IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *Brandt v. Moldovan,*
2013 BCSC 1218

Date: 20130710
Docket: S121186
Registry: Vancouver

Between:

Clarence Brandt, Dorothy Brandt, Helene Crane, Jenica Epp, Gunter Koplin, Sandra Koplin, Bikkar Singh Lalli, Surjit Lalli, Marlin Investments Inc. and Gisela Marx

Plaintiffs

And

Traian Moldovan, Robert Holmes and Canaccord Genuity Corporation

Defendants

Before: The Honourable Madam Justice Adair

Reasons for Judgment

Counsel for the Plaintiff Marlin Investments Inc.:	Robert E. Breivik and J. Scott Stanley
Counsel for the Defendants:	David Mitchell and Chantelle Rajotte
Place and Date of Trial:	Vancouver, B.C. January 21-25, 28 and 29, 2013
Place and Date of Judgment:	Vancouver, B.C. July 10, 2013

Introduction

[1] The plaintiff Marlin Investments Inc. ("MII") sues for damages it claims to have suffered in the fall of 2008 as a result of its participation in an option trading program (the "Option Program") developed and managed by the defendants Traian Moldovan and Robert Holmes, both of whom were then employees of the defendant Canaccord Genuity Corporation. The claim is brought in negligence.

[2] MII is wholly owned by Mr. Kenneth Marlin, who, as of trial, was in his late 80s.

[3] The claims of the remaining named plaintiffs have been settled.

[4] MII says that Mr. Moldovan and Mr. Holmes did not properly screen MII to determine whether its participation in the Option Program was suitable, and therefore failed to satisfy the obligation owed by an investment advisor to "Know your client." MII says further that the Option Program was negligently designed and operated by Mr. Moldovan and Mr. Holmes, and asserts that not only did Mr. Moldovan and Mr. Holmes fail to explain the risks associated with the Option Program to MII, but Mr. Moldovan and Mr. Holmes did not themselves understand those risks. MII says that Mr. Moldovan and Mr. Holmes also failed to take appropriate steps to reduce the risks associated with participation in the Option Program, and failed to take appropriate steps to insure against some of the risks involved in option trading. Finally, MII says that Canaccord, in addition to being vicariously liable for the actions of its employees Mr. Moldovan and Mr. Holmes, failed to supervise Mr. Moldovan and Mr. Holmes adequately and failed to ensure that they complied with reasonably prudent practices.

[5] The defendants say that MII's claim should be dismissed. They acknowledge a duty to "Know your client" and to assess whether investments are suitable for a client. However, they say that, based on the information provided to them by MII, and based on Mr. Marlin's sophistication, MII was suitable for the Option Program. They say further that, even if MII can show a breach of the standard of care, it

cannot show the breach caused MII to suffer damage, and therefore MII cannot make out an essential part of its negligence claim. The defendants say in addition that, if they are found liable, then MII should be found contributorily negligent, and fault should be apportioned equally between MII and the defendants.

[6] For the reasons that follow, I conclude that the defendants are liable to MII, and that MII was not contributorily negligent. MII is entitled to damages, taking into account both the gains and losses in its Canaccord accounts.

[7] I will first describe the factual background, culminating in the losses experienced by MII in its Canaccord accounts in the fall of 2008, and then describe relevant industry practices. This will include a review of the expert report of Mr. C. Douglas Fox, which discusses those practices. I will then set out my analysis and conclusions on liability and damages.

Background

[8] MII was incorporated in July 2004. Since MII's incorporation, Mr. Marlin has been its president and sole shareholder.

[9] Mr. Marlin was born in June 1923. As of the fall of 2005, when MII became a client of Canaccord, Mr. Marlin was devoting substantial time to the care of his wife, Helen, who for many years had a number of very serious health problems. (Mrs. Marlin is now deceased.) Around this time, Mr. Marlin also began experiencing some serious health problems of his own. There were problems with his pacemaker. Mr. Marlin lost the sight in his good eye (his right eye) as a result of treatment in connection with prostate cancer. Since then, Mr. Marlin has been getting by with his left eye and using a large magnifying glass. Once he lost sight in his right eye in the fall of 2005, and although his practice had been to check his bank and investment accounts regularly on-line, Mr. Marlin was no longer able to read material on a computer screen. He was also unable to drive.

[10] Finally, and especially in the two or three years prior to trial, Mr. Marlin has noticed significant problems with his memory. These were apparent when he

testified at trial. In some areas and on some topics (for example, his time as a businessman in Alberta), his memory seemed reasonably reliable. However, in others, Mr. Marlin clearly struggled, and not merely with details of relevant events. For example, he had difficulty answering questions concerning the notices of assessment for his income tax filings over the last few years, and he struggled to recall more recent events such as his examination for discovery in this action.

[11] However, as of trial, it was not only Mr. Marlin whose memory of relevant events was poor. Mr. Moldovan's memory was also poor and not very reliable. For example, Mr. Moldovan, who communicated from time to time with clients in the Option Program by e-mail, did not recall knowing that Mr. Marlin could not read material on a computer screen. Although he and Mr. Holmes met with Mr. Marlin from time to time after Mr. Marlin lost the sight in his right eye, Mr. Moldovan did not recall seeing Mr. Marlin using a magnifying glass. There were inconsistencies between evidence Mr. Moldovan gave at his examination for discovery and his testimony at trial. He had no real recollection of what he did to satisfy himself that the Option Program was a suitable investment for MII.

[12] In 2007, Mr. Marlin and Mrs. Marlin moved into assisted living in Surrey. Before that, they were living in a house in Surrey that was owned by their son, Ron, and Mrs. Marlin.

[13] Mr. Marlin has a connection with the company known as Marlin Travel. Mr. Marlin explained that Marlin Travel was started many years ago in the family basement in Edmonton. At the time, Mr. Marlin was managing a large sales staff, and Mrs. Marlin came up with the idea of offering travel services for these employees. Their son, Ron Marlin, who was about 19 at the time, then ran with the idea. He developed and managed the business. Marlin Travel grew into a large and successful company, run by Ron Marlin. Mr. Marlin explained that when another large travel company bought Marlin Travel, most of the money from the sale went to his son. As a result, Ron Marlin has helped and supported Mr. Marlin from time to time. This included helping Mr. Marlin with MII.

[14] For many years, until the late 1980s, Mr. Marlin was a successful businessman in Alberta, and, at least on paper, he had substantial assets. Mr. Marlin was an executive with companies (First Investors Corp. and Associated Investors of Canada) that eventually were absorbed and became part of what was known as the "Principal Group" of companies. At First Investors, Mr. Marlin was selling mutual funds and investment contracts. At Associated Investors, Mr. Marlin was responsible for marketing materials and training sales staff. In the 1980s, Mr. Marlin was president of a company ("Principal Neo-Tech") that was listed on what was then the Toronto Stock Exchange. Mr. Marlin explained that, at the time, the Principal Group was trying to expand into Ontario. However, the provincial government refused permission to sell investments, and so, instead of pursuing acquisition of a trust company, Principal Neo-Tech went into software and graphics.

[15] In addition, in the 1980s, Mr. Marlin was a vice-president in the Principal Group. As he recalled, he was responsible for overseeing the sale of various financial instruments, including term deposits, promissory notes and mutual funds. He recalled that, at this time, margin loans were allowed on mutual funds, and most of the loans were made by First Investors and Associated Investors.

[16] The Principal Group (including First Investors and Associated Investors) suffered a financial collapse in the late 1980s. Mr. Marlin owned 10.5% of the Principal Group's shares. Prior to the collapse, he had been a wealthy man on paper. After the collapse, he was virtually wiped out. The Principal Group brought proceedings under the ***Companies' Creditors Arrangement Act*** (the "***CCAA***"). There was also a commission of inquiry, known as the "Code Inquiry," which investigated the Principal Group's business affairs and practices and produced a substantial report. Mr. Marlin provided evidence for both the ***CCAA*** proceedings and the Code Inquiry.

