litigation evolved, only two defendants remained in the case for trial, namely, Keybase Financial Group Inc. ("Keybase") and Global Maxfin Investments Inc. ("Global"). These were the last two successor mutual fund dealerships for whom Mr. Allen was a licensed financial advisor before his fraudulent conduct was discovered. He worked for Global from April, 2005 until March, 2007 before transferring to Keybase where he worked until the end of August, 2007.

[4] Although a named defendant, Mr. Allen disengaged from the litigation around 2010, as he was then facing personal bankruptcy and discipline proceedings by the Nova Scotia Securities Commission. The plaintiffs eventually discontinued their claims against him. He was not called as a witness at this trial. Mr. Allen has also been recently sentenced for associated criminal convictions.

[5] Of the nine pairs of plaintiffs, eight were spousal relationships, the other being a mother-daughter relationship. All plaintiffs were represented by one counsel, Mr. MacGillivray, while both remaining defendants were represented by Mr. Awad. Prior to trial, both counsel agreed that all evidence adduced, and legal submissions made, would apply across the board to all nine actions.

[6] Defence counsel also made a number of formal admissions shortly before trial which will be set out later in this decision. First, however, it is important to summarize the nature and scope of Mr. Allen's pattern of fraudulent conduct to fully understand how the various plaintiffs were victimized. This can be conveniently done by reciting the following excerpt from the Statement of Agreed Facts found in the Settlement Agreement entered into between Mr. Allen and the Nova Scotia Securities Commission in May, 2011, which is in evidence at this trial:

> 14. While registered with the Commission, the Respondent [John Allen] promoted an investment strategy whereby clients would use the proceeds from investment loans to purchase distribution paying mutual funds. Clients were encouraged and advised by the Respondent to rely on the distributions received from the mutual funds to fully fund the loan payments ("the leveraged strategy").
>
> 15. In facilitating the leveraged strategy for his clients, the Respondent forged loan applications for AGF Trust and B2B [the two investment loan banks used] by inflating the value of clients' assets, reducing or omitting the value of their liabilities, and fabricating client employment details and salaries. By forging the loan applications and inflating the net worth of the clients, the Respondent was able to receive approval for loans for higher amounts than the client would have qualified.
>
> 16. In facilitating the leveraged strategy, the Respondent also forged Know- Your-Client ("KYC") information on Keybase new-account opening forms, by inflating the value of clients' assets and the extent of their investment knowledge and by extending the time horizon.

17. The Respondent forwarded the forged loan and KYC documents to compliance personnel at Keybase, and he received approval to open the new accounts pending receipt of the proceeds from the new loans.

18. Between March and September of 2007, the Respondent received approval for approximately 42 AGF Trust loans for his clients, most of which were in the amount of $245,000. The total amount of loans he received for his clients during this time, from both AGF Trust and 828, was approximately $14 million. In all cases, the proceeds of the loans were used to fund the leveraged strategy, based upon the advice and recommendations of the Respondent.

19. In some cases, clients who received loans from AGF Trust also had investment loans from 828, which had been facilitated by the Respondent. In many cases, the Respondent did not disclose the existence of previous loans on the client's subsequent loan applications.

20. In all cases, the Respondent did not inform his clients that he forged their loan application forms and KYC information for the purpose of inflating their net worth. In all cases, the Respondent did not inform his clients that they would not have received approval for the loans if he had not forged the forms.

21. The Respondent instructed his clients to sign the loan documentation and KYC documentation without disclosing that he had falsified their net worth and KYC information. He did not give clients any copies of the loan or KYC documentation or a prospectus for the mutual funds they purchased with the loan proceeds.

22. In all cases, the Respondent informed his clients that the leveraged strategy would not be subject to risk and that the clients would not have to make the loan payments from their own cash flow, but rather that the leveraged strategy would "pay for itself' in typically less than 10 years. The Respondent also informed his clients that the leveraged strategy would provide them with additional monthly cash flow which the clients could use as a primary or additional source of income.

23. A number of the Respondent's clients undertook the leveraged strategy as a primary or additional source of income to meet their everyday household spending requirements. Others relied upon the leveraged strategy to fund lifestyle expenses and make payments on other household debts.

24. Many of the Respondent's clients who agreed to use the leveraged strategy were unsophisticated investors, with little to no investment experience, they did not understand the strategy, but trusted the Respondent's advice and recommendations.

25. The leveraged strategy was grossly unsuitable for many of the Respondent's clients.

26. Between March and September of 2007, the Respondent received approximately $594,000.00 in commissions from Keybase.

[7] As an aside, by subsequent Order of the Securities Commission Mr. Allen was essentially given a lifetime ban in the investment industry and ordered to pay a penalty of $1,050,000 along with costs of $7,000.

[8] Separate Settlement Agreements were also entered into between the Nova Scotia Securities Commission with Keybase itself and its local Branch Manager, Gregory Duncan, respectively. The Statement of Agreed Facts in those proceedings document their respective failures to properly supervise the new accounts and investment trades implemented by Mr. Allen between April and August, 2007. In short, industry supervision standards and regulatory requirements were not met at either the branch or head office level.

[9] In the result, Keybase was ordered to repay the $148,798 in commissions it had received from the business conducted by Mr. Allen, along with a penalty of $100,000 and costs of $10,000. Mr. Duncan was fined a lesser amount as well.

ADMISSIONS

[10] Against that backdrop, Global and Keybase made a number of formal admissions at this trial which are enumerated as follows:

(a) Since Mr. Allen was their sales agent (being registered as such pursuant to the *Securities Act*), Global and Keybase respectively acknowledge that they

are vicariously liable for any compensable pecuniary losses caused by the wrongdoing of Mr. Allen during the relevant time period between April, 2005 and August, 2007 (excluding any losses from pre-Global era investments, any disgorgement order against Allen if sought, and any punitive damages);
(b) The wrongful conduct admitted was that Mr. Allen misrepresented client net worth or income on the subject loan applications of all the plaintiffs;
(c) Such conduct constituted a dereliction of duty by Mr. Allen, giving rise to prima facie liability on the part of the dealers, to compensate the plaintiffs for compensable pecuniary losses arising from the impugned investments;
(d) Keybase owed an ongoing fiduciary duty to each of the plaintiffs during and after the John Allen period of employment.

[11] These admissions were made subject to the plaintiffs' burden to prove their pecuniary losses and the issues of mitigation and contributory negligence.

FINANCIAL CONSEQUENCES

[12] All of the plaintiffs ended up keeping their leveraged mutual fund investments, albeit with some adjustments later recommended by their successor advisor, which will be chronicled later in this decision.

[13] Unfortunately, beginning in the latter part of the following year (2008), the global financial markets crashed. As a result, all of the plaintiffs sustained relatively heavy financial losses while still carrying the burden of their oversized investment loans. They have struggled on ever since, trying to

cope with their oppressive debt loads, facing financial ruin and for most, the ill effects on their health.

ISSUES

[14] Given the admissions made by Keybase and Global, the main issue to be decided by the court is whether the plaintiffs had a duty to mitigate their losses by selling their investments and paying down their loans as far as possible, once aware of their predicament.

[15] The defendants take the position that by not doing so within a reasonable mitigation period (to be fixed by the court), the plaintiffs made a conscious choice to accept the market risks in keeping their investments going forward such that any future losses beyond the mitigation period would be their own responsibility. Therein lies the nub of the case.

[16] Both counsel have agreed on expert methodology on how to calculate the pecuniary losses for each plaintiff. However, the calculation depends on the "valuation day" chosen. The plaintiffs maintain that the valuation day should be the date of trial. The defendants, on the other hand, maintain that the valuation day should coincide with the end of a reasonable mitigation period. It is suggested that the valuation day should be fixed by the court some time before the end of the year 2007 and that it not necessarily be the same for each pair of plaintiffs, depending on when they developed an awareness of the seriousness of their predicament and were in a position to make an informed choice.

[17] Accordingly, the court is presently asked to determine whether there was a breach of the duty to mitigate and if so, what the appropriate mitigation period(s) should be which, in turn, would determine the appropriate valuation day for each plaintiff. Those findings would then be referred to the experts to perform the calculations of the respective plaintiffs' pecuniary losses (with the court retaining jurisdiction to resolve any further dispute, if necessary).

[18] Beyond that, the Court is also asked to determine whether the plaintiffs are entitled to an award of damages for non-pecuniary loss, be it general damages and/or aggravated damages or punitive damages. There is also a remedy sought for disgorgement of profits from Keybase.

REVIEW OF THE EVIDENCE

[19] Given the facts admitted to by Mr. Allen in his Settlement Agreement with the Nova Scotia Securities Commission and the more client specific admissions made by Keybase and Global, all above recited, it is not necessary for purposes of this decision to trace through each fraudulent transaction perpetrated against various plaintiffs. My review of the evidence therefore focusses more on the interactions between Keybase and the replacement financial advisors, Messrs. Duncan and White, with the various plaintiffs in the aftermath of Mr. Allen's termination of employment.

[20] I begin with a summary of the evidence given by Mr. Duncan.

Evidence of Greg Duncan

[21] Mr. Duncan has been employed in the investment industry for approximately 20 years, having become a licensed mutual fund salesman in the early 1990's. More recently, he joined Global in 2004 where he became branch manager soon thereafter.

[22] In 2005 he was approached by John Allen and Jim White (and one other individual) who, as he put it, were looking for a new home with a mutual funds dealer. All three were taken on as financial advisors by Global until March of 2007 when they all transferred to Keybase. Mr. Allen and Mr. White set up an office in Truro (where they shared expenses but not clients) while Mr. Duncan remained in Halifax as branch manager and financial advisor.

[23] Mr. Duncan explained in some detail the two tier supervision system in the highly regulated mutual funds industry. The first tier was his domain as branch manager where he was required to review all new account applications, checking for all appropriate documents and signatures. Also, he was required to review a summary of all trades that had taken place the day before for those under his watch.

[24] The second tier of supervision was in the domain of the Keybase head office and, in particular, its compliance officers. The latter were also required to supervise all new account applications and trades to ensure compliance with all regulatory requirements.

[25] Mr. Duncan acknowledged that an investment strategy involving leveraging (sometimes known as the Smith Manoeuvre) as earlier described required a heightened level of scrutiny because of the additional layer of documentation required and the heightened need to confirm the suitability of such investments by the client. A key document used in the industry to ensure suitability is the Know Your Client form ("KYC") which requires the financial advisor to ascertain from the client and record, *inter alia*, household incomes, assets and liabilities, net worth, level of investment knowledge and risk tolerance.

[26] Indeed, Keybase had updated and approved its own policy and procedures on leveraged investments on April 12, 2007. In that document, its stated purpose is to "ensure that leveraging is used appropriately for clients; that it is suitable for clients, and that all the risks of leveraging are clearly disclosed and explained to clients".