[17] As best as Mr. Marlin could recall at trial, he retired and moved to the Lower Mainland in 1989. He had made an assignment in bankruptcy in 1988, while still in Alberta. The record from the Office of the Superintendent of Bankruptcy Canada

shows Mr. Marlin as having total liabilities of $7,617,761 and total assets of $22,000. Mr. Marlin was discharged from bankruptcy in 1995. He was then 72 years old. As far as Mr. Marlin could recall, he did not work after 1995. Rather, he was busy looking after Mrs. Marlin. His evidence in that regard was uncontradicted.

[18] In the early 2000s, Mr. Marlin was a member of what was referred to at trial as an investment club. Mr. Marlin explained that the make-up of the group varied, and was usually not more than ten people. They met at Mr. Marlin's home in Surrey, socialized and talked about different theories of investing. Around this time, Mr. Marlin took a course in trading options. He had a recollection of testing option trading in 2003, and said that he would keep a record of trades as if he had made investments, but without actually doing any trading. In other words, the trades and results were hypothetical, not actual.

[19] At trial, Mr. Marlin was unable to recall why he incorporated MII in 2004, although the incorporation coincided with the beginning of the relationship with Mr. Moldovan and Mr. Holmes.

[20] As of 2004, Mr. Moldovan and Mr. Holmes were working together at TD Waterhouse in Kelowna, essentially as a team, dealing with clients who were participating in the option trading program there. Both Mr. Moldovan and Mr. Holmes held themselves out to the public as "option specialists," although there is no such formal designation. Mr. Moldovan started work as an investment advisor in 1996 in Vancouver, and joined TD Waterhouse in Kelowna later that year. He was licensed to trade in options. Mr. Holmes had been a licensed broker since the late 1990s, and was also licensed to trade options. He joined TD Waterhouse in 2000.

[21] Mr. Moldovan explained that he devised his OEX 100 option trading strategy (which evolved into the Option Program) in the fall of 1998. Initially, only a single client was involved. However, according to Mr. Moldovan, the number of clients grew gradually and steadily. As Mr. Moldovan recalled, at its peak, the Option Program had about 120 accounts and was generating substantial monthly

commissions (about $90,000 per month), which were shared between Mr. Moldovan and Mr. Holmes, and their employer.

[22] Mr. Moldovan explained that the strategy was based on the S&P 100 index. He explained that he picked that index because he felt that, given its make-up, that index represented the least amount of risk. Mr. Moldovan explained that the strategy held up during the market decline in September 2001. Essentially, the strategy involved the simultaneous selling (or "writing") of a put option and the selling of a call option on the S&P 100 index. By the time Mr. Moldovan and Mr. Holmes joined Canaccord, the strategy included the purchase of a put option (a "protective put") with an exercise price below the exercise price of the put option sold in connection with the call option. The full strategy would consist of two or three contracts on each side (e.g., two puts and two calls). Ideally, the options would expire unexercised (or worthless), and the client would keep the premium and thereby make a profit. However, at times, the client could find itself "in the money" and with a liability, which could be substantial. A client could lose money unless it "rolled out" a new position. Mr. Moldovan explained that a client would have to purchase the option "in the money", and then sell a new option position two months out. In most cases, the sale would cover the cost of the expiring option that was "in the money."

[23] Sometime in the fall of 2004, MII opened an account at TD Waterhouse to participate in the option trading program being run there by Mr. Moldovan and Mr. Holmes. As of trial, no one involved was able to recall how events unfolded at that time. With very limited exceptions, no documents were produced at trial in connection with MII's TD Waterhouse account. If information was collected when MII's account was opened, I do not know what the information was or how it was collected. I do not know if an assessment was done of MII's suitability for participation in the strategy, and if it was, how the assessment was done or what factors were considered.

[24] Mr. Holmes's discovery evidence read in as part of MII's case was to the effect that he did not recall anything specifically about any of the plaintiffs, and he did not recall meeting with them the first time and explaining the advice and products he would be selling.

[25] Mr. Moldovan's discovery evidence read in as part of MII's case was to the same effect. Mr. Moldovan recalled that, while he and Mr. Holmes were running the option trading program at TD Waterhouse, basic criteria for participation included that the client have a high net worth (minimum $1 million), and that the client required a level of sophistication in order to know what he or she was involved in, that is, that the nature of the trading was short-term and high risk. If a client did not have a sufficiently high net worth, the client would not qualify for the program. A high net worth was required because of the potential liability associated with trading in uncovered options. Mr. Moldovan explained that more margin might be required if the market moved severely against the positions. Mr. Moldovan did not recall how he and Mr. Holmes determined suitability, and he did not keep any notes of the initial interviews with clients.

[26] In his evidence at trial, Mr. Moldovan confirmed that option trading is done through a margin account, and that to open an account and participate in the Option Program, a client needed to have a minimum of $100,000 (preferably in cash) available as margin capital. According to Mr. Holmes, the expectation was that $100,000 would be between 10% and 15% of a client's net worth. An important part of the strategy involved having capital available in the event of a margin call, and a client needed to have the ability to meet a margin call. In the event of a rapid decline in the stock market, a put option that has been sold can go "into the money" for the seller, leaving the seller with a significant liability and facing a possible margin call. If the seller was unable to meet the margin call and could not introduce new capital, the position would be closed off and a loss realized. Mr. Moldovan explained that buying a "protective put" as part of the strategy could limit the potential exposure.

[27] As best as Mr. Marlin could recall, he had dealt with TD Bank for about ten years, and trusted them, and he also had a few investments with TD Waterhouse. As best as he could recall, he had bought and sold options through TD Waterhouse, and he said that he relied on TD representatives for advice about where he should invest and what was safe. He recalled meeting Mr. Moldovan and Mr. Holmes when they were at TD Waterhouse. Mr. Marlin said that he did not have much experience trading options. Apart from the paper trading Mr. Marlin did, essentially for his own amusement, there is little to indicate he had any significant experience trading options prior to MII's account being opened at TD Waterhouse.

[28] Mr. Moldovan and Mr. Holmes left TD Waterhouse in the fall of 2005 and moved to Canaccord. One of the reasons for the move was because TD Waterhouse did not want brokers selling options. Another reason was that it was possible for Mr. Moldovan and Mr. Holmes to make more money at Canaccord because of the different compensation structure. They brought most of the clients who were participating in the option program at TD Waterhouse with them to Canaccord. This included MII.

[29] Canaccord set out the terms of Mr. Moldovan's and Mr. Holmes's employment in separate letters dated September 8, 2005, and in a separate "Investment Advisor Employment Agreement" dated September 9, 2005. Mr. Moldovan and Mr. Holmes were each to have the title "investment advisor," and each of them reported to Bruce Dickson, a Canaccord vice-president and branch manager of the Kelowna office. Their official start date was October 27, 2005. Under the heading "Miscellaneous," the letters set out some special terms regarding the Option Program, and stated:

> As per your strategy of employing extensive use of short selling calls and puts simultaneously on the S & P 100 and various other indexes, it is agreed by both yourselves and Canaccord that the margin requirements for the purchase and sale of these instruments will be more strict than currently established normal industry regulations.
>
> - All short put positions will have offsetting long positions at a level further out of the money than the main position.
> - All margin on put positions will cover the entire spread.

- All short call positions will be covered by twice the normal industry margin requirements.
- As there is risk at any one time on only one side of a put/call spread trade, Canaccord will not require margin on both sides of the trade but only on the larger of the two sides, i.e., puts or calls.
- All margin required for the short option positions must be held in U.S. dollars.

The "offsetting long positions at a level further out of the money than the main position" are the "protective puts."

[30] Mr. Moldovan and Mr. Holmes brought over about a hundred Option Program clients to Canaccord from TD Waterhouse. At Canaccord, Mr. Moldovan's and Mr. Holmes's compensation was based on the number of transactions they executed each month, rather than the performance of the portfolio. An average month would generate between $80,000 and $100,000 in revenue, of which 50% went to Canaccord. Mr. Moldovan and Mr. Holmes then split the other 50% equally. Mr. Holmes acknowledged that both he and Mr. Moldovan were responsible for the clients. Whatever Mr. Moldovan did, Mr. Holmes was also responsible for, and vice versa. They marketed themselves to clients as a team, and I find that is in fact how they carried on business at Canaccord.

[31] Since MII was a new client at Canaccord, new accounts needed to be opened, and, for that purpose, Mr. Marlin signed and initialled a number of Canaccord documents. Mr. Holmes was probably not involved in generating the documents. He believed that anything typed into the documents was done before the documents were sent to Mr. Marlin to sign. As of trial, both Mr. Marlin and Mr. Moldovan had a poor recollection of the events.

[32] It seems most likely, and I conclude, that the forms, with information already typed in, were generated at Canaccord's office in Kelowna, on Mr. Moldovan's instructions, and then sent to Mr. Marlin in Surrey to sign or initial and send back. At least one document – a personal guarantee given by Mr. Marlin for MII – was completed incorrectly by Mr. Marlin and had to be redone. The corrected document

(dated in December 2005, about a month after MII's account at Canaccord was opened) shows Mr. Holmes as the witness to Mr. Marlin's signature.

[33] A total of three margin accounts were opened at Canaccord for MII: a Canadian dollar account, a U.S. dollar account for fixed income and common shares and a second U.S. dollar account for option trading.

[34] At trial, two copies of an "Account Information Legal Entity" form signed and initialled by Mr. Marlin (on behalf of MII) and dated October 27, 2005 were produced. This is the basic information form for MII. Although the copies are very similar, they are not identical. On both copies, most of the information is typed in, although some information has been written in by hand.

[35] On both copies, in the "Account Holder Assets" section, information has been typed in. "Estimated Net Liquid Assets" are shown as $500,000, while "Estimated Net Fixed Assets" are shown as $200,000, for an estimated total net worth of $700,000. At trial, Mr. Marlin was unable to say where these figures came from. He said further that there were very few assets in MII. He said that in October 2005, he still had a car but otherwise had very few fixed assets. Mr. Marlin thought that MII held whatever assets he had, and he could not recall having anything in his own name.

[36] At trial, neither Mr. Moldovan nor Mr. Holmes was able to shed any further light on these "assets." I do not know what they consisted of, or where or how they were held, although the "net liquid assets" probably included what was being transferred from TD Waterhouse to the new accounts at Canaccord.

[37] In the box "Approximate annual income from all sources," $50,000 is typed in. At trial, Mr. Marlin said that amount sounded "excessive," since he was living on government subsidies, CPP and old age security. He did not know how the amounts ended up on the form. Mr. Marlin did not recall meeting with anyone from Canaccord and talking about these dollar amounts. His evidence on this point is uncontradicted.

[38] Mr. Holmes was asked at trial about some of the information on the completed "Account Information" document. He said that he did not know how or where either the $500,000 in net liquid assets or the $200,000 in net fixed assets were held. He did not know whether anyone asked. He did not know where the $50,000 in approximate annual income from all sources came from. Mr. Moldovan was not asked.

[39] There is a difference between the two copies in the section "Investment Objectives." On one copy (which came from Canaccord's file for MII), 100% is typed in under "Speculative High risk." In the other copy, there is a line through this number, and 100% has been written in by hand under "Short Term Trading Medium-High risk."

[40] The "Investment Experience" section is identical on both copies, and information has been typed in. The boxes indicating "Extensive" experience in options, commodities/futures, venture situations and margin have all been checked. On the other hand, boxes for such things as common shares, preferred shares and mutual funds (among other categories) have been checked to indicate "Moderate" experience, even though Mr. Marlin was selling mutual funds in the 1980s. At trial, Mr. Marlin said that he did not have extensive experience in options, or in commodities/futures or venture solutions. He described his experience in margin accounts as moderate.

[41] The nature of MII's business is described as a private holding company.

[42] Canaccord's file for MII also contains a "Supplemental Account Profile" form. This form has information about Mr. Marlin personally, and Mr. Holmes explained that the document is intended to record information about the person with beneficial ownership of a corporate client. In the context of the Option Program, information about Mr. Marlin was important because he was giving a personal guarantee for MII. Again some information on the form is typed, and some is written in by hand. At trial, no one was able to identify the source of the typed information. However, I

conclude that, like the information on the "Account Information Legal Entity" form, the typed information was inserted at Canaccord on Mr. Moldovan's instructions.

[43] The form does a poor job of capturing information about Mr. Marlin. There is nothing on the form in the section for Mr. Marlin's spouse, although at the time Mrs. Marlin was still alive. "# of Dependents" is left blank. MII is typed in under "Employer's Name," although the form also shows "Self Employed" typed in as Mr. Marlin's occupation. Beside "Years with Employer," the figure "45" is typed in. What all of this is actually supposed to mean in relation to the "Know your client" rule is a mystery, since MII was in fact incorporated in 2004 and Mr. Marlin had been retired since about 1995. Mr. Marlin never made any secret of this. Mr. Marlin's correct birth date has been typed in. A reader would be informed he was in his 80s. I conclude that both Mr. Moldovan and Mr. Holmes knew how old Mr. Marlin was, and that in fact he was retired.

[44] In the section "Co-account Holder Assets," some figures are written in by hand. At trial, Mr. Marlin was asked about the handwritten figures, and when asked if it was his handwriting, indicated that he would say yes. However, he also said that he did not know what the numbers meant. For example, the figure "565,000" appears under estimated net liquid assets, "850,000" under estimated fixed assets and "1,415,000" under estimated total net worth. The circumstances in which the figures were placed on the form were never explained. In the absence of some credible explanation, I am not prepared to infer that Mr. Marlin, on his own, deliberately wrote down on this form figures purporting to represent his personal assets when he knew those figures did not accurately represent the facts.

[45] Canaccord's file contained a page that Mr. Holmes identified as a client summary for MII's account that he printed in October 2005, while still at TD Waterhouse. There are some handwritten notes on the document. The notes appear to relate to MII and Mr. Marlin. The defendants observed in argument that the figures in these notes were "consistent" with, although "slightly different from," the handwritten figures that appear on the Supplemental Account Profile form. They

submitted both that Mr. Marlin was in fact the source of the information about MII's assets and that he was willing to misrepresent his own assets. Mr. Holmes identified the handwriting on the TD Waterhouse client summary page as Mr. Moldovan's, and he said that he did not know how Mr. Moldovan got the information. However, Mr. Moldovan was not asked anything about the notes. As a result, I do not know anything about the circumstances in which the notes were created. In particular, I know nothing about when Mr. Moldovan made the notes, why he was making the notes, how he came to record what is in the notes or whether at any relevant time he reviewed anything in the notes with Mr. Marlin. In those circumstances, I am not prepared to infer that Mr. Marlin was the source of what is recorded in the notes.

[46] Mr. Marlin signed a "Margin Account Agreement" on behalf of MII, and an unlimited personal guarantee. In both, he consented to Canaccord obtaining personal and credit information from a variety of sources "for the purpose of establishing my identity, reputation and credit worthiness."

[47] Mr. Marlin also signed a collection of form documents related specifically to option trading.

[48] The "Risk Acknowledgment Statement for Uncovered Option Writers" stated in part (**bold** in original):

> There are special risks associated with uncovered option writing which expose the investor to potentially significant losses. Therefore, this type of strategy may not be suitable for all clients approved for options transactions.
>
> The potential loss of uncovered call option writing is **unlimited**. The writer of an uncovered call is in an extremely risky position and must understand that he/she can incur large losses if the value of the underlying instrument increases above the exercise price. The Firm does not generally support this strategy.
>
> As with writing uncovered calls, the risk of writing uncovered put options is substantial. . . .
>
> Uncovered option writing is thus suitable only for the knowledgeable investor who understands the risks, has the financial capacity and ability to handle potentially large losses, and has sufficient liquid assets to meet applicable margin requirements. . . .
>
> . . .

> This risk statement does not and was not intended to enumerate all of the risks entailed in writing uncovered options.
>
> NOTE: It is expected that you will read the document "**Risk Disclosure Statement for Futures and Options (Exchange Contracts)**" which was provided to you at the time the option account was opened.
>
> . . .
>
> The undersigned acknowledges having read and understood the foregoing Risk Acknowledgement Statement.

Mr. Marlin's signature then appears.

[49] At trial, Mr. Marlin acknowledged signing a letter dated November 11, 2005 and addressed to Canaccord to the attention of the Compliance Department and Mr. Moldovan. The text of the letter reads:

> I, Kenneth Marlin President and owner of Marlin Investments Inc [sic] Fully [sic] understand all the risks and implications of trading Uncovered US Index Options.