[27] The ensuing policy statement reads as follows:

> Keybase does not have the facility to provide loans to clients to invest. However, Keybase is obligated to comply with the regulations to ensure that investment proceeds meet the client's objectives once the funds are invested. Leveraging can be part of an effective investment strategy for some of Keybase's clients, but could lead to significant losses for others. Branch Managers and Approved Persons must ensure that clients who do not have a strong understanding or are uncomfortable with leveraging do not utilize the leveraging strategy. Approved Persons must provide each client with a risk disclosure document containing the information prescribed by the MFDA upon opening an account, and when an Approved Person has recommended purchasing securities by borrowing funds or otherwise becomes aware of a client borrowing monies for the purchase of a security.

[28] Following this policy statement is a list of the required procedures under which s. 16.1 reads as follows:

> **Guidelines for Using Leveraging**
> A good guideline for clients wanting to utilize a leveraging strategy should be:
> Significant cash flow
> Debt load of less than 35%
> Good investment knowledge
> A high risk tolerance
> A growth or aggressive growth strategy
> A time horizon of seven years or more
> Less then 60% of net worth leveraged

[29] The document then goes on to set out the requirements in obtaining and explaining the Leverage Risk Disclosure form and the Client Disclosure Brochure.

[30] Clearly, each and every plaintiff in these proceedings did not have the income, net worth, investment knowledge or risk tolerance to make this leveraged strategy suitable for them. Unfortunately, Mr. Allen's pattern of fraudulent conduct as above described was compounded by the failure of both Mr. Duncan and Keybase head office (under both tier 1 and tier 2 supervision levels) to properly supervise the new accounts and trades that Mr. Allen was generating, which should have exposed the unsuitability of the leveraged strategy for these investors. Indeed, both Mr. Duncan and Keybase were disciplined by the Nova Scotia Securities Commission for these supervision failures.

[31] The consequences of this for the various plaintiffs were that they incurred large investment loans which they were not eligible for and should never have had, found themselves in a high risk leveraging strategy that was totally unsuitable for them, and ultimately suffered financial ruin when the investment markets crashed the following year in 2008.

[32] Mr. Allen's nefarious activities came to light in August of 2007 when one of the investment banks with whom these loans were placed became suspicious about the propriety of certain loan applications. That prompted an internal review by Keybase of certain loan applications which heightened their suspicion that Mr. Allen had been overstating clients' net worth in obtaining investment loans beyond their qualification. Keybase therefore tasked Mr. Duncan to meet with Mr. Allen immediately to confront him about their concerns. He did so at a meeting in Mr. Allen's office on August 27, 2007 at which time Mr. Allen admitted his wrongdoing. Mr. Allen was immediately suspended and his employment was terminated shortly thereafter, effective September 4th.

[33] In between those dates, Mr. Allen wrote a cryptic form letter to his clients to inform them that he was leaving his position as a financial advisor, alluding to unspecified health reasons. This was the first indication to the clients that anything was amiss.

[34] Keybase decided to deal with the situation they were faced with by drafting two similar form letters to go out to all of Mr. Allen's clients under Mr. Duncan's signature. The first letter was dated September 6, 2007 and it was sent to all clients who were borrowers from the AGF bank. The second letter was sent to all other clients of Mr. Allen under date of September 12, 2007.

[35] The key content of those form letters can be summarized as follows:
(a) Clients were advised of the termination of Mr. Allen's employment with cause by Keybase due to breach of fiduciary obligations under licensing regulations;
(b) Clients were advised "Your investment program remains the same" and that they have been assigned a new financial advisor (or will be so assigned within the coming weeks), inviting clients to speak directly with Mr. Duncan if they wished to do so;
(c) In the letter to AGF borrowers, a comment was added that Mr. Allen may have overstated their net worth, thereby qualifying the client for a larger investment loan and that Keybase was working closely with AGF Trust "to create solutions that will have minimal or no impact to your current financial plan".

[36] Keybase then tasked Mr. Duncan as the main organizer in reassigning Mr. Allen's former clients among Mr. White, a Mr. Harrigan and himself. All were to contact their assigned clients to review the accuracy of their financial information on file and to ascertain or verify whether the clients were

qualified for the amount of the loans they had taken out. Mr. Duncan was tasked to do this on top of all his regular responsibilities as branch manager and his financial advisor work.

[37] Mr. Duncan thereupon began to set up meetings with the clients he had assigned to himself (numbering between 30 and 32) which included the plaintiffs Andrews, Cameron, Phillips, Shane, Verney and Phillips/Waterfield. He also tasked Mr. White with the responsibility to contact the clients assigned to him to likewise inquire and ensure the accuracy of the information on file.

[38] With this admittedly "daunting" task, Mr. Duncan explained that his game plan on meeting with individual clients was to review their true financial situation and update the KYC forms accordingly, and to try to make the clients understand the financial position they were in, particularly the leveraged strategy that had been used (this approach being the best way to assess suitability of this investment strategy). His next step was to verbally identify and explain the options each client had going forward in dealing with the situation.

[39] Mr. Duncan readily acknowledged that this was not an easy decision for clients to make, especially with their unsophisticated level of investment knowledge. He acknowledged that it was important for them to understand the situation they were in but that there were probably situations where the clients did not fully understand their predicament. Mr. Duncan sometimes

used graphs as visual aids in his explanations.

[40] Needless to say, the clients wanted advice as to what they should do. Mr. Duncan testified that the standard protocol which he followed in his discussions with all former clients of Mr. Allen was to identify the options available and discuss their pros and cons. The options he generally identified were:

(1) Sell the investment in its entirety and apply the proceeds to the investment loans;

(2) Sell the investment in part and apply those proceeds against the loans so as to reduce their leveraged position;

(3) Stay with the investment and reinvest the continuing monthly distribution income by purchasing new mutual fund units so as to increase the asset;

(4) Stay with the investment and use a hybrid approach of reinvesting some of the distribution income and using some of it to apply against the investment loan to reduce their leveraged position.

[41] In discussing the pros and cons of the pivotal decision of whether to sell or keep the leveraged investment, Mr. Duncan said that he identified the advantage of a selling position as ending the risk of being in such a leveraged investment program. He identified its disadvantages as being the incurring of early redemption fees as a penalty, a potential loss on the sale, a potential capital gains tax, and, of course, the end of the monthly distribution income stream the clients had been enjoying the benefit of.

[42] With one exception (to be reviewed later), none of this was ever put in writing by Mr. Duncan to the former John Allen clients. The only written communication they ever received was a form letter in early September of 2007 above described which advised the clients that their investment program remains the same (and in the case of AGF trust borrowers, that solutions would be created that would have minimal or no impact to their current financial plan).

[43] After describing the general approach he took in his discussions with former John Allen clients, Mr. Duncan went on to recount his recollection of his discussions in his individual meetings with the plaintiffs in the fall of 2007, as best he could after the passage of six years.

[44] Beginning with the Wilma Shane file (the second plaintiff Ruth Shane having since passed away), Mr. Duncan was referred to a letter written by their legal counsel Sean Foreman dated October 31, 2007. In addition to requesting certain disclosures, Mr. Foreman demanded immediate suspension and investigation of a certain loan account in the amount of $245,000 that had been fraudulently obtained by forgery, and that no further payments of income or loan be completed on that account. He also requested that this fraudulent transaction be reversed without loss or impact on Ms. Shane. He asked for a response on all available options after Keybase had contacted the investment bank.

[45] Mr. Duncan treated this letter as a formal complaint which he thereupon sent to Keybase head office to deal with. It appears that Keybase never responded to that letter. Indeed, the next event that was related was a meeting requested by Keybase's compliance officer in Nova Scotia, Jane Frost, in March of 2008 following a margin call warning letter sent by B2B Trust (advising that their loan to investment value ratio was beyond permissible limits).

[46] As a result, a meeting took place on March 10, 2008 attended by Greg Duncan, Jane Frost, Wilma Shane and her lawyer Mr. Foreman. Notes were made at that meeting of their review of the margin call situation and other options to be considered in the investment strategy going forward.

[47] This meeting was followed by an e-mail sent by Mr. Duncan on March 18, 2008 to Ruth Shane (who had not attended the meeting) with a copy to Wilma Shane and her legal counsel. This is the one instance (earlier alluded to) in which Mr. Duncan set out in writing for a client what options were available going forward.

[48] Essentially, Mr. Duncan set out two strategies. The first was to convert existing margin call loans to a no margin call loan and the second was to reinvest monthly distributions net of interest cost to purchase more units. Mr. Duncan went on in that e-mail to present the choice of either liquidating the investment entirely (in respect of which he had prepared a financial analysis of the consequences) or staying with the existing plan. In the latter event, Mr.

Duncan set out a series of six requirements that he would need to complete, including an updated KYC, independent legal advice form, and a leverage financial analysis to assess suitability. It appears that nothing further was ever done from either side.

[49] Turning to the Phillips/Waterfield file, Mr. Duncan explained that the position of these clients was unique because the leveraged investment of $120,000 was being used as a source to make accelerated payments on a home mortgage loan. The accompanying investment loan was taken out in the amount of $80,000, with the remaining $40,000 sourced from personal funds (a so-called 2 for 1 loan). Without the distribution income from that, the clients could not afford to keep their home.

[50] Mr. Duncan testified that he told these clients that they were at substantial risk and could lose their home. He said he went on to explain that they could "rewind" the investment loan but that it would be very challenging for them. They would not be left in a good situation because it would be hard to unwind the investment loan (and lose the monthly income distribution) without unwinding the home mortgage loan as well. He said the clients were not pleased with this predicament (particularly with a new baby at home) but that they did not instruct that any change be made because they wanted to try to keep their home. Mr. Duncan also acknowledged in cross-examination that a corrected KYC form was not completed for these clients until July of 2008.

[51] The Phillips file (Jeffrey and Denise) presents an egregious situation where, essentially through a series of forgeries, Mr. Allen arranged loans in their names in the aggregate of $460,000 which was far and beyond their financial means. In his fact finding meeting with these clients on October 16, 2007 Mr. Duncan says that he went over with them their true financial picture, and the investment strategy implemented by Mr. Allen. Mr. Duncan ascertained that some of the monthly distribution income was being paid towards their home mortgage and also to cover the purchase of a Harley motorcycle.

[52] Mr. Duncan testified that he went through his standard protocol in advising the Phillips of their options but that ultimately, the only remedial steps that were taken were to switch the investment fund to one better suited to them and to increase the payment being made on the investment loan. This was designed to reduce the leveraging exposure to these clients and the attendant risk factor, but he said they had no interest in selling the motorcycle.

[53] It is to be noted that in updating the KYC form at that meeting, Mr. Duncan checked off their level of investment knowledge as being "sophisticated" which was clearly a mistake and one that he could not explain in his evidence. This is one of a number of examples where the KYC form was not properly completed or corrected in the aftermath of Mr. Allen's fraudulent conduct, even though the KYC form is acknowledged to be a key document in assessing suitability of an investment.

[54] Mr. Duncan next referred to a chart that he arranged to have prepared at the request of the Phillips as of July 24, 2008 setting out the financial consequences of selling the investments at that point, including a listing of the early redemption fees that would be incurred. This was presented to them but the trail appears to have ended there and it appears that nothing further was ever done by either side.

[55] With respect to the Cameron file, Mr. Duncan testified that he first met with Linda Cameron (who has since passed away) at her place of business in New Glasgow (a Saint Cinnamon franchise) on October 16, 2007. At that time, he reviewed with her their household assets and liabilities which included an investment loan with AGF in the amount of $245,000 arranged by Mr. Allen in July. He said he also went through his standard protocol with Mrs. Cameron as outlined in his earlier testimony.