[50] Mr. Marlin could not remember reading the letter, although he recalled someone giving it to him to sign. Neither Mr. Moldovan nor Mr. Holmes was asked about it. The letter's purpose or the circumstances in which it was created were never explained. No one explained what use, if any, was made of it, or whether it was required in order to open MII's Canaccord accounts. Neither Mr. Moldovan nor Mr. Holmes testified that either of them relied on the contents of the letter in any way. I seriously doubt that reliance on the bald statement in the letter, to conclude that Mr. Marlin in fact fully understood <u>all</u> the risks and implications of trading uncovered options, would be reasonable in the circumstances.

[51] MII began trading options in the Option Program in November 2005. Protective puts were purchased for the S&P 100 index options. However, MII's trading was not limited to the S&P 100 index. It also included trades on gold and oil indexes. As Mr. Holmes recalled, within a few months after MII's accounts were opened at Canaccord, no protective puts were purchased for this trading, even though there was more volatility on those indexes. Mr. Moldovan looked after the

OEX 100 side of the Option Program, while Mr. Holmes looked after the commodities.

[52] Neither Mr. Moldovan nor Mr. Holmes had any notes or e-mail confirming instructions from clients (including MII) concerning trades. However, Mr. Moldovan explained that he communicated with clients (including Mr. Marlin on behalf of MII) in a variety of ways concerning their accounts at Canaccord: by telephone, by electronic newsletters, through the client's transactions records and monthly statements, through personal meetings and at seminars. Mr. Marlin was, of course, living in Surrey, while Mr. Moldovan and Mr. Holmes were in Kelowna. Neither Mr. Moldovan nor Mr. Holmes could recall seeing Mr. Marlin at a seminar after May 2007, although Mr. Moldovan's phone records indicate he was in reasonably regular contact with Mr. Marlin.

[53] Mr. Moldovan identified an e-mail message sent by him dated May 21, 2007 as an example of an electronic newsletter. In his evidence-in-chief, he testified that the e-mail was sent to all clients, including MII. However, there is nothing on the face of the document to show this, and Mr. Marlin was not asked about the document. As of May 2007, he could not read material on a computer screen.

[54] The e-mail provides some useful insight into Mr. Moldovan's (and presumably also Mr. Holmes's) thinking about the Option Program and about the importance of margin. It also mentions a change concerning protective puts.

[55] The message reads in part:

> Dear OEX Clients,
>
> Happy Victoria Day!
>
> . . .
>
> The "Strategy" and its Purpose
>
> It is important to remind ourselves the purpose of what we are doing – that is to create positive monthly cash flow, on a trade date settlement basis. . . .
>
> However, we also know at times, such as NOW, getting caught "deep in-the-money" on the CALLS, the cash flow is much harder to generate. Nevertheless, given the ability to "stay-the-game," EVENTUALLY, the higher

> cash flows will return, if you have FAITH in the fundamental principals [sic] of the strategy (and margin).
>
> . . .
>
> "MARGIN" Game
>
> We cannot stress the fact enough that, beyond the "fundamental beliefs" the MOST important aspect of what we are doing is based on MARGIN.
>
> . . .
>
> With "unlimited" margin, you cannot loose [sic] at this game. However, that is NOT the case for most of us.
>
> For the first time ever, the recommended margin of $100,000 per 3 CALLS/PUTS, a total of 6 outstanding short combinations, is slightly not enough for the accounts with the lowest CALL positions.
>
> So, for those clients with the June 640 CALLS, and the new July 640 CALLS, the margin, or collateral, or total equity in your account may not be sufficient. Meaning that, to hold the existing positions and the same quantity of contracts, additional margin is needed.
>
> . . .
>
> Insurance – Change in Strategy
>
> No PUT protective "crash" insurance was purchased in May, for the July expiration. We are applying a change in "protective put insurance" to all. If you still wish to maintain the "full", instead of the new "half" insurance strategy, please let me know, and I can buy it for you.
>
> We will automatically purchase protective puts every month for the "near term month" instead of buying it, as we have, for two months out. . . .
>
> . . .

[56] In their evidence, both Mr. Moldovan and Mr. Holmes talked about the importance of having margin or capital in order to stay invested or "stay in the game."

[57] Mr. Holmes described the essence of the strategy as being having margin to stay in the game, and without a high net worth, an investor might not be able to do this. He explained further that an investor could lose a lot of money if forced out.

[58] Mr. Moldovan's evidence was to a similar effect. The strategy required investors to have the ability to contribute more capital if need be; in other words, it was a margin strategy. They also had to have the financial resources to be able to withstand the consequences of option trading.

[59] As of November 30, 2005, the market value of the cash and securities in MII's accounts at Canaccord (described as the "Total Consolidated Assets" on MII's account statements from Canaccord) was $200,552.69. Every month from December 2005 to August 2008, $2,000 was transferred out to an account belonging to MII at TD Canada Trust in Surrey. I did not hear any evidence from Mr. Marlin about this account, and I do not know what the account was used for or how much money was on deposit at any given time. When asked on cross-examination (at a point where it appeared to me that Mr. Marlin was really struggling with his memory), Mr. Marlin did not recall taking any income or dividends from MII in the years 2005 to 2008. He was not asked further about the monthly transfers of $2,000. Mr. Marlin personally deposited $29,000 to the MII Canaccord account in December 2006. He was not asked about this at the trial, and therefore I do not know anything about the source of these funds.

[60] As of August 31, 2008, the value of the "Total Consolidated Assets" in MII's accounts at Canaccord was $258,891.76. However, the next few months brought disaster. As of December 31, 2008, and despite an additional contribution from MII of $60,000 in November, the value of the "Total Consolidated Assets" was reduced to $5,600.47.

[61] Of course, MII was not alone.

[62] Mr. Moldovan invested his own money (about $200,000), as well as money that he borrowed, in the Option Program. He lost all of it. Although Mr. Moldovan considered himself a sophisticated investor, he was unable to take steps to avoid or recoup any of his losses when the markets crashed in the fall of 2008. He essentially lost everything.

[63] Mr. Holmes also suffered personal losses in the hundreds of thousands of dollars: this was his whole investment in the Option Program. Like Mr. Moldovan, Mr. Holmes considered that he was a sophisticated investor. However, he was unable to survive the crash because he ran out of capital. Mr. Holmes said that his

father (who was in his 70s) also invested in the Option Program and lost a substantial amount of money.

Industry Practice

[64] I turn next to the industry practice. I will first discuss some of the regulatory framework, and in particular the "Know your client" rule, in which Mr. Moldovan and Mr. Holmes operated the Option Program, and then discuss the opinion evidence from Mr. Fox, a recognized expert in this area.

(a) Regulatory framework

[65] At the relevant time, the ***Securities Rules***, B.C. Reg. 194/97 contained a specific rule concerning the obligation on an investment advisor to "Know your client" and concerning suitability. The rule (s. 48) provided in relevant part:

> **Know your client and suitability rules**
>
> 48 (1) A registrant . . . must make enquiries concerning each client
>
> (a) to learn the essential facts relative to every client, including the identity and, if applicable, credit worthiness of the client and the reputation of the client if information known to the registrant causes doubt as to whether the client is of good business or financial reputation, and
>
> (b) to determine the general investment needs and objectives of the client, the appropriateness of a recommendation made to that client and the suitability of a proposed purchase or sale for that client.
>
> (2) If a registrant considers that a proposed purchase or sale is not suitable for the investment needs and objectives of a client that is an individual, the registrant must make a reasonable effort to so advise the client before executing the proposed transaction.

[66] As of January 2008, industry standards were also described in the rule book of the Investment Industry Regulatory Organization of Canada ("IIROC"). IIROC was created in 2008 as a result of the consolidation of the Investment Dealers Association of Canada and Market Regulation Services Inc. IIROC Rule 1300 concerns supervision of accounts. Rule 1300.1(p) and (q) provide in relevant part:

> (p) . . . [E]ach Dealer Member shall use due diligence to ensure that the acceptance of any order from a customer is suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance.
>
> (q) Each Dealer Member, when recommending to a customer the purchase, sale, exchange or holding of any security, shall use due diligence to ensure that the recommendation is suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance.