[56] This meeting was followed by a second meeting which he said was primarily a meeting with John Cameron on October 23, 2007. The paper trail here includes a KYC update form but it was left incomplete for reasons which Mr. Duncan cannot recall. The paper trail also includes Mr. Duncan's notation on an AGF loan application form in which he revalued Ms. Cameron's business ownership of the Saint Cinnamon franchise as an asset worth $500,000. At the same time, he noted her income from that business as being between $20-25,000 which clearly do not mesh. Indeed, Mr. Cameron testified in his evidence that they were not making any money from the business and that it was failing.

[57] Another anomaly in this file is that it is replete with the misnaming of the client as Campbell rather than Cameron, which is an egregious example of the lack of supervision that was exercised at both the tier 1 and tier 2 levels.

[58] In any event, the paper trail also includes a page of handwritten notes made by Mr. Duncan dated October 23, 2007 which he made either just before or during his meeting with Mr. Cameron. These notes contain a comment that “DSC Fees to be covered by Keybase if they wish to dilute - Client to send letter to - - - - that effect.”

[59] Mr. Duncan was questioned at length about this note as to whether it was an actual offer made to the Camerons on behalf of Keybase to cover payment of the early redemption fees or simply reflected a discussion of that possibility for which Mr. Duncan would have to get head office approval (which he did not have on his own).

[60] Although I generally found Mr. Duncan to be a reliable and credible witness who candidly acknowledged various shortcomings in the handling of this entire fiasco by both himself and Keybase head office, I found his evidence about this notation of DSC fees to be inconsistent and somewhat confusing. Looking at the evidence on this point as a whole, however, including his previous discovery testimony and the evidence of John Cameron himself, I find as a fact that Mr. Duncan was not given the authority by Keybase head office to offer to cover the early redemption fees that would be incurred on selling the investments. Rather, I find that it was simply a point of

discussion which the Camerons would have to pursue by sending a letter of request to that effect.

[61] Mr. Duncan made further handwritten notes on October 31, 2007 which reflect that as a result of the previous meetings, he implemented a switch from one mutual fund to another, as well as an increase in the payment being made on the investment loan from the monthly distribution income.

[62] In the meantime, in an e-mail sent on October 25, 2007 Mr. Duncan assured the Camerons that the investment banks did not have a lien on their home and could not touch it. He also advised them that their mutual fund holdings would fluctuate and that although he could not forecast the future, he could mitigate and control the amount of risk taken on a go forward basis.

[63] The evidence indicates that Mr. Duncan's next contact with the Camerons was a meeting held on February 19, 2008 in respect of which he again made handwritten notes either prior to or during the meeting. In those notes, he listed a number of options under discussion including reinvestment of all distributions, readjusting the loans, the suitability of leveraging with Keybase and the option to dilute (i.e., sell). Mr. Duncan also made a note to himself to write the clients a letter but it is acknowledged that that never happened. Indeed, it appears that no further steps in the matter were taken by either side.

[64] Turning to the Andrews file, Mr. Duncan testified that he met with the clients on September 24, 2007 and followed his usual approach of ascertaining and verifying their true financial picture, trying to identify an investment strategy for them with their input and explaining their options to them. The Andrews had taken out three leveraged loans in the aggregate of $305,000 and the distribution income (net of servicing the loan) was being used to reduce the mortgage on their home and to make the payments on a new truck. Mr. Duncan said that he disagreed with this strategy in respect of the truck and advised the clients to look at trying to return it to the dealership because it was something they could not afford based on their incomes. He said the clients were not receptive to this recommendation and indeed, they did not actually turn in the truck until early 2010.

[65] It appears that no changes were made in respect of the Andrews' investment until mid-November when certain adjustments were made, namely, a switch from one mutual fund to another, a direction to increase the loan payment to AGF, and later in March of 2008, a direction to reinvest $400 from the monthly distribution income in response to a margin call warning.

[66] Mr. Duncan acknowledged that a KYC update was not accurately completed for the Andrews until 2010. He maintained, however, that he continued to recommend to the Andrews that they downsize their vehicle by returning the truck because with a lower car payment, other options of reducing their leveraged position would open up.

[67] Even so, however, Mr. Duncan acknowledged that the Andrews were in debt way over their heads, regardless of the truck purchase. Neither could they pay the early redemption fees that would be incurred on selling their investment. In that context, Mr. Duncan acknowledged that the clients' reluctance to return the truck in downsizing to a less expensive vehicle was "a red herring".

[68] Mr. Duncan again attempted to assist the Andrews in March of 2010 by presenting them with a list of debt restructuring options which he set out in an e-mail to them. He identified their options at that time as being the restructuring of all their debt, declaring bankruptcy and/or downsizing their vehicle. Soon thereafter, they did return the truck to the dealership but otherwise have struggled on ever since. Unfortunately, Sheila Andrews passed away later that year.

[69] Finally, in dealing with the Verney matter, Mr. Duncan's notes indicate that he met with these clients on September 13, 2007 at which time he sought to verify their true financial picture and review their overall investment strategy (which was to reduce their mortgage debt). The Verneys were using the monthly distribution income to pay down the mortgage on their home and to retire a line of credit and consumer debt. Their investments through Mr. Allen were leveraged by three bank loans in the aggregate amount of $445,000.

[70] Mr. Duncan testified that he followed his standard protocol as above described in reviewing financial information and discussing the options that were available, including cashing in the investments.

[71] Mr. Duncan did further KYC updates in November of 2007 and again on or about March 8, 2008 in conjunction with a further meeting with the Verneys. In the latter respect, Mr. Duncan followed up with an e-mail on March 11, 2008 with the intention of covering items that were discussed at that meeting. No mention was made in that e-mail about the option of deleveraging their loans. An attempt was made to convert the B2B Trust loan to a non-margin call loan but that attempt was unsuccessful. It appears that the only other outcome from that March 8th meeting was the direction to reduce the loan payment to AGF by $400 per month. Otherwise, no further steps appear to have been taken by either side and unfortunately, Mr. Verney has since passed away.

[72] In summary, Mr. Duncan candidly made the following acknowledgements in the course of his testimony:

● the leveraged loans placed by Mr. Allen were unsuitable for all six pairs of plaintiffs who he inherited as clients, having regard to the Keybase leveraging guidelines;

● none of these clients was ever advised in writing that this leveraged investment strategy was unsuitable for them (all they got in writing from Keybase was the assurances contained in the original form letters sent out in September of 2007). Mr. Duncan acknowledged that in his opinion, this is

something that should have been done by Keybase;

● with the exception of the Shanes, the available options for the clients were never put in writing to them (notwithstanding that Keybase knew that they were all unsophisticated investors with little to no investment knowledge and placed in a predicament where it was not an easy decision for them to make;

● more specifically, it was never suggested to the clients in writing that they sell their investment and get out of this leveraged strategy for which they were unsuited; nor was the possibility held out (except perhaps verbally to the Camerons) that Keybase might help them extricate themselves from this leveraged strategy by assisting with payment of the early redemption fees (notwithstanding that these fees were associated with investment loans which they never should have gotten but for Mr. Allen's fraudulent conduct, which went unchecked by the failure to supervise on the part of both Mr. Duncan and the Keybase head office);

● once the magnitude of the problem became known to Keybase, it did not assign sufficient resources to deal with it. It was pretty much left to Mr. Duncan to handle the approximately 80 affected clients (with Mr. White's assistance) on top of all their regular duties. Mr. Duncan acknowledged that in hindsight, it would have been a better strategy to have dedicated an advisor from Keybase to deal with the situation in a more thorough and timely fashion;

● Mr. Duncan was not given any specific direction from Keybase on how to advise or deal with the affected clients, other than to assign them to a replacement advisor and verify the pertinent financial information;

● Keybase never made a centralized effort of any sort to help the affected clients extricate themselves from this unsuitable leveraged investment scheme

their agent John Allen had gotten them into. Keybase offered no financial assistance other than to refund its portion of the related commissions in conjunction with the Settlement Agreement with the Securities Commission;

- Keybase did not provide any direction to treat the affected clients as new accounts with their replacement advisor which would have ensured that accurate information be obtained promptly and that all required paperwork was put in place (including risk disclosure to the clients). Mr. Duncan acknowledged this would have been a reasonable approach in the circumstances;
- none of these clients were given a Client Disclosure brochure or were asked to sign a Leveraged Risk Disclosure form, all as required by Keybase's internal policy above recited;
- KYC updates were not completed accurately or in a timely manner in many instances which perpetuated false information on file with respect to the clients' true financial picture, their level of investment knowledge and their risk tolerances;
- a properly completed KYC form and their updates is a key document for assessing the suitability of an investment for a client;
- Keybase gave no direction that clients opting to stay in the leveraged investment strategy should obtain independent legal advice.

Evidence of Jim White

[73] Jim White became a financial advisor when he joined Investors Group in 1993. There he met John Allen and within three or four years, they became partners. Subsequently, they went through a number of moves together to

other mutual fund dealerships, the most recent two of which were a move in 2005 to Global and, in the Spring of 2007, to Keybase. They operated out of an office in Truro where they shared office expenses (but not clients) until Mr. Allen's termination around the end of August.

[74] Soon after that occurred, upwards of 50 of Mr. Allen's former clients were assigned to Mr. White by Mr. Duncan, including the plaintiffs Bateman, Crowell and Ramsay and Matheson. Mr. White was asked to contact two or three specific clients first but he was given very little information from anyone at Keybase, including the details surrounding the termination of Mr. Allen's employment.

[75] The process which Mr. White then adopted on his own accord was to print out pertinent KYC documents and account summaries by the investment loan banks. With that bare information, he set up interviews with the former clients of Mr. Allen. In those interviews, he said he wanted to determine the accuracy of the financial information contained on the KYC forms and to determine if the clients understood the nature of the loans they had taken out, their obligation to repay those loans and the associated risks of the investment. He also said that he informed them that they could sell their investments to apply against the loans but that it would be at a loss, not to mention the early redemption penalties that would be incurred. The other option explained to the clients was that they could stay in the investment program and reinvest the income distributions in hopes that their asset would grow.

[76] Mr. White said that he did a KYC update with each client to get a feel whether they wanted to stay in the program. He acknowledged that in his view, what was best for the clients was to encourage them to stay in the investment program, reinvest the income distributions and grow their assets. He also encouraged them to try and lower their debt level.

[77] Mr. White recounted that most of the former John Allen clients that were assigned to him decided to continue with the leveraged investment program, not wanting to give up the monthly stream of distribution income, including the plaintiffs Crowell, Bateman and RamsayMatheson.

[78] Mr. White acknowledged his limited recollection of his meetings with these particular clients, which is not surprising where they took place some six years ago without his having recorded any notes at the time.

[79] As for the Crowells, Mr. White performed a KYC update with them on November 13, 2007 at which time no changes were made to the pre-populated tick marks on the form concerning their financial details, which perpetuated those errors. These clients had taken out a leveraged 2 for 1 loan through Mr. Allen of $107,000.

[80] Mr. White acknowledged that this type of investment probably wasn't suitable for the Crowells but that they were happy with it as long as they continued to receive their monthly distribution income. Although they decided to stay put in the investment program, they did follow two subsequent

recommendations by Mr. White made in 2008. The first was to make a switch from one Stone mutual fund to another which would provide a lesser level of monthly distribution, but leave the capital more secure. The second instance was to implement a change of the leveraged loan to a non-margin call basis accompanied by a change in the principal and interest payment. Apart from those two changes, the Crowells stayed with the leveraged loan investment program only to see the market collapse in late 2008.

[81] As for Mr. Ramsay and Ms. Matheson, Mr. White met with them on November 5, 2007 but has little recollection of what was discussed. These clients had taken out two leveraged loans through Mr. Allen in the aggregate of $270,000.

[82] Mr. White explained that the financial data ticked off in the KYC was then left uncorrected because Ms. Matheson didn't want it changed, apparently because she was concerned about falling in bad favour with the investment bank if they knew her true financial picture. Ms. Matheson denied this in her rebuttal evidence. In any event, Mr. White did not insist on correcting the KYC form (which was not a document that went to the investment banks) because, as he put it, this information has no bearing on the loan and how they were to deal with it.

[83] As a result of this meeting, Mr. White felt that these clients were headed for trouble by not reinvesting the monthly distributions. He says he therefore gave them two options. First, they could sell their investment and take their

loss and incur the early redemption fees as well. Secondly, they could face reality and start reinvesting the monthly distributions and try to manage the investment. Mr. White recounted that these clients thought that they could not afford to absorb the loss and the early redemption fees and elected the latter option although they never implemented it. The only change they ever made was the same switch of funds as the Crowells had made to another Stone fund which yielded a lower return but better protected the capital amount.

[84] When asked on cross-examination whether this leveraged investment was unsuitable for these clients, given their financial situation, he candidly agreed that it was. He said that the tenor of his discussions generally with clients about suitability was to advise them that they shouldn't have this type of investment loan but they did, and what they were going to do with it. As stated above, he felt that the right thing to do in these circumstances was to encourage them to stay in the investment program but to reinvest the distribution income and grow the asset.

[85] As for the Bateman plaintiffs, Mr. White was unable to set up a meeting until January 9, 2008, earlier attempts having been unsuccessful. Mr. White said he recalled little of that meeting but that he would have given him the same options as the other clients, namely, to either sell the investment and suffer the financial consequences of a loss plus early redemption fees or, as he put it, "better still to reinvest the distributions and grow the asset". The Batemans had taken out four investment loans through Mr. Allen in the aggregate amount of $400,000.

[86] Mr. White testified that Mr. Bateman wanted to know if he could do even more loans. Mr. White's response was that he could not and there wasn't enough financial information known to support it. He said that Mr. Bateman didn't like providing full financial information and without that, it would be a tough call for him to agree that the leveraged investment loans he was into were unsuitable for him.

[87] At the conclusion of his cross-examination, Mr. White acknowledged the following points:

- he was given no advice from Mr. Duncan or head office whatsoever on how to deal with the clients he inherited from Mr. Allen or how to clean up the mess. Rather, the Keybase head office left it up to him to do so and, at the same time, keep up the duties of his regular job;
- although he asked each client if they were comfortable with it, his general plan was to keep the leveraged investment program the same when taking over these former John Allen accounts;
- because these clients were not treated as new clients, Mr. White felt that there was no point in assessing the suitability of their investment program, i.e., by looking at their net worth in comparison with the leveraged loan amounts, because the loans were already in place;
- the worst case scenario for over-leveraged clients was a collapse of the market which is exactly what happened in late 2008;
- because of the large number of clients assigned to him (upwards of 50) quick interviews were required and to some extent, there wasn't enough time to do them properly. He therefore had trouble properly updating the KYC

forms in what he described as a very, very busy time.

[88] I found Mr. White to be a straightforward, credible witness who was quite candid about what he did and did not do in handling the three pairs of plaintiff clients he inherited from Mr. Allen. Having received no guidance or direction from his superiors at Keybase, he encouraged his clients to do what he thought was best for them in a bad situation. Unfortunately, the worst case scenario of a market collapse came to be in late 2008 which left the various plaintiffs crushed by the weight of the investment loans that Mr. Allen got them into, far beyond their true financial means. It is fair to say that the shortcomings in adequately dealing with the affected clients once Mr. Allen's scam was discovered lies mainly with the management personnel at the Keybase head office, none of whom testified.

Evidence of Janice Verney

[89] Ms. Verney is currently employed as a part-time receptionist at a dental office and has a high school education. She and her husband Robert (who has since passed away) took out leveraged investment loans through Mr. Allen in the aggregate of $445,000. They were assigned to Mr. Duncan after receiving the form letter from Keybase dated September 6, 2007 and went to Halifax to meet with him later that month.

[90] The advice they were given, as recounted by Ms. Verney, was that Keybase would do their best to have things remain the same, so that nothing would change for anyone, which was consistent with the content of the form

letter they received.

[91] Ms. Verney stated that she and her husband met with Mr. Duncan two or three times during the fall of 2007 and that she found him to be vague. She said that he lead her to believe that things were under control and made her feel comfortable at that point that what she had by way of an investment program was okay. She said they were not cautioned of the risks of this type of investment program. She added that it was only much later, in her final meeting with Mr. Duncan (which appears to have been in January of 2009 when she had a meltdown in his office) when Mr. Duncan advised her that she shouldn't have that type of investment and should get a lawyer.

[92] Ms. Verney testified that prior to the market crash in 2008, Mr. Duncan never suggested to her that she should cash in the investments and pay down the investment loans. She acknowledged that she knew that mutual funds could be cashed in, but was aware that that would invoke huge penalties which she couldn't afford. In any event, she stressed that that option was never suggested to her by Mr. Duncan. Rather, the only options ever presented by Mr. Duncan were to leave the investment plan as is, or make changes to the allocation of monthly distribution income by reinvesting that income to buy new units instead of paying down debt. In March of 2008, this and other adjustments to the loans were implemented on Mr. Duncan's recommendations, as earlier referred to in this decision.

Evidence of Darlene and Charles Crowell

[93] Darlene Crowell is currently employed as a warranty clerk in a Toyota dealership and has a high school education. She and her husband took out an investment loan through Mr. Allen in the amount of $107,000 while investing another $53,000 of their own.

[94] The Crowells were assigned to Mr. White as their replacement investment advisor in the fall of 2007. Their first meeting with him took place on November 15, 2007 at which time they expressed their concern about where they stood and what would happen. Ms. Crowell testified that Mr. White's advice to them was to carry on with their investment plan and that eventually things would come around. She said they were not told by Mr. White of the unsuitability of this investment plan or the associated risks.

[95] Ms. Crowell testified that they asked Mr. White if they could sell their investments and get out of this leveraged strategy which they wanted to do. She said they were advised that they could but that big penalties would be incurred. Although the amount of these penalties was not specifically quantified, the Crowells understood that they could not afford to pay them and no offer of assistance was made by Keybase to help them do so.

[96] Ms. Crowell added that the only recommendation made by Mr. White in carrying on with the investment plan was to change from one mutual fund to another and to reallocate their monthly income distributions which they did.

Charles Crowell is currently employed as a custodian with a regional school board. He has a high school education plus two years of arts studies in university.

[97] Mr. Crowell affirmed his wife's testimony that they asked Mr. White if they could get out of the scheme and that Mr. White advised that it was better to stick it out or else penalties would be incurred which they couldn't afford. He said that they were not advised to follow that route and that no offer of assistance was otherwise given to them.

Evidence of Martin Andrews

[98] Mr. Andrews is employed as a truck driver and has a grade 10 education. He and his wife, who has since passed away, took out three investment loans through Mr. Allen in the aggregate of $305,000. He also invested $30,000 of his own money. He understood that the monthly distribution income would be used to pay down his home mortgage and cover the payments of a new truck purchase.

[99] Mr. Andrews and his wife were assigned to Mr. Duncan as their replacement investment advisor. At their first meeting in his office, Mr. Duncan told them, after going through the documentation, that they shouldn't have this investment and were in debt way over their heads. Nonetheless, he said that Mr. Duncan's advice to them was that he would look after things and make it work.

[100] Mr. Andrews testified that he and his wife told Mr. Duncan that they did not understand how all this worked. They were lead to believe that Mr. Duncan would be working with the investment bank for a solution and that in the meantime, things were to remain the same. This ultimately lead to changes being made to the investment program whereby the Andrews switched from one mutual fund to another (with less risk) and increased their loan payment.

[101] Mr. Andrews' testimony was that beyond those changes, he was not given the option of getting out of the investment scheme by selling his investments, at least not that he could recall. He said he did not understand he had that choice to make and that he could not remember if early redemption penalties were discussed.

[102] When referred to the KYC updates completed by Mr. Duncan in November of 2007 for Mr. Andrews and his wife respectively, Mr. Andrews' testified that although they were signed at that time, they contained inaccuracies in that their net worth remained overstated, they did not have either good or fair investment knowledge and they did not have a risk tolerance of "medium high". Mr. Andrews further testified that the risk or dangers of leveraged investing were not explained to him, either by Mr. Allen or Mr. Duncan.

[103] Mr. Andrews did acknowledge, however, that Mr. Duncan advised him from the outset that he should sell the new truck he had purchased, the payments on which were being made from the monthly distribution income

from the investments. Mr. Andrews did not follow that advice initially because he didn't want to give up the truck and it also meant taking a significant loss if he were to return it to the dealership. He eventually did do that (a couple of years later) on a breakeven basis.

Evidence of Becky Waterfield/Jarrod Phillips

[104] Ms. Waterfield and Mr. Phillips were the only young couple amongst the plaintiffs to be taken in by Mr. Allen's fraudulent conduct. In 2007, they were both 25 years old and expecting their first child and anxious to buy a home.

[105] Mr. Phillips had just come into an inheritance of approximately $86,000 of which $40,000 was applied to a down payment on a house and another $40,000 invested with Mr. Allen. They also took out a so-called 2 for 1 loan of $80,000 to make a total investment of $120,000, the income from which was used to make their mortgage payments.

[106] Ms. Waterfield is currently employed at a realty management company where she performs administration and bookkeeping functions. She has a high school education and also studied commerce at university for two and half years (a program she did not complete). She was the one who looked after all the household finances.

[107] Ms. Waterfield recalled meeting with Mr. Duncan as their replacement investment advisor in the fall of 2007 to discuss their situation and the available options going forward. She recalled Mr. Duncan's advice that this

investment scheme was not intended to be set up for payment of a mortgage on their home. Mr. Duncan raised the question with them whether they would consider giving up their home to get rid of the investment loan but they said that was not an attractive option with their first child on the way.

[108] Ms. Waterfield acknowledged that they couldn't afford to keep the home without the monthly dividend income. That lead Mr. Duncan to suggest making changes in their investment program whereby they later switched to a different investment fund and remortgaged their home to achieve a lower monthly payment.