[67] Canaccord's Policies and Procedures manual included a chapter (Chapter 4) on compliance. Section 4.8, entitled "Inappropriate High Risk Strategies," stated:

> This can be difficult to assess, but in general, older, low net worth, and most unsophisticated clients should not be participating in any material way in speculative securities.

[68] In the evidence read in from Mr. Moldovan's discovery as part of MII's case, Mr. Moldovan indicated that he was aware of the "Know your client" rule, although he was not specifically aware of s. 48 of the ***Securities Rules*** or IIROC Rule 1300. Nevertheless, he agreed that, as a broker, he had to make sure he knew his clients sufficiently to ensure that a client was matched with appropriate securities. He agreed that the "Know your client" rule is the standard that applies to everyone in the securities industry and is generally accepted. Mr. Moldovan also agreed that he had an obligation initially to gather information about clients to make sure that they were going to be suitable participants in the Option Program.

[69] In his evidence at trial, Mr. Moldovan agreed with the proposition that even if a client wanted to participate in the Option Program, the onus was on him to refuse if it was not suitable for that client. However, he also said that he was not aware he had to investigate concerning suitability. He was prepared to accept that "perhaps" he would need to know what other investments a client had, in order to ensure a balanced portfolio. However, in this case, he could not recall what he did. Mr. Moldovan could not recall whether he contacted Mr. Marlin to ask him questions about what was on the account opening documents, and I conclude that he probably did not. Mr. Moldovan had no notes of such activities.

[70] In Mr. Holmes's discovery evidence read in at trial, he agreed that a broker needed to know his or her client, and that, not only was the obligation grounded in various regulatory requirements, it was also simply a matter of good, standard practice. He was familiar with IIROC Rule 1300. Mr. Holmes agreed that a broker needed to know a client's situation, and needed to make sure that each transaction that was executed for the client was appropriate for that client. Mr. Holmes agreed that the onus is on the broker to do the due diligence to make sure that the transaction is appropriate. He acknowledged that the Option Program was really only for sophisticated people who knew what they were doing and had the resources to back it up.

[71] In his evidence at trial, Mr. Holmes said that Mr. Moldovan was primarily the one who dealt with Mr. Marlin, something that Mr. Moldovan did not dispute. Mr. Holmes also said that he thought that Mr. Moldovan would have done the suitability review for MII. However, Mr. Moldovan was unable to say what he did. In any event, Mr. Holmes did not recall ever doing a suitability review himself. He agreed with the views expressed by his branch manager, Mr. Dickson, that the "Know your client" rule is a basic rule in the securities industry, and that to gather information, you would speak to the client at length, ask questions, do a bank check, and also try and do this on a regular basis. Mr. Holmes considered that updating client information every three years would be adequate, unless there was a material change.

[72] Both Mr. Moldovan and Mr. Holmes were very firm in their views that the Option Program was not speculative investing.

(b) Opinion evidence

[73] MII filed an expert report from Mr. Fox concerning industry practices. The defendants did not require Mr. Fox to attend for cross-examination, and, accordingly, Mr. Fox did not testify at trial. The defendants did not tender any opinion evidence.

[74] Mr. Fox is an independent consultant with over 25 years' experience in the securities industry, and a principal with the firm Risk Management Services Inc. Among other things, Mr. Fox's firm provides regulatory risk consulting for investment dealers, mutual fund dealers, portfolio managers and others, as well as litigation support services for both plaintiffs and the securities industry. Mr. Fox has been qualified to give opinion evidence on broker standards and industry standards in courts in Ontario, B.C. and the Bahamas. Over his career, Mr. Fox has held several senior "compliance" positions, including that of "Chief Compliance Officer" and "Ultimate Designated Person." He has spoken at industry conferences and participated on several regulatory committees dealing with standards and practices of the financial services industry.

[75] In order to prepare the report, plaintiffs' counsel provided Mr. Fox with a set of assumptions and a selection of documents. The documents included account statements and other documents relating to three other plaintiffs (Ms. Crane, and the Koplins). Mr. Fox was not provided with any documents or information relating specifically to MII or Mr. Marlin, nor was he asked to express an opinion on questions relating specifically to the circumstances of either MII or Mr. Marlin. Although Mr. Fox was not asked to and did not consider the specific circumstances of MII, I have found his opinions helpful both on questions that would apply generally to the relationship between a client and a broker and to anyone who invested in the Option Program (including MII), and on matters relating to the practices of a reasonably prudent investment advisor.

[76] In Mr. Fox's opinion, the appropriate investment objectives to engage the OEX options strategy would fall in the highest risk category available on the account information form, whether or not protective puts were purchased as part of the strategy. On the Canaccord Account Information form, this category was "Speculative High risk." This is where Mr. Moldovan had typed in "100%" for MII.

[77] Mr. Fox explained that the probability of loss on the downside would decrease with the purchase of a protective put. However, the strategy required the investor to

sell an uncovered – or "naked" – call option (i.e., no protective calls were purchased). The theoretical risk of selling a call option without owning the underlying security to sell or deliver if required to by the buyer is infinite. Thus, an investor's entire capital and more was at risk every time the investor sold a call option. Mr. Fox's opinion on this point is consistent with the statement in Canaccord's "Risk Acknowledgment Statement for Uncovered Option Writers."

[78] Mr. Fox noted that, in his experience acting as a "designated registered options principal" of an investment dealer, special care was required and taken in the supervision of accounts engaged in naked call writing. He noted further that naked call writing is viewed as holding such risk that many firms simply do not permit the activity at all, even though they may permit options trading.

[79] In Mr. Fox's opinion, a reasonably prudent investment advisor would always consider the percentage of liquid assets that are exposed to loss at any one time as a result of the OEX options strategy, as the advisor should when recommending any investment to a client. Mr. Fox explained that industry standards as described in the IIROC rule book say that the investment advice of an advisor must be appropriate to a client, taking into account the client's financial circumstances, age, occupation and other factors. He noted in particular provisions of IIROC Rule 1300.1 (p) and (q), and said that the standards require that an advisor take into account the financial circumstances of the client when advising on "any security," not just on an option strategy. In Mr. Fox's opinion, taking into account the capital available to invest and the risk of loss to that capital is a fundamental consideration with any investment.

[80] Mr. Fox explained further that, in any option writing/selling strategy, the capital to sustain the strategy becomes extremely important, and margin is required by the regulations and the broker to be a safeguard against loss to both the client and the firm. In their evidence, both Mr. Moldovan and Mr. Holmes also confirmed the importance of having margin capital available in relation to participation in the Option Program, and the importance of having the financial resources to be able to withstand the consequences of option trading.

[81] In Mr. Fox's opinion, after taking into account the margin requirement for a particular trade and the risk tolerance of the client, a reasonably prudent investment advisor would then examine the amount of liquid assets that the client could put at risk. Mr. Fox explained that:

> In most cases, and in my experience, advisors will generally suggest to clients that they place no more than 10-25% of their liquid assets at risk at any one time. This amount will be greater or smaller depending upon the financial circumstances and age of the client. For instance, accepted investment wisdom dictates that a retired person should make investments that do not put their principal at risk, and certainly not if they require their principal to provide income in their retirement years. The reason being is that they are by definition no longer employed, need the funds to finance their retirement, and are unable to replace them if they were to suffer a loss. For certain retired persons it would be inappropriate for them to make any high risk investments. For others, a small percentage of high risk may be acceptable if it would not put their financial health at risk.

[82] Mr. Fox also noted the statement in Canaccord's Policy and Procedures manual that "in general, older, low net worth, and most unsophisticated clients should not be participating in any material way in speculative investments." In his view, this indicated that Canaccord recognized that speculation is normally not appropriate for older and/or unsophisticated clients.

[83] Mr. Fox noted that the account information forms he reviewed for Ms. Crane and the Koplins indicated they had "extensive" knowledge of the commodities and futures market, in addition to options and other high risk investments such as short selling. The MII account information form also has these same boxes checked indicating "extensive" experience in options, commodities and futures, and margin. Mr. Fox said that, in his experience, it is very rare to encounter a retail investor with sophisticated knowledge of the futures market, and that only few in the investment industry have this type of knowledge. In other words, "extensive" experience (whatever "extensive" might mean) in these areas is unusual.