[109] Ms. Waterfield testified that Mr. Duncan never gave them the option of selling or cashing in their investments. She assumed they were locked in (subject to being transferred from one fund to another). She said that early redemption penalties were never discussed, nor were the associated risks of staying in such an investment program.

[110] On cross-examination, Ms. Waterfield acknowledged that they couldn't afford to keep the house without receiving the monthly distribution income to meet the mortgage payments. They therefore opted to maintain the status quo for the time being with the knowledge that their investments were in a declining trend and that the investment program was not suitable for them. She later clarified that she understood this investment to be unsuitable only in the way it was set up, namely, to cover monthly mortgage payments. She said she was not advised that a borrowing to invest strategy itself was unsuitable

for them.

[111] In any event, Ms. Waterfield thought they were locked into these investments and no assistance was offered by Keybase to help them extricate themselves from the situation they found themselves in. They therefore gave no instructions to Mr. Duncan to make changes (except for their delayed response in switching to a different investment fund) which enabled them to keep their house.

[112] Mr. Phillips is currently employed as a tire technician. He relied on his wife Becky to handle their financial affairs and doesn't remember much about their meetings with Mr. Duncan. He said that he had no real understanding about their options at the time; only that he thought they were locked in and couldn't do anything about it.

Evidence of Lisa Matheson/James Ramsay

[113] Ms. Matheson is currently employed as an elementary school teacher in Truro and has undergraduate university degrees in science and education. She is now divorced from James Ramsay following their separation in 2009.

[114] These plaintiffs took out two investment loans through Mr. Allen, the first in June, 2005 in the amount of $20,000 and the second in June, 2007 in the amount of $250,000. After Mr. Allen's fraudulent conduct came to light, these plaintiffs were assigned to Mr. White as their replacement financial investment advisor. They then learned that they had an investment loan that

they were not eligible for (although they were not advised of the forgeries perpetuated by Mr. Allen until some years later). They therefore asked if they could get out of the investment scheme by selling their investments, which they wanted to do. However, Ms. Matheson testified that they were told by Mr. White that this was not their best option because huge penalties would be incurred, that the investment portfolio they presently had was working and that they should just leave it. She said that Mr. White showed them some historical charts of market fluctuations and that he was always reassuring when answering the questions that she asked, without ever explaining the associated risks.

[115] Ms. Matheson said that she trusted Mr. White's advice. She thought they could not get out of the investment scheme, that the penalties were so high (without being quantified) that it wouldn't work and that it would be best to stay with the portfolio they had which was working for them.

[116] Ms. Matheson testified that Mr. White's advice remained the same after the market collapse in 2008 when they were told they were stuck and that they should stay in the investment program until the market eventually turned around so as to generate monthly income to pay down their loans. He even encouraged them to then reinvest the monthly distribution income by buying new units while the market was low. At no time were the plaintiffs offered any financial assistance by Keybase, through Mr. White or otherwise, in getting out of the investment program.

[117] When referred to the KYC update forms completed by Mr. White, Ms. Matheson pointed out that the income levels, net worth, investment knowledge and risk tolerance were all overstated. She denied, contrary to the testimony of Mr. White, that she instructed him to leave these inaccuracies in place in order to keep the true financial information from the investment bank who she mistakenly believed would receive a copy of the KYC forms.

[118] Mr. Ramsay briefly testified as well. He is a barber in Truro and has a high school education plus one year at university.

[119] Mr. Ramsay did not add much to the testimony of Ms. Matheson as she looked after the household finances. He recalled being told by Mr. White that things were a mess but that he didn't really know what was going on. He affirmed that they asked Mr. White what they should do and whether they could get out of the investment program. He said those questions were met by assurances from Mr. White that it would be too expensive for them to sell out because of the high early redemption penalties and that they should stay the course because in time, everything would be fine and work itself out. He also testified that the risks of leveraged investing were not explained by Mr. White, nor was any assistance offered to help them get out of the investment program.

Evidence of Wilma Lee Shane

[120] Ms. Shane has worked in various secretarial and administrative jobs over the years but is currently unemployed. She has the equivalent of a high school diploma and attended secretarial school in Boston. Her mother Ruth

Shane passed away in 2012.

[121] Ms. Shane attested to having a learning disability and Attention Deficit Disorder (ADD) which, when under stress, affects her concentration and takes her longer to process information.

[122] Ms. Shane was introduced to Mr. Allen through a relative back in 2000 and took out her first investment loan through Mr. Allen in 2001 when he worked for Dundee Private Investor Inc. Ms. Shane has since settled with Dundee but continues her action against the present defendants in respect of two investment loans in the aggregate of $310,000. She also invested another $30,000 of her own.

[123] Upon receiving the Keybase form letter sent in early September, 2007 Ms. Shane said she knew she was in over her head and needed a lawyer. She thereupon retained Mr. Sean Foreman who wrote a letter to Mr. Duncan at Keybase dated October 31st as earlier recited.

[124] In that letter, a demand was made for the immediate suspension and investigation of the AGF Trust loan account and confirmation that no further payments of income or loan payments be completed on that account. The request was also made, if possible, to reverse that fraudulent transaction without loss or impact on Ms. Shane. The letter further requested disclosure of a complete copy of the client file for Ms. Shane and her mother Ruth Shane.

[125] As mentioned earlier, it appears that letter was never responded to, nor was there any follow up to a brief meeting Ms. Shane attended with Mr. Duncan and Mr. Harrigan from whom she sought to get a complete copy of their file. Indeed, Ms. Shane made a complaint to the Nova Scotia Securities Commission over Keybase's lack of disclosure. In November of that year, she also consulted an outside financial advisor for a second opinion who recommended against any leveraging strategies given their personal circumstances and low risk tolerance.

[126] The first meaningful meeting Ms. Shane had with Mr. Duncan took place on March 10, 2008 after Ms. Shane had received a margin call warning letter from B2B Trust. Ms. Shane said that she was still not clear at that point what had happened and asked Mr. Foreman to accompany her to the meeting because she was concerned about her ability to understand this level of investing.

[127] Ms. Shane acknowledged that Mr. Duncan presented a couple of options to them at this meeting but that she was struggling to understand what he was saying. Minutes of that meeting were taken which indicate that discussions covered the subjects of reinvesting the monthly income distributions, converting the loan to a no margin call loan, liquidating the investments and disclosure. The minutes reflect that Mr. Duncan advised that he did not have the authority to offer any remedy concerning the AGF loan and that this would have to come from head office.

[128] Mr. Duncan followed up that meeting with an e-mail to Ruth Shane (with copies to Ms. Shane and her counsel) on March 18th. In that e-mail, Mr. Duncan set out the options of converting to a no margin call loan with B2B Trust, reinvesting the distribution income (net after interest costs), liquidating the investments or staying with the existing plan.

[129] Ms. Shane testified that she felt scared about her situation and didn't want to make any quick moves until she was sure what the appropriate next step would be. Indeed, on June 27, 2008 Mr. Foreman again wrote to Mr. Duncan essentially raising three points. First, he complained about the continuing inaccuracies in the KYC update forms. Secondly, he asked for confirmation that the B2B Trust loan had been switched to a non-margin call status (which appears to have never happened). Thirdly, he referred to advice from an independent financial planner to not cash out their investments with Keybase until they obtained a complete picture of what had occurred and what losses and damages had been sustained (including early redemption penalties).

[130] Ms. Shane testified that at no time did Keybase make any offer of financial assistance to remedy the situation. She said if they had, she would have cashed in her investments.

Evidence of David and Sharleen Bateman

[131] Mr. Bateman is a resident of Pictou county where he works as a freelance building designer. He did not complete high school but graduated from vocational school in 1967 in the field of architectural drafting.

[132] Mr. and Ms. Bateman took out leveraged investment loans through John Allen in 2007 in the aggregate of $400,000. These loans, advanced in two stages, were taken out in pursuit of an investment strategy whereby the return of monthly distribution income would pay down mortgages they placed on a rental property and their residential property respectively. The Batemans also invested an additional $200,000 from their own resources.

[133] The first sign of trouble was Mr. Bateman's receipt of Mr. Duncan's form letter of September 12th, 2007 which he did not show to his wife to avoid any upset. Mr. Bateman was not overly concerned at first but was aware from Mr. Duncan's letter of October 13th that Jim White had been assigned as his replacement investment advisor.

[134] It appears from the evidence that Mr. Bateman first met with Mr. White on or about January 9, 2008 followed by a second meeting in January 2009 after the receipt of a margin call warning letter. Mr. Bateman was obviously confusing the two meetings during his evidence and could only actually remember the meeting held in January of 2009 when the margin call warning letter was addressed and changes made.

[135] Although Mr. Bateman was confused about the dates, he did recall Mr. White advising him that it was too late to get out of the investment program because of the loss that would have to be taken, on top of which large penalties would be incurred (which he understood were estimated to be around $60,000). He admitted that this discussion might have taken place at the

January, 2008 meeting.

[136] In any event, Mr. Bateman testified that he was not given advice that his investment program was unsuitable and if he had known that, he would have gotten out of it. Neither were the risks of staying in this leveraged strategy explained to him. Nor was he ever offered any financial assistance to help him get out of the program, even after he made a formal complaint to Keybase.

[137] Sharleen Bateman was unable to add anything in her testimony because her husband looked after all the household finances and she only became aware of the problems through him (not having attended any meetings herself).

Evidence of John Cameron

[138] Mr. Cameron is also a resident of Pictou County whose wife Linda passed away on August 1, 2012. Mr. Cameron is a former police officer in New Glasgow, having been forced to retire six or seven years ago by reason of a disability. Mr. Cameron and his wife took out a leveraged investment loan through Mr. Allen in 2007 in the amount of $245,000.

[139] It was little more than a month after they received a letter from AGF Trust confirming approval of their loan that they received Mr. Duncan's form letter dated September 6th. Mr. Duncan then became their replacement financial advisor who gave assurances that he would be looking after them and that everything would be okay.

[140] Mr. Cameron did not attend the first meeting held between Mr. Duncan and his wife Linda on October 16th . However, he did meet with Mr. Duncan himself on October 23rd and again on October 31, 2007.

[141] Mr. Cameron's evidence was often sketchy in the details where his wife Linda looked after all the household finances and he was not always in the loop. It appears that he had a limited understanding of what was going on at the time and he acknowledged as well that his memory of these events is not good.

[142] Mr. Cameron testified that he had no recollection of the available options being explained to him by Mr. Duncan in their meeting of October 23rd. More specifically, he could not recall being advised by Mr. Duncan of the option of cashing in their investments to pay down their loans or anything about the possibility that Keybase might cover the early redemption fees. The handwritten notes made by Mr. Duncan in connection with these meetings indicates otherwise although as I have already found, no offer to assist with payment of these fees was ever actually made.

[143] Although Mr. Camerson appears to have attended the October 31st meeting with Mr. Duncan together with his wife (held for the purpose of making certain changes within their investment plan), he was not privy to a subsequent meeting held with Mr. Duncan on February 19, 2008. As recited earlier, Mr. Duncan has attested to ongoing discussions of the options available at that time but it appears nothing further was done by either side.

[144] Mr. Cameron added that if Keybase had offered to cover the early redemption fees on cashing in the investments, they would have done so to clear the slate.