[84] Mr. Fox was asked to express his opinion on whether a reasonably prudent investment advisor would make any assessments as to the client's ability to meet

margin calls prior to allowing the client to trade in options, and if his opinion was that an assessment would be made, to explain the nature of that assessment.

[85] Mr. Fox explained that the ability of a client to meet a margin call has a direct bearing on whether the recommendation to engage in a particular strategy or stock purchase is in fact suitable, based on the client's financial circumstances. In the event that the margin in a client account falls below a certain level, the firm will demand more capital or ultimately may sell or close the position at what could prove an inopportune time for the client. Losses can result when the client's account falls under margin. Mr. Fox explained that, for these reasons, a reasonably prudent investment advisor would assess whether a client has sufficient capital so that an early margin call will not put them at risk of suffering a loss, prior to allowing the client to trade in options. If a client lacks the capital to meet a margin call, this invariably means that the client may suffer a loss that the client cannot afford.

[86] Mr. Fox explained further that:

> In assessing a client's ability to meet margin calls the advisor must use "due diligence" to learn the essential facts of a client's financial circumstances. Do they have significant assets outside of their trading account; how much can they afford to put at risk, or are the funds in the trading account the only liquid assets available? These are questions that will and should be part of the process when making a suitability determination.

[87] In Mr. Fox's opinion, a reasonably prudent investment advisor would not recommend a strategy that would put the client at a risk that was greater than the client could afford. Mr. Fox explained that trading uncovered index options is not a strategy that is suitable for the retail investor unless the investor has significant means and can afford large near term losses. If the investor can accept these types of losses and has the capital to stay with the strategy over the long term, then profits are possible. But to do this, the investor would also need to have the resolve and discipline not to panic when there are swings in the market.

[88] Mr. Fox stated that his opinion on the point would not change even if the account information form had indicated an investment objective of "100%

speculative high risk," rather than "100% short term trading medium-high risk." He explained:

> The simple expedient of selecting another box or category on the application form would not be sufficient information for the advisor to change his/her recommendation for the client. Additional information would be required in order to satisfy compliance with the standard that the advisor use "due diligence" to learn essential facts and financial circumstances of a client. To be clear, the strategy must be suitable to the client and not merely conform to the information recorded on an account opening form.

[89] The final matter on which Mr. Fox was asked to express his opinion concerned the profile of an investor that would reasonably be considered a "suitable" investor for participation in the Option Program, with reference to the criteria normally used by a reasonably prudent investment advisor to make such an assessment. Mr. Fox said:

> The OEX Index option strategy on its own is a systematic approach to producing income through the action of selling combinations of options. First, it requires a very large capital base; much more than merely the margin requirements of a single trade. It is a strategy that may succeed over time but only if one has the capital to continue to roll over the losing positions and re-establish new ones that one will hope, eventually, will show a profit. It requires capital, but moreover it also requires the discipline to follow it without deviation – and potentially for a long period of time, as in the near term one may suffer adverse short term volatility.
>
> The strategy also requires the ability to withstand consistent short-term losses that may persist in the event that the market continues in one direction unchecked for a period of time. The investor must be able to withstand these losses. In addition, the investor must also be able to withstand the occasional large loss that will result from a "spike" in the markets.
>
> Finally, the investor must have a certain level of sophistication and understanding of the mechanics and the risk/reward of the strategy so that they also understand the results that they are achieving on a month to month basis.
>
> For those who may not fall into this bracket, it is difficult to see the need for it as a bona-fide holding in their portfolio. To make [a] suitability determination for this strategy it might include an investor who had some risk capital at their disposal; which if lost, would not represent any financial hardship. It would also require a sophisticated investor with a solid understanding of the dynamics of the options markets. It would not be appropriate for an investor looking for stable income or growth in their portfolio. It is a portfolio strategy that is market-neutral and does not require the markets to go up or down over time.

Discussion and Analysis

(a) Liability

[90] There cannot be much doubt that an investment advisor in the position of Mr. Moldovan and Mr. Holmes owes a duty of care to the investment advisor's client. The scope of the duty varies with the nature of the particular relationship: see, e.g., ***Quantum Financial Services (Canada) Ltd. v. Yip***, 1998 CanLII 3981, 60 B.C.L.R. (3d) 365 (S.C.), at para. 82.

[91] In this case, and while they were employed at Canaccord, Mr. Moldovan and Mr. Holmes were offering and providing services to clients, including MII, that went well beyond those of a broker who merely makes sales and purchases on clients' instructions. Both Mr. Moldovan and Mr. Holmes held themselves out as "option specialists." They offered to provide clients, including MII, with advice and services concerning option trading, following the strategy that Mr. Moldovan had developed in the late 1990s and that evolved into the Option Program. According to Mr. Moldovan, clients came to him and Mr. Holmes for the Option Program. I do not doubt this. It was the basis of MII's relationship with Mr. Moldovan and Mr. Holmes during the time MII had accounts at Canaccord. MII followed Mr. Moldovan and Mr. Holmes from TD Waterhouse, with the objective of continuing to participate in the Option Program. MII then traded options in the Option Program, based on the recommendations of Mr. Moldovan and Mr. Holmes.

[92] The duty of care owed by an investment advisor is not only shaped by the particular relationship between advisor and client, but also by the regulatory framework that governs the relationship: see ***Quantum***, at para. 83. Although Mr. Moldovan in particular may not have been specifically acquainted with, for example, IIROC Rule 1300, both Mr. Moldovan and Mr. Holmes accepted that they had obligations to comply with the "Know your client" and suitability rules, as part of standard practice. The considerations described in the Canaccord Policy and Procedures manual concerning "Inappropriate High Risk Strategies" would be an example of something that should be kept in mind when assessing whether an

investment was suitable for a particular client, as an aspect of prudent and proper practice.

[93] An investment advisor is not a guarantor of financial success, so the question for determination is not whether the advisor's advice was correct or whether the client achieved the desired result. Rather, the question is whether the advisor has brought to bear an appropriate degree of care and skill in the exercise of his or her professional judgment. See ***Varcoe v. Sterling*** (1992), 7 O.R. (3d) 204 (Gen. Div.), at p. 236. Thus, it is necessary to consider whether the advisor has acted in accordance with a practice that is accepted as proper by a person skilled in that profession.

[94] A breach of duty (such as non-compliance with rules and regulations) does not, in and of itself, give rise to liability. In a negligence claim, a plaintiff must still prove that the breach caused the plaintiff to suffer damage. See ***Junko v. Canaccord Capital, Toles***, 2012 ONSC 6966, at para. 52.

[95] There can also be little doubt that the cardinal rule of the brokerage business is the "Know your client" rule. The rule is designed to ensure that a portfolio is suitable for the client: see ***Junko***, at para. 52 and ***Robinson v. Fundex Investments Inc.***, 2006 CanLII 24459 (Ont. S.C.J.), at para. 101. The concept of suitability involves a consideration of a variety of factors relating to the investor: age, income and net worth, investment knowledge, investment objectives and risk tolerance. See ***Davis v. Orion Securities Inc.*** , 2006 CanLII 26966 (Ont. S.C.J.), at para. 35.

[96] The forms that a client is asked to complete when an account is opened are one method whereby an investment advisor can collect information for purposes of the "Know your client" and suitability rules. However, these forms are not the only method for an investment advisor to know his or her client.

[97] For example, the information-gathering process that Mr. Dickson described (and that Mr. Holmes agreed with) as part of complying with the "Know your client"

rule went well beyond merely accepting at face value information on account opening forms. Mr. Fox expressed the views that the investment advisor must use due diligence to learn the essential facts of a client's financial circumstances, and that an investment strategy must be suitable to the client, not merely conform to the information recorded on an account opening form. I agree.

[98] Here, much of the information on the forms was filled in at Canaccord, on Mr. Moldovan's instructions, before the forms were sent to Mr. Marlin. In other words, Mr. Moldovan, in his capacity as investment advisor, took on the initial responsibility to complete the forms. Mr. Moldovan could provide little assistance concerning how he gathered the information about MII and Mr. Marlin that ended up on the forms. His evidence is too thin to support a conclusion that, in carrying out this task, he exercised reasonable care. Mr. Marlin, for example, did not recall anyone from Canaccord contacting him, and his evidence is uncontradicted. As I noted above, some of the information typed on the Supplemental Account Profile form did not make much sense. Information that is incomplete or ambiguous or does not appear to make sense is a poor guide to "knowing your client."