[145] Also in evidence by consent is a transcript of the discovery evidence of Linda Cameron taken on December 13, 2010. The upshot of that evidence is that she does not remember Mr. Duncan ever speaking about selling their investments and paying down the loan or mentioning the associated early redemption fees. She said she didn't think she could do that as an option. Rather, she followed his advice to switch their investments from one mutual fund to another.

Evidence of Denise Kowalski-Phillips and Jeffrey Phillips

[146] Ms. Kowalski-Phillips is another Pictou County resident where she works as a registered nurse. She and her husband had known John Allen for over 20 years and they fully trusted him, not only as their financial advisor but as a friend. However, through forgeries and having documents signed in blank in advance, Mr. Allen placed investment loans on their behalf in the aggregate of approximately $460,000.

[147] After they were assigned to Mr. Duncan as their replacement financial advisor in September, the Phillips met with him at their home on October 16, 2007. Ms. Kowalski-Phillips testified that after reviewing their financial situation, Mr. Duncan's advice was to stay put in anticipation that the market would improve, with the one exception being a recommendation that they

change their investments from one mutual fund to another (which they did).

[148] In cross-examination, Ms. Kowalski-Phillips acknowledged that she knew at that point that it was an option for them to sell their investments and pay down the loans. However, she countered that Mr. Duncan's advice was to stay with the investment program and that he made it appear that it was doable for them to financially sustain the loan payments. She said that Mr. Duncan never advised them of anything contrary to his September 6th letter stating that their investment program would remain the same (except for the switch of mutual funds aforesaid). She also thought that if they were to cash in, they would incur huge penalties which they couldn't afford and which Keybase offered no financial assistance with.

[149] She did not recall any mention by Mr. Duncan of the associated risks of staying put in their investment program. She also said that Mr. Duncan perpetuated errors in their KYC update completed at that meeting by overstating their net worth, their risk tolerance and describing them as "sophisticated" investors which they were not.

[150] Her husband, Jeffrey Phillips, was a career police officer in New Glasgow until having to retire due to illness.

[151] Mr. Phillips testified that his wife looked after all the household finances and they he did not pay much attention to the investment program and simply relied on the steady assurances from Mr. Allen. Mr. Phillips did not

add much to his wife's testimony but confirmed that Mr. Duncan's advice to them was to hold the course, notwithstanding that they were over extended. Mr. Phillips recalled no discussion with Mr. Duncan about the option of cashing in their investments and paying down the loans or anything about the associated early redemption penalties. He said that basically, even though he knew they were in big financial trouble, he was not aware that they had the option of cashing in their investments but rather, simply followed Mr. Duncan's advice to hold the course.

FINDINGS OF FACT AND LIABILITY

[152] This is one of those infrequent cases where I found all of the witnesses who testified, without exception, to be credible and sincere persons who were all caught up in a bad situation. I am satisfied that they were all trying to be truthful to the best of their knowledge and recollection.

[153] I say this notwithstanding an obvious and recurring discrepancy between the evidence of several plaintiffs and the evidence of Messrs. Duncan and White relating to the issue of mitigation. Several plaintiffs said that the option of getting out of this investment program in the fall of 2007, by selling their investments and applying the proceeds against their loans, was never properly explained to them by Messrs. Duncan or White; nor were the financial implications of doing so. For those plaintiffs who acknowledged their awareness of this option, their evidence collectively was that their replacement financial advisor, whether Mr. Duncan or Mr. White, did not ever recommend that they pursue that course of action. Indeed, Mr. White in particular

recommended that they stay the course with the investment program, with the implementation of some remedial changes.

[154] Messrs. Duncan and White, on the other hand, attested that they did verbally explain the available options to their assigned clients, including the liquidation or “dilution” of their investments, together with the pros and cons of each option (as recited in more detail in their foregoing evidence summaries). The thrust of their evidence was that each and every client made the decision to stay in the investment program, with the implementation of certain changes they recommended.

[155] I find, on a balance of probabilities, that it is more likely than not that Messrs. Duncan and White did identify the available options to their assigned clients, and the relevant advantages and disadvantages, during their respective meetings. It logically stands to reason that they would have done so, as experienced professionals in the investment industry, in dealing with a mess that was not of their own making. Indeed, Mr. Duncan spoke of following the standard protocol he used when meeting with his clients in this situation, and there is no reason to disbelieve that he did.

[156] That does not mean, however, that those plaintiffs who attested to the contrary were deliberately being untruthful. The answer to this discrepancy, in my view, lies in the following factors:

(a) They were all unsophisticated investors, having virtually no investment knowledge, finding themselves in an unprecedented situation;

(b) They had little familiarity with the concepts and terminology of investments, and particularly a more complicated leveraged investment strategy;
(c) They were being given, as one put it, a flood of information on a subject they did not fully understand;
(d) With one exception (the Shanes) they were given the information about their options verbally, with no follow up in writing to help them digest it;
(e) They were understandably upset at the time;
(f) Disadvantaged as such, they were being asked to recall verbal conversations that took place some six years ago.

[157] The inescapable conclusion is that these plaintiffs by and large did not fully absorb or fully understand the information being given to them about their options in this manner. There was no concerted effort by Keybase to properly inform or assist them. That, and the subsequent passage of time before trial, helps explain their unreliable testimony in this regard.

[158] What ought to have been done by Keybase in the wake of such a fiasco created by one of their own agents, was the development of a central strategy that provided guidance and assistance to Messrs. Duncan and White for their handling of the affected clients, including a proper communications strategy. That strategy should have included a directive to make full and immediate disclosure to the clients about their financial plight and the unsuitability of this type of investment for them, ensuring that the available options were communicated in writing, along with the pros and cons, risks and financial

consequences of each option. These plaintiff clients would have been much better served by that approach.

[159] Instead, Messrs. Duncan and White were largely left to their own devices. What is clear from the evidence is that although it is likely that they verbally identified liquidation of the investment program as a possible option, neither of them actually recommended that course of action to any of the plaintiffs. Nor was any financial assistance ever offered to that end. Rather, the plaintiffs were all enticed to stay with the program, albeit with the implementation of certain recommended adjustments to the individual investments and/or the loans.

[160] This verbal advice simply reinforced the one written communication ever sent by Keybase to the affected clients (with the exception of one e-mail later sent to the Shanes who had difficulty understanding it all), assuring them that their "investment program remains the same" and, in the case of AGF Trust borrowers, that Keybase would be working closely with that bank "to create solutions that will have minimal or no impact to your current financial plan". Nothing to the contrary was ever sent in writing by Keybase to the plaintiffs at any subsequent time.

[161] At this juncture, I will refer briefly to the expert reports filed in these cases. The Keybase expert, Lorne Levy, is the CEO of an investment industry consulting service in Toronto. The main thrust of his opinion was that Keybase's actions in response to the discovery of Mr. Allen's fraudulent

conduct and in subsequently dealing with the affected clients were fully consistent with the rules, regulations and practices of the industry. Perhaps so, if this were the more common type of case where a financial advisor has been terminated for simply making unauthorized transactions. The situation here, however, is far more egregious and it follows from what has been said earlier in this decision that Keybase, in my view, failed to adequately respond to and address the financial plight of the affected clients.

[162] Mr. Levy's opinion also served to rebut the opinion of the plaintiffs' expert, Anthony Davidson, who is a chartered accountant with a practice in Toronto specializing in providing litigation support in securities matters.

[163] Mr. Davidson was asked to provide an opinion on whether Keybase, in the present situation, would be required to disclose to the clients its own potential liability for the losses incurred, according to mutual fund industry standards.

[164] Mr. Davidson first opined that when Mr. Allen's unethical actions were discovered, Keybase was obligated to disclose to clients in writing the unethical actions of their agent and that the investments made as a result of those actions were unsuitable to the clients. I accept that part of Mr. Davidson's opinion.

[165] Mr. Davidson went on, however, to advance an alternate theory of liability on the part of Keybase. He based this theory on the Conflict of Interest rule of MFDA requiring the exercise of responsible business judgment influenced only by the best interests of the client. In his view, the best interests of the clients would be to have the firm be responsible for the losses, the fact of which should be disclosed to the clients.

[166] With these bare expert reports (neither expert was required to testify), I am not persuaded that the MFDA conflict of interest rules apply to this situation. As espoused by Mr. Levy, it appears to me that they are principally intended to ensure that clients are provided with all material information upon a recommended purchase of an investment product so that the client can make a fully informed decision prior to its purchase.

[167] Frankly, I did not find either of these expert reports to be instrumental in the disposition of this case.

[168] I would add that there is nonetheless a sound basis for the obligation on the part of Keybase to have acted in the best interests of the affected clients, namely, the ongoing fiduciary duty owed to them. It is well established that the hallmark of fiduciary relationship is that a fiduciary, at least within a certain scope, is expected to pursue the best interests of the client over its own (see, for example, **Canson Enterprises Ltd. et al. v. Boughton and Co. et al.**, [1991] S.C.J. No. 91 at para. 23).

[169] I infer from the actions of Keybase above described that it was more concerned with protecting its own best interest by trying to preserve the various investment portfolios, thereby keeping its book of business and the associated commissions, with no payouts to make while hoping for a market turnaround. This would explain why Keybase failed to advise the affected clients of the unsuitability of their leveraged investments, its self-centred efforts to assure the clients that their investment program "remains the same", and its failure to offer any financial assistance to these clients to extricate themselves from improper investment loans they never should have had in the first place, but for their own agent's misconduct. There can be little doubt that it was not in the clients' best interests to remain in this ill-suited leveraged investment scheme.

[170] It is not necessary for me to go so far as to say that Keybase had a legal obligation in 2007 to provide financial assistance with early redemption fees to the affected clients. Nor do I need go so far as to say that Keybase, through the subsequent actions of Messrs. Duncan and White, is liable in negligence to these clients (which indeed is not pleaded). The indisputable basis of Keybase's liability here is breach of contract and breach of fiduciary duty, and vicarious liability therefor. Keybase also has direct liability to the plaintiffs for negligent supervision.

[171] Rather, the actions of Keybase in failing to adequately respond to or address the financial plight of the affected clients should be treated for purposes of these cases as bearing upon the issue of mitigation.

DEFENCE OF FAILURE TO MITIGATE

[172] The defence argument of failure to mitigate was outlined earlier in this decision (at paras. 14-17) and need not be repeated here at length. Essentially, the defendants argue that once the various plaintiffs met with their replacement investment advisor in the fall of 2007 and thereby learned of their true financial situation, a reasonable mitigation period was triggered during which they became subject to a duty to take reasonable steps to mitigate their damages.

[173] Defence counsel, in final submissions, framed the question for each plaintiff to then decide as being whether to accept the risk of staying in their investment program or to sell their investment to pay down their loans to cut their losses. Defence counsel acknowledges that the plaintiffs in these circumstances needed some reasonable length of time to react, which is suggested to be some time prior to the end of 2007 (with the possible exception of the Batemans whose first meeting with Mr. White was not until January of 2008).

[174] The culmination of this argument is that all future losses incurred after the end of the mitigation period are the responsibility of the investors. This takes on added significance in the present cases because the global market collapse followed in the latter part of 2008.