[99] I find that it was Mr. Moldovan who made the decision to check the boxes indicating "extensive" knowledge of the commodities and futures markets and options, because unless those boxes were checked, the accounts would not be opened. He probably did not know the level of MII's (or Mr. Marlin's) experience with option trading, and made an assumption. Mr. Moldovan checked off "moderate" for mutual funds, even though Mr. Marlin in fact had experience selling mutual funds.

[100] The defendants argue that, if the information on the account information forms is wrong, MII and Mr. Marlin are nevertheless bound, and that if the misrepresentations misled Canaccord into believing that MII was suitable for the Option Program when in fact it was not, Canaccord cannot be held accountable. They cite ***Fraser Jewellers (1982) Ltd. v. Dominion Electric Protection Co.***, 1997 CanLII 4452, 148 D.L.R. (4th) 496 (Ont. C.A.), at para. 30, in support.

[101] I am unable to accept this argument.

[102] First, ***Fraser Jewellers*** is a *non est factum* case, not a case about liability of a broker or investment advisor. The account information forms are not intended to create contractual liability. They are a step in gathering information.

[103] Second, I conclude that neither Mr. Moldovan nor Mr. Holmes in fact relied on the information on the forms signed by Mr. Marlin when the MII accounts were opened. Mr. Moldovan in particular knew how the forms were generated. I do not think it reasonable for him to generate a form indicating that Mr. Marlin was still earning an income from employment at age 82, without making some further inquiry about the facts. There is no evidence that he did, and the careless manner in which the forms were generated leads me to conclude that Mr. Moldovan never placed much importance on them, other than as a means to get the accounts opened. Moreover, neither Mr. Moldovan nor Mr. Holmes used the information on the forms to assess and determine the suitability of the Option Program for MII. Mr. Holmes acknowledged that he never did a suitability review at any time. Mr. Moldovan was not aware that he needed to investigate to make a determination about suitability, and if he did something, he could not recall what it was.

[104] Third, in the context of the "Know your client" rule, there is a limit to the use that can and should be made of the forms. This point is made, for example, by Lederer J. in ***Parent v. Leach***, 2008 CanLII 26688 (Ont. S.C.J.), at paras. 111 and following and paras. 162 and following. At best, they are a statement of a position at a point in time, and there are other sources of information that contribute to an advisor's knowledge about a client.

[105] Fourth, Mr. Fox does not suggest that a reasonably prudent investment advisor would stop the "Know your client" process at the account information forms, nor did Mr. Dickson (with whose evidence Mr. Holmes agreed). In his report, Mr. Fox uses the term "due diligence" to describe the steps that a reasonably prudent investment advisor should take, and he says that an investment strategy must be suitable to the client and not merely conform to information recorded on an account

opening form. In addition to being a matter of prudent practice, it simply makes common sense.

[106] In my view, Mr. Moldovan and Mr. Holmes failed to take reasonable care in assessing MII's suitability for participation in the Option Program, and I conclude that if a proper assessment (as described by Mr. Fox, and consistent with the obligation to "Know your client") had been done, MII would not have been accepted as a client. Moreover, because of the undisputed importance of margin and the ability to "stay in the game," and because Mr. Marlin was giving a personal guarantee for MII, Mr. Marlin's personal circumstances needed to be taken into account in assessing whether the Option Program was suitable for MII. In that light, since Mr. Marlin was personally at risk, Mr. Moldovan and Mr. Holmes needed to consider whether participation in the Option Program was suitable for a retired person in his 80s. I find that they simply failed to do this.

[107] The defendants argue that, based on what was contained in the forms Mr. Marlin signed when the accounts were opened, MII looked suitable, and MII was a suitable client for the Option Program because Mr. Marlin was a sophisticated investor. However, I do not think this is sufficient to satisfy the defendants' obligations to take reasonable care in assessing MII's suitability.

[108] It is true that Mr. Fox was not asked to express his opinion on whether MII was a suitable client. However, what is important for my purposes is that Mr. Fox does describe the profile of an investor that could be considered suitable for participating in the option trading program, with reference to the criteria normally used by a reasonably prudent investment advisor to make such an assessment. Based on his evidence, I am in a position to come to my own conclusions concerning MII, and whether the defendants complied with their duty to exercise reasonable skill and care.

[109] As Mr. Fox describes, the investor requires a large capital base, discipline to follow the strategy without deviation for potentially a long period of time, the ability to withstand consistent short-term losses and the ability to withstand the occasional

large loss. This description is consistent with both Mr. Moldovan's and Mr. Holmes's evidence concerning both basic features of the Option Program and the importance of margin. However, there is no indication that either Mr. Moldovan or Mr. Holmes spent any time with Mr. Marlin when the accounts were being opened at Canaccord to investigate and discuss with him whether MII fit this description, or whether MII (or Mr. Marlin) had capital available to "stay in the game" over the long term. In Mr. Fox's opinion, the program might be suitable for an investor who had some risk capital at their disposal, which, if lost, would not represent any financial hardship. However, there is no indication Mr. Moldovan or Mr. Holmes ever had this discussion with Mr. Marlin either.

[110] Depending on the circumstances, it can be true that a broker is not obliged "to put his nose into his client's business": see ***Reed v. McDermid St. Lawrence Ltd.*** (1990), 52 B.C.L.R. (2d) 265 (C.A.), at p. 270. However, here, the nature of the investment proposed to be made (one which Canaccord itself recognized as high risk, with potentially unlimited risk) and the importance of margin and having the capital to stay invested, coupled with Mr. Marlin's age, meant that properly assessing suitability was very important. Even if one accepts at face value the information on the account opening form concerning MII's assets, neither Mr. Moldovan nor Mr. Holmes made any inquiry about how those assets were held, for example. They were, therefore, not in a position to make a considered assessment about whether it made sense for MII to participate in the Option Program, or whether it was suitable.

[111] The defendants say that Mr. Marlin was a "sophisticated investor." I am not persuaded that as of the fall of 2005, Mr. Marlin was in fact a sophisticated investor. He certainly had a long history in the financial services industry, but that was several decades old as of 2005. Mr. Marlin had a current interest in learning and discussing different investment vehicles with others – his club members, for example. He had taken a course in option trading, and had done some paper trading to see how things would work. But I doubt whether these things made him a "sophisticated

investor" in this area, where, based on Mr. Fox's opinion, "extensive experience" was rare.

[112] I share Mr. Fox's scepticism about the boxes checked off on the account information form, indicating "extensive experience" in areas where it would be unusual for a retail investor to have such experience. In context, I do not think a reasonably prudent investment advisor would place much weight on such representations. On the evidence, neither Mr. Moldovan nor Mr. Holmes did in fact place weight on what was in the forms.

[113] I agree with Mr. Stanley's submission that, like all the clients Mr. Moldovan and Mr. Holmes brought with them to Canaccord, Mr. Moldovan already regarded MII as suitable. In other words, Mr. Moldovan assumed MII was suitable, without actually looking at whether MII (with Mr. Marlin as guarantor) was in fact suitable. Mr. Holmes did not assess MII's suitability.

[114] Even if Mr. Marlin could legitimately be described as a sophisticated investor with respect to option trading, there were other factors – particularly Mr. Marlin's age – that made the Option Program, where Mr. Marlin was giving a personal guarantee and where the ability to contribute margin capital was critical, an unsuitable investment for MII, his holding company. In my view, had a proper suitability assessment been undertaken by Mr. Moldovan and Mr. Holmes when MII became a client of Canaccord in the fall of 2005, consistent with the "Know your client" rule and the practices described by Mr. Fox in his report, MII would have been excluded from participation in the Option Program, as it was not a suitable investment.

[115] But for the failure of Mr. Moldovan and Mr. Holmes to take reasonable care in assessing suitability, MII would not have invested in the Option Program. Their breach of duty caused MII to suffer damage. Canaccord, as Mr. Moldovan's and Mr. Holmes's employer, is vicariously liable for their negligence.