[175] The well known principles of the law of mitigation were recently restated by the Supreme Court of Canada in **Southcott Estates Inc. v. Toronto Catholic District School Board** [2012] S.C.J. No. 51 where the Court said (at paras. 23-25):

> This Court in Asamera Oil Corp. v. Seal Oil & General Corp., [1979] 1 S.C.R. 633, cited (at pp. 660-61) with approval the statement of Viscount Haldane L.C. in British Westinghouse Electric and Manufacturing Co. v. Underground Electric Railways Company of London, Ltd., [1912] A.C. 673, at p. 689:
>
> > The fundamental basis is thus compensation for pecuniary loss naturally flowing from the breach; but this first principle is qualified by a second, which imposes on a plaintiff the duty of taking all reasonable steps to mitigate the loss consequent on the breach, and debars him from claiming any part of the damage which is due to his neglect to take such steps.
>
> In British Columbia v. Canadian Forest Products Ltd., 2004 SCC 38, [2004] 2 S.C.R. 74, at para. 176, this Court explained that "[l]osses that could reasonably have been avoided are, in effect, caused by the plaintiff's inaction, rather than the defendant's wrong." As a general rule, a plaintiff will not be able to recover for those losses which he could have been avoided by taking reasonable steps. Where it is alleged that the plaintiff has failed to mitigate, the burden of proof is on the defendant, who needs to prove both that the plaintiff has failed to make reasonable efforts to mitigate and that mitigation was possible . . . .
>
> Mitigation is a doctrine based on fairness and common sense, which seeks to do justice between the parties in the particular circumstances of the case.

[176] In **Paniccia Estate v. Toal** [2012] A.J. No. 1395, the Court of Appeal added the comment (at para. 86) that “Courts are extremely slow to criticize good-faith decisions by victims of torts about both whether to take steps in mitigation, or which steps, or how much expense or risk to incur in doing so. Hindsight, or whether the attempted mitigation ultimately pays off, is emphatically not the test”.

[177] The leading case on the duty to mitigate in the context of a trust or fiduciary relationship in the investment industry between brokers and clients is **Laflamme v. Prudential-Bache Commodities Canada Ltd.** [2000] S.C.J. No. 25. That case is conveniently summarized by the Ontario Court of Appeal in **Hunt v. TD Securities** [2003] O.J. No 3245 (at paras. 87-88):

> In Laflamme, an unsophisticated investor entrusted funds from the sale of his business to a broker for discretionary investment. The purpose of the investment was to provide retirement income. The investor later learned from his auditor that some of the investments being made on his behalf were speculative and that the broker was managing the portfolio on margin. The investor instructed the broker to stop the margin transactions and to make only safe investments. The broker failed to follow these instructions. Stock prices fell. After approximately one year, the investor closed his account and sustained major losses.
>
> The Quebec Court of Appeal found that the plaintiff should have acted sooner to mitigate his losses. The Supreme Court of Canada disagreed, saying (at paras. 53-54):
>
>> In the case of injury resulting from mismanagement of a securities portfolio, a flexible approach must be taken in determining what constitutes a reasonable period of time for the client to act and mitigate the damages. In particular, regard must be had to the client's level of experience and knowledge of investments, and to the complexity of the situation.
>>
>> I would add that the sense of trust that is characteristic of a contract of mandate also has a significant impact on the state of mind of a client who is the victim of a fault committed by a manager. In this case, that trust lay in the belief acquired in the professional merit of the manager, as a result of which a client, especially one who is not knowledgeable, may be unable or at least reluctant to believe that the manager is incompetent. Both that trust and the confusion resulting from a loss of trust will make it particularly difficult for the victim to take charge of the situation. Awareness of the extent of the injury dawns more slowly. The situation, which the manager himself has create by representing himself as a professional worthy of trust, must be taken into account before blaming the victim for any want of diligence in mitigating damages, especially since the measures to be taken were not obvious and responsibility for taking or advising those measures rested primarily on the respondents, as knowledgeable dealers and managers. A number of options were available: transfer the portfolio to another manager, sell the securities held, or hold onto them in the hope that they would go up

> in value. Obviously, it is easy to identify the right course of action in hindsight. At the time however the decision was one that called for an assessment of highly complex risks, and that involved risks of its own. The Laflamme family held onto the securities. Should they be faulted for that? In the circumstances, we must conclude that they are not to blame.

[178] The Supreme Court of Canada in **Laflamme** went on to say (at para. 56) as follows:

> In order to prevail on this issue, the respondents had to show that the Laflamme family were negligent when they failed to intervene in the respondents' management earlier in the hope of minimizing the losses. The trial judge noted the state of mind and the knowledge of the Laflamme family, who held onto securities in reliance on assurances given by the respondent Roy, whom they trusted. The losses caused by the bad advice and grossly negligent management by Roy cannot be laid at their doorstep. It is reasonable to assume that an average investor faced with similar circumstances would have been indecisive and hesitant when faced with the various options: selling the securities and taking the loss, holding onto them and hoping that they would go back up in value, or transferring the account to another manager. Nor was any evidence tendered to suggest that, on the information available to them at the time, any of these options would have been beneficial. For all these reasons, the Laflamme family cannot be faulted for failing to take further measures in the hope of minimizing the losses. Those losses were sustained as a result of mismanagement by the respondents, which, as the trial judge found, continued until the account was closed.

[179] The **Laflamme** case thus provides guidance on the kinds of factors and considerations that may flex the duty to mitigate, particularly in the context of a fiduciary relationship.

[180] There is also an earlier decision of the Supreme Court of Canada that is helpful in the present analysis, namely, **Canson**, supra. Once again, that case is conveniently summarized in **Hunt**, supra as follows (at paras. 108-110):

> In Canson, [1991] 3 S.C.R. 534, supra, the Supreme Court of Canada discusses the applicability of the concept of mitigation to compensation for breach of fiduciary duty. LaForest J. reviewed the historical interaction of law and equity and the role

that common law concepts, such as mitigation, play in equitable claims including breach of fiduciary duty. At p. 581, LaForest J. concludes that:

> barring different policy considerations underlying one action or the other, I see no reason why the same basic claim, whether framed in terms of a common law action or an equitable remedy, should give rise to different levels of redress.

In a concurring judgment in Canson, McLachlin J. (as she then was) emphasised the distinction between compensatory damages in cases of tort or contract, and equity. McLachlin J. reasons, at p. 545, that "the better approach ... is to look to the policy behind compensation for breach of fiduciary duty and determine what remedies will best further that policy." She distinguishes the policies behind tort and contract from those behind breach of fiduciary duty stating, at p. 554:

> In negligence and contract the law limits the actions of the parties who are expected to pursue their own best interest. Each is expected to continue to look after their own interests after a breach or tort, and so a duty of mitigation is imposed. In contrast, the hallmark of fiduciary relationship is that the fiduciary, at least within a certain scope, is expected to pursue the best interest of the client. It may not be fair to allow the fiduciary to complain when the client fails forthwith to shoulder the fiduciary's burden. This approach to mitigation accords with the basic rule of equitable compensation that the injured party will be reimbursed for all losses flowing directly from the breach. When the plaintiff, after due notice and opportunity, fails to take the most obvious steps to alleviate his or her losses, then we may rightly say that the plaintiff has been "the author of his own misfortune". At this point the plaintiff's failure to mitigate may become so egregious that it is no longer sensible to say that the losses which followed were caused by the fiduciary's breach. But until that point, mitigation will not be required.

McLachlin J. concludes, at p. 556, that:

> The plaintiff will not be required to mitigate, as the term is used in law, but losses resulting from clearly unreasonable behaviour on the part of the plaintiff will be adjudged to flow from that behaviour, and not the breach.

[181] There are a number of cases subsequently decided by Canadian courts on the issue of mitigation in investment industry cases which apply the legal principles set out in the **Canson** and **Laflamme** decisions. The one principally relied on by the defendants is the **Hunt** decision of the Ontario

Court of Appeal.

[182] That case is useful in setting out a review of the legal authorities and identifying the factors warranting consideration in determining the duration of a reasonable mitigation period. On the individual facts of that case, it was held that the plaintiffs were required to mitigate shortly after discovering the defendant's unauthorized selling of certain shares of stock, which they could easily have done by directing the purchase of replacement shares in a timely way. In the result, the plaintiffs were not entitled to any damages beyond the transaction costs and commissions charged to them.

[183] That case is distinguishable on the facts, however, being a case where the Court found no fiduciary duty to exist because the plaintiffs were reasonably knowledgeable investors and had not been vulnerable or relied on the broker's advice. They were operating a non-discretionary account which was not compatible with a finding of trust and reliance. Rather, the relationship found to exist was only a contractual one.

[184] In the present cases, Keybase clearly owed an ongoing fiduciary duty to the plaintiffs. They were all unsophisticated investors having little to no investment knowledge, particularly with respect to the leveraged investment scheme they had been wrongly placed in by Mr. Allen. That made them all the more vulnerable.

[185] This was a huge problem for Keybase, created by the fraudulent misconduct of one of its own agents. They had on their books nine pairs of plaintiffs (and likely others not part of these lawsuits) who were in a wholly unsuitable investment plan, carrying large bank loans they were not eligible for. Even without the benefit of hindsight, it is readily apparent that it was not in their best interest to stay with that investment plan.

[186] Yet Keybase, neither through a centralized effort or through Messrs. Duncan and White, made any actual recommendation to these investors at any time that they get out of this leveraged investment plan. Nor did Keybase offer any financial assistance with the early redemption fees that would accrue. Rather, these plaintiffs were by and large enticed to stay in their investment plan (with certain adjustments later being made) in hopes that the market would eventually bounce back from the crash in 2008. That was the tenor of the form letters sent in September of 2007, which was not dispelled by any subsequent correspondence or by the replacement advisors verbally.

[187] So what were these plaintiffs to do, particularly in their state of mind at the time? They only had two choices: sell or stay the course. Some of the plaintiffs did not fully understand they had the option to sell (as earlier canvassed in this decision). Those who did understand the availability of that option did not have the financial resources to pay the early redemption fees and take the loss. They were, in the vernacular, between a rock and a hard place, trying to deal with what was for them a highly complex situation. Indeed, this is another situation where it is apt to adopt the language in

Laflamme that "an average investor faced with similar circumstances would have been indecisive and hesitant when faced with the various options".

[188] Whether through indecisivenes, lack of resources or conscious choice, all of these plaintiffs stayed the course. In hindsight, it was not the right route to take. However, in my view, they cannot be faulted for that. It bears repeating that Keybase never actually recommended the selling option to anyone, notwithstanding the unsuitability of this type of investment. Rather, the plaintiffs were in some measure enticed to stay the course which was in the best interest of Keybase, not theirs.

[189] The burden of proof on the issue of mitigation lies with the defendants. That burden becomes heavier when applied in the context of a fiduciary relationship. In the final analysis, it is Keybase's own failure to adequately respond to and deal with the financial plight of these plaintiffs that defeats its argument on mitigation. It would be inequitable to now shift the blame onto the plaintiffs.

[190] The defendants have also raised the parallel argument of contributory negligence on the part of the plaintiffs. The resemblance between contributory fault and mitigation is explained by the authors Burns and Blom in the text *Economic Interests in Canadian Tort Law* (Lexisnexis, 2009) as follows (at page 413):

> The mitigation principle closely resembles that of contributory fault, but the two are analytically distinct. Contributory fault is a defence . . . to liability based on the plaintiff's fault being a cause of the damage. Mitigation is an issue of quantification

> that arises after the damage is done, based on the idea that the defendant's responsibility for the loss ends at the point where the plaintiff could reasonably have prevented further loss. Contributory negligence is not a defence to certain wrongs, most notably deceit, but the obligation to mitigate exists irrespective of the nature of the wrong.

[191] The defence of contributory negligence fails in this case for the same reasons as the mitigation defence. Essentially, the defendants have failed to prove fault on the part of the plaintiffs as a material cause of their losses.

[192] In the result, the valuation day to be used in the agreed upon methodology of calculation of the plaintiffs' financial losses should be the trial date. Where the trial lasted 12 days, I accept the plaintiffs' proposed date of December 1, 2013 which is the date used in all the loss valuation reports for the various plaintiffs filed by their experts, Krofchick Valuation Partners.

[193] Although these reports are in evidence by consent, they were not specifically addressed during the trial. I therefore prefer to have counsel submit an agreement on the specific amount to be awarded to each pair of plaintiffs, rather than simply plugging in the numbers from those reports into this decision. If there is any room for disagreement on these amounts, notwithstanding the agreement on methodology and the Court's determination of the valuation date, I will retain jurisdiction to resolve any remaining dispute.

NON-PECUNIARY DAMAGES

[194] In addition to suing for recovery of their financial losses, the plaintiffs have also claimed for mental distress damages, aggravated damages and punitive damages.

[195] In support of that aspect of the claim, plaintiffs' counsel lead evidence from all 14 surviving plaintiffs describing their psychological and emotional injury resulting from their financial devastion perpetrated by Mr. Allen. For the sake of brevity, I will refrain from a recitation of that evidence by each individual plaintiff. Suffice it to say that the commonality of that body of evidence is the plaintiffs' description of the stress, anxiety, grief, anguish, humiliation and embarrassment, insomnia, loss of self-esteem and loss of trust which they have all suffered over the past six plus years. Although there was no medical evidence adduced on this aspect of the claim, I am satisfied from listening to the plaintiffs that they have all suffered a psychological and emotional injury, perhaps some more deeply than others, in dealing with the fallout from Mr. Allen's fraudulent conduct.

[196] Indeed, their evidence in this respect was not challenged in cross-examination, and understandably so. They have undoubtedly suffered long lasting ill effects on their psychological well-being from these events which cannot be fully compensated for in an award of pecuniary loss.

[197] The questions therefore to be determined are whether the plaintiffs are entitled in these circumstances to a non-pecuniary award of damages and if so, on what basis and in what amount.

[198] I have not been referred to any case precedents by counsel where such damages awards have been made in similar kinds of cases. I therefore go back to first principles, beginning with the availability of mental distress damages for breach of contract (which clearly is one of the footings of liability established in the present case through the misconduct of Mr. Allen).

[199] As noted in *Halsbury's Laws of Canada - Damages, HDA - 48*, modern jurisprudence has established that mental distress damages for breach of contract are to be treated the same as other types of contract damages and that recovery of mental distress damages is governed by general contract damages principles.

[200] The seminal case clarifying the law in this respect is **Fidler v. Sun Life Assurance Co. of Canada** [2006] S.C.J. No. 30 in which the Supreme Court concluded, after briefly reviewing the history of the subject, that it is no longer necessary that there be an independent actionable wrong before damages for mental distress can be awarded for breach of contract, whether or not it is a "peace of mind" contract. The Court stated (at para. 49) that this class of cases should be viewed as an application of the reasonable contemplation or foreseeability principle that applies generally to determine the availability of damages for breach of contract. That fundamental principle

emanates, of course, from the venerable case of **Hadley v. Baxendale** (1854), 9 EX. 341, 156 E.R. 145.

[201] The Supreme Court added the following perspective (at para. 45):

> It does not follow, however, that all mental distress associated with a breach of contract is compensable. In normal commercial contracts, the likelihood of a breach of contract causing mental distress is not ordinarily within the reasonable contemplation of the parties. It is not unusual that a breach of contract will leave the wronged party feeling frustrated or angry. The law does not award damages for such incidental frustration. The matter is otherwise, however, when the parties enter into a contract, an object of which is to secure a particular psychological benefit. In such a case, damages arising from such mental distress should in principle be recoverable where they are established on the evidence and shown to have been within the reasonable contemplation of the parties at the time the contract was made. The basic principles of contract damages do not cease to operate merely because what is promised is an intangible, like mental security.

[202] The Court then went on to say (at para. 47):

> This does not obviate the requirement that a plaintiff prove his or her loss. The court must be satisfied: (1) that an object of the contract was to secure a psychological benefit that brings mental distress upon breach within the reasonable contemplation of the parties; and (2) that the degree of mental suffering caused by the breach was of a degree sufficient to warrant compensation. These questions require sensitivity to the particular facts of each case.

[203] In my view, both these requirements are met on the particular facts of these cases.

[204] As to the first requirement, I draw the conclusion that one of the objects of the various contracts for investment products arranged by Mr. Allen was to gain the psychological benefit of financial security for these investors in paving the way for their eventual retirement. Time and again, the evidence discloses that Mr. Allen made all kinds of false assurances to the various

plaintiffs about the failsafe nature of the leveraged investment scheme he was promoting and how it would bring them a reasonable expectation of financial security. He repeatedly downplayed the risk of such an investment scheme as being negligible. While the plaintiffs may well be said to have been too gullible in relying on these assurances, they did so in placing their trust in Mr. Allen. Because of his misconduct, they are now devastated by the oppressive financial consequences which understandably has caused them mental distress.

[205] I have already touched on the second requirement in summarizing the nature of the psychological and emotional injury suffered by the various plaintiffs. I draw the conclusion from the evidence referred to that the plaintiffs genuinely suffered significant mental distress from these devastating financial consequences to a degree sufficient to warrant compensation.

[206] As for quantum of damages, it is difficult to put a figure on an intangible loss such as this amongst the various plaintiffs. I conclude, however, that the evidence before the court justifies only a modest award for non-pecuniary damages which I therefore assess at $7,500 for each of the 14 surviving plaintiffs. Although I recognize that one or two pairs of plaintiffs may not have suffered a psychological and emotional injury to the same degree as the majority, I conclude that it would be trying to put too fine a point on those distinctions by making separate awards, especially where the award I have made is at a modest level.

[207] In his closing submissions, plaintiffs' counsel also pressed for an award of aggravated damages, albeit somewhat clouded with the claim for general damages.

[208] It is clear from the **Fidler** decision that general damages for mental distress are to be distinguished from true aggravated damages. The principles to be taken from **Fidler**, supra, are nicely summarized in the section from *Halsbury's Laws of Canada* above recited as follows:

> Contract damages for mental distress are sometimes referred to in the jurisprudence as "aggravated damages". However, use of this term to describe mental distress contract damages is "unnecessary and, indeed, a source of possible confusion". True aggravated damages "arise out of aggravating circumstances" and "are not awarded under the general principle of *Hadley v. Baxendale*, but rest on a separate cause of action — usually in tort — like defamation, oppression or fraud". "If a plaintiff can establish mental distress as a result of the breach of an independent cause of action, then he or she may be able to recover accordingly. The award of damages in such a case arises from the separate cause of action. It does not arise out of the contractual breach itself, and it has nothing to do with contractual damages under the rule in *Hadley v. Baxendale*." True aggravated damages are to be distinguished from mental distress damages for breach of contract. Damages for mental distress "arise out of the contractual breach itself" and "are awarded under the principles of *Hadley v. Baxendale*". Furthermore, such damages "exist independent of any aggravating circumstances and are based completely on the parties' expectations at the time of contract formation". The ability of the plaintiff to recover mental distress damages does not require proof of the existence of an independent actionable wrong.

[209] Bearing these principles in mind, I am of the opinion that an award of aggravated damages could be considered in the circumstances of this case, resting on the separate cause of action of breach of fiduciary duty. Such damages can be sought on the basis of aggravating circumstances that extend beyond that which was foreseeable when the various investment contracts were formed.

[210] I conclude, however, that it would be duplicative to make an award of aggravated damages here in addition to the general damages award for mental distress. It is the same injury for which compensation should only be awarded once.

[211] I also decline to make an award of punitive damages in this case against the present defendants. The courts in this country have consistently held that punitive damages are restricted to advertent wrongful acts that are so malicious and outrageous that they are deserving of punishment on their own, as opposed to being compensatory. They are designed to address the purposes of retribution, deterrence and denunciation and should only be resorted to in exceptional cases (see, for example, **Fidler**, supra and **Honda Canada Inc. v. Keays** [2008] S.C.J. No. 40).

[212] While the circumstances of these cases might well have justified an award of punitive damages against Mr. Allen personally, he is no longer engaged in this litigation and there can be no vicarious liability imposed on the defendants for such damages solely in their capacity as his principal (see, for example, **Markarian et al. v. CIBC World Markets Inc.**, [2006] QCCS 3314). Although Keybase has been found to be liable for negligent supervision and breach of fiduciary duty, there is nothing in its conduct either during or after the John Allen period of employment that is so malicious or outrageous as to independently attract an award of punitive damages.

[213] In summary, each of the 14 surviving plaintiffs is awarded general damages for mental distress in the amount of $7,500 in addition to recovery of their respective pecuniary losses.

DISGORGEMENT OF PROFITS REMEDY

[214] As noted earlier, Keybase's commissions on the impugned transactions perpetrated by Mr. Allen were refunded to clients as part of its settlement agreement with the Nova Scotia Securities Commission. All that remains to be addressed, therefore, is the trailer fees that Keybase has gained during the post John Allen period.

[215] I accept the plaintiffs' position that these profits should be disgorged as an equitable remedy flowing from Keybase's breach of fiduciary duty.

[216] In closing submissions, defence counsel submitted that if this remedy were to be granted, the calculations using the applicable percentages would produce an annual return to Keybase of $2,250. That calculation was not challenged by plaintiffs' counsel in his submissions. Accordingly, it will be ordered that Keybase is liable to the plaintiffs to pay an amount equivalent to the trailer fees it has received during the post John Allen period at the rate of $2,250 per annum.

CONTRIBUTION AND COSTS

[217] On a final note, defence counsel has advised that as part of their agreement to be jointly represented, Global and Keybase have agreed privately between themselves to decide the issue of apportionment of damages

pertaining to those plaintiffs who invested through Mr. Allen while he was with Global. The Court has therefore been asked not to rule on the issue of contribution between them but rather to find Global and Keybase jointly and severally liable in respect of those cases. The Court so orders.

[218] The plaintiffs are also entitled to costs in these proceedings, to be taxed in one bill of costs. If the parties are unable to reach agreement on costs, written submissions should be filed on behalf of the plaintiffs within 30 days, followed by the defendants' reply two weeks later.

J.