[116] The defendants argue that MII should be found to be contributorily negligent, and liability apportioned equally to MII and to the defendants. They argue that MII

never informed Canaccord after October 2005 that the information on the account information forms was incorrect, something that might have permitted Canaccord to know that MII was inappropriate for the Option Program.

[117] However, I cannot accept this submission. Mr. Moldovan and Mr. Holmes had an obligation to know their client, and to undertake an assessment of MII's suitability for participation in the Option Program. I have concluded that they failed at the outset to take reasonable care in assessing MII's suitability. They did not do what a reasonably prudent investment advisor would and should have done, and they breached their duty to "Know your client." In those circumstances, I am not prepared to find that MII was also at fault for the damage caused.

[118] Since I have concluded the defendants are liable based on the failure to take reasonable care in assessing suitability, I will deal only briefly with other grounds of liability advanced by the plaintiff.

[119] MII says that the Option Program was negligently designed and managed, and that, since Mr. Moldovan and Mr. Holmes did not themselves have a reasonable understanding of the risks and rewards associated with the strategy, they were therefore never in a position to advise clients properly in respect of it.

[120] I do not agree that the Option Program was negligently designed. Mr. Fox, for example, does not express such a view. Rather, as I read his opinion (including his comment that it is a "portfolio strategy that is market-neutral"), the basic program was reasonably designed <u>provided that the investor was suitable</u>. The nature of the Program meant that the suitability assessment was especially important.

[121] Mr. Moldovan (who had the most contact with Mr. Marlin) had confidence in the Option Program (as did Mr. Holmes). At trial, both Mr. Moldovan and Mr. Holmes strongly resisted describing the Program as a "speculative" investment. I have some doubts that they believed this, because someone at Canaccord (probably on Mr. Moldovan's instructions) typed in "100%" under "Speculative High risk" in the investment objectives section of the Account Information form for MII.

However, assuming that in the fall of 2005 neither Mr. Moldovan nor Mr. Holmes thought the Option Program was a speculative investment, I think it unlikely that either would have told Mr. Marlin that MII was engaging in a speculative investment.

[122] What about level of risk however? In my view, the evidence (including Mr. Fox's opinion) supports the conclusion that the Option Program was at the very least a high-risk investment, and not suitable for many (probably most) investors, even with protective puts. Although (as illustrated by the May 2007 e-mail newsletter), Mr. Moldovan recognized the importance to the strategy of margin and the ability to meet margin calls, I am not persuaded that either he or Mr. Holmes fully appreciated how important a large capital base, and the discipline to follow the strategy over the long term despite losses, were to success. They did not recognize that, despite their personal sophistication, they themselves were not suitable investors. In my view, the value of whatever advice they could give their clients (including MII) was therefore limited. In addition, probably neither Mr. Moldovan nor Mr. Holmes fully appreciated the critical importance of assessing the suitability of this particular investment for a client. This would be an explanation for why no proper suitability assessment was ever done for MII.

[123] MII also argues that Mr. Moldovan and Mr. Holmes had a duty to have protective puts in place, and breached this duty by removing the protective puts, so that by September 2008, there were none. MII also points out that it was an express term of their employment contracts that Mr. Moldovan and Mr. Holmes have protective puts in place, and that no one could identify who – if anyone – approved trading naked put options, despite a requirement for prior approval in the Canaccord policies and procedures manual. In his evidence at trial, Mr. Marlin mentioned the existence of protective puts as something that was important to him.

[124] However, I see the removal of protective puts as an aspect of the suitability assessment. For the right client, removal of protective puts may not present a problem. In MII's case, the suitability assessment that ought to have been done at the outset was not done according to the standard that applies to a reasonably

prudent investment advisor, and MII suffered damage as a result. In those circumstances, Mr. Moldovan's and Mr. Holmes's failure to have protective puts in place is not the cause of MII's losses.

(b) Damages

[125] MII tendered an expert report from Mr. Dean E. Holley, which calculated net gains and losses in MII's accounts at Canaccord. Mr. Holley is a past executive director of the B.C. Securities Commission and is the founder and president of CMC Capital Market Consulting Corp. Since 1996, he has provided consulting services to public and private sector clients in matters relating to regulatory requirements, enforcement issues, securities trading, portfolio construction, investment suitability, industry standards of conduct and investor and professional education. He has been qualified to give opinion evidence before the B.C. and Alberta Securities Commissions, IIROC and the B.C. Supreme Court (among others). Mr. Holley was not required for cross-examination, and therefore did not testify at trial.

[126] MII nominated a "Claim Period" from September 1, 2008 to December 31, 2008. Mr. Holley was asked, using MII's statements of account from Canaccord, to calculate the net gain or loss over that period. He was also asked to calculate the gains or losses MII experienced in its Canaccord accounts from account opening to August 31, 2008.

[127] Mr. Holley calculated the losses during the Claim Period to be $311,291.29. He calculated the gains made by MII while it had accounts at Canaccord, and before the Claim Period, to be $98,339.07. If the gains are taken into account, and set off against the losses, the net losses are $212,952.22.

[128] MII says that Canadian courts have adopted two approaches to the assessment of losses in a case such as this. One approach is to examine the impugned transactions and assess the loss associated with each. The other approach is to allow a plaintiff to nominate a claim period and examine the loss within that period. On that approach, gains outside the claim period are not taken

into account. MII says the latter approach is the correct approach here, and that the defendants are not entitled to offset the losses against past profits. In support of its position, MII cites ***Sharpe v. McCarthy*** (1994), 94 B.C.L.R. (2d) 384 (C.A.) and ***Zraik v. Levesque Securities Inc.***, 2001 CanLII 21223 (Ont. C.A.).

[129] The defendants say that the gains must be taken into account. They say that the Option Program was a strategy, month after month, that MII engaged in for three years; that each trade was linked to another trade (where an expiring option was bought back and a new one sold) as a single transaction; and that these were not discrete and independent trades. The defendants argue further that MII says the Option Program was inappropriate or unsuitable for it, not that individual transactions were unsuitable, and therefore all activity should be taken into consideration.

[130] The defendants say that ***Sharpe v. McCarthy*** and ***Zraik v. Levesque Securities*** (and the cases that have followed it) are distinguishable on the facts, because, in those cases, the transactions in question (ones with losses; ones with gains) were separate and distinct, and the plaintiff was held to be entitled to adopt one transaction but not the other. The defendants submit that, on the facts here, I should follow the approach taken in ***Allen v. Girard***, 2002 BCSC 1354, 5 B.C.L.R. (4th) 320, where (at para. 212) Hood J. distinguished ***Sharpe v. McCarthy***.

[131] I agree with the defendants concerning the method of assessment. Both gains and losses should be taken into account.

[132] Unlike ***Sharpe v. McCarthy***, this is not a case where the complaint is about individual transactions that are separate and distinct from one another. Rather, the transactions and trades are linked. They are part of a systematic approach to producing income through the action of selling combinations of options, that may succeed over time, if one has sufficient discipline and capital. Moreover, I have found the defendants liable on the basis that they failed to exercise reasonable care in assessing whether participation in the Option Program was suitable for MII, and that but for their negligence, MII should and would have been excluded from the Program at the outset. In those circumstances, MII would not have suffered the

losses, but also would not have enjoyed the gains. In my view, to put MII back in the position it would have been in had the breach of duty not occurred, both the gains and the losses should be taken into account.

[133] I therefore assess MII's damages in the sum of $212,952.22.

Disposition and Summary

[134] In summary, I find that the defendants were negligent in that they failed to take reasonable care in assessing whether participation in the Option Program was suitable for MII, and, as a result of their negligence, MII suffered damage. MII was not contributorily negligent.

[135] I award MII damages in the sum of $212,952.22. MII shall have judgment against the defendants, jointly and severally, for that amount, together with interest pursuant to the ***Court Order Interest Act***, R.S.B.C. 1996, c. 79.

[136] Subject to any submissions that the parties may wish to make, MII is entitled to costs on Scale B. The parties are at liberty to make arrangements to make submissions with respect to costs within 30 days of these reasons. Submissions may be made in writing or orally, as the parties may wish.

"Adair J."