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ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:	
Ontario Securities Commission - **Applicant**	Kevin McElcheran Ruth Promislow **For BDO Dunwoody Limited, Receiver and Manager of Buckingham Securities Corporation**
- and -	
Buckingham Securities Corporation - **Respondent**	Heath Whiteley **For W.D. Latimer Co. Limited**
	HEARD: June 3 to 9, 2002

GROUND J.

REASONS

[1] This is a trial of issues, within the above Application, directed by Colin Campbell, J. with respect to a priority dispute as between former customers of Buckingham Securities Corporation ("Buckingham") and W.D. Latimer Co. Limited ("Latimer"). Latimer claims a security interest in the securities of customers of Buckingham pledged by Buckingham to Latimer pursuant to a Customer Account Agreement entered into between Buckingham and Latimer dated May 7, 1997, (the "Latimer Agreement") when Buckingham initially opened an account with Latimer. The Latimer Agreement provided for both cash and margin accounts although Buckingham initially opened only a cash account with Latimer.

The Latimer Agreement provides in part as follows:

> "That all securities and credit balances held by Latimer for the Customer's account shall be subject to a general lien for any and all indebtedness to Latimer howsoever arising and in whatever account appearing including any liability arising by reason of any guarantee by the Customer of the account of any other person, that Latimer is authorized hereby to sell, purchase, pledge, or re-pledge any or all such securities without notice or advertisement to satisfy this lien, that Latimer may at any time without notice whenever Latimer carries more than one account for the customer, enter credit or debit balances, whether in respect of securities or money, to any of such accounts and make such

adjustments between such accounts as Latimer may in its sole discretion deem fit, that any reference to the Customer's account in this clause shall include any account in which the Customer has an interest whether jointly or otherwise".

Background

[2] From its inception in May, 1997, to July, 2000, Buckingham was registered as a securities dealer with the Ontario Securities Commission (the "OSC") under the *Ontario Securities Act* R.S.O. 1990, c. S-5 (the "OSA"). Buckingham provided investment services to its customers, which numbered approximately 1,000 on an active basis. The OSC renewed Buckingham's registrant status each year.

[3] Buckingham, not being a member of the Investment Dealers Association ("IDA"), was required to trade through member firms of the Investment Dealers Association (the "IDA"). From May, 1997, to July, 2000, Buckingham conducted the majority of its trading using a margin account (the "Canaccord Account") at Canaccord Capital Corporation ("Canaccord"). On July 28, 2000, Buckingham transferred the securities it held at Canaccord to a margin account at Latimer (the "Latimer Account") established pursuant to the Latimer Agreement. No further Agreement was entered into between Buckingham and Latimer when the margin account was opened. Latimer is registered as a securities dealer in Ontario, Quebec, Alberta and British Columbia; a member of the Toronto Stock Exchange, the Montreal Exchange and the Canadian Venture Exchange; and a member of the IDA.

[4] In mid June, 2001, the OSC attended at the offices of Buckingham and inspected its records. There was no evidence as to what prompted this attendance by the OSC. On July 6, 2001, (the "Cease Trade Date"), the OSC issued a Temporary Cease Trade Order prohibiting the trading of securities in Buckingham's account with Latimer.

[5] BDO Dunwoody Limited was appointed Receiver and Manager (the "Receiver") of the assets and undertaking of Buckingham by order dated July 26, 2001.

[6] As at August 16, 2001, Buckingham owed Latimer $1,902,641.76 in respect of the Latimer Account, with interest accruing at prime plus 4%.

[7] Each of the forms of the Client Account Agreement entered into between Buckingham and its customers provides as follows:

> "As continuing collateral security for the payment of any Indebtedness which is now or which may in the future be owing by the Client to Buckingham Securities Corp., the Client hereby hypothecates and pledges to Buckingham Securities Corp. all his Securities and Cash, including any free credit balances, which may now or hereafter be in any of his accounts with Buckingham Securities Corp. (collectively, the "Collateral"), whether held in the Account or in any other accounting which the Client has an interest and whether or not any amount owing relates to the Collateral hypothecated or pledged. So long as any indebtedness remains unpaid, the Client authorizes Buckingham Securities Corp., without notice, to use at any time and from time to time the Collateral in the conduct of Buckingham Securities business, including the right to, (a)

combine any of the Collateral with the property of Buckingham Securities Corp. or other clients or both; (b) hypothecate or pledge any of the Collateral which are held in Buckingham Securities Corp. possession as security for its own indebtedness; (c) loan any of the collateral to Buckingham Securities Corp. for its own purposes; or (d) use any of the Collateral for making delivery against a sale, whether a short sale or otherwise and whether such sale is for the Account or for the account of any other client of Buckingham Securities Corp."

or provides:

"You shall have the right, from time to time and without notice to me, to lend any securities held by you for or on my account with you either to yourselves as brokers or to others and to raise money thereon and carry them in your general loans and pledge and re-pledge them either separately or with your own securities or those of others or otherwise in such a manner and for such an amount and for such purposes as you may deem advisable and to deliver them on sales for others, without retaining in your possession or control securities of like, kind and amount".

[8] The trades processed by Buckingham through Latimer involved both cash accounts which held fully paid securities for Buckingham's customers and margin accounts which held marginable securities for Buckingham's customers. Securities held in a cash account are fully paid and must be segregated. With a margin account, if there is no borrowing by the customer, the securities in the account are fully paid and must be segregated. If there is borrowing by the customer, the broker must determine the net loan value of the securities and may have to segregate securities if the loan value exceeds the amount of borrowing. Securities that are not marginable because the trading prices are below a minimum amount have to be fully segregated. A software system called the ISM System used by most brokers and investment dealers determines the marginability of the securities held in the account of any particular customer. This determination is based upon the trading price of the various securities and the margin limit for various securities and will vary on a daily basis. The ISM System will also show which securities in a customer's account have to be segregated as fully paid or excess margin securities. Segregation is required by Section 117 of Regulation 1015 pursuant to the OSA and by the by-laws and regulations of the IDA.

[9] The accounts operated by Buckingham with Canaccord and, subsequently with Latimer, were omnibus accounts which included inventory securities of Buckingham, securities owned by employees of Buckingham and predominantly securities owned by customers of Buckingham. Because the Buckingham account with Latimer was an omnibus account, Latimer would treat all of the securities in the account as Buckingham's securities and would segregate the securities in that account using the ISM System in the same way as Latimer would segregate securities in the account of any other customer of Latimer. Latimer viewed it as Buckingham's responsibility to ensure that the securities in its customers' accounts were properly segregated.

[10] In addition to monthly statements for each customer, which would indicate all securities held for such customer, the market value of such securities and whether such securities were segregated, the ISM System produces Segregation Allocation Reports, Segregation Control

Reports and Security Position Reports. Segregation Allocation Reports show how many shares of each security ought to be segregated for each customer. Segregation Control Reports show whether a particular security is over-segregated or under-segregated and Security Position Reports show how many shares of each security are held by each customer and with which broker. It is my understanding that only the Segregation Allocation Reports would clearly indicate which securities of which customer ought to be segregated. Buckingham's monthly statements to its customers and its Segregation Allocation Reports showed that customers' securities were not being segregated as required by Regulation 1015 pursuant to the OSA.

[11] It is the position of the Receiver that Buckingham was in breach of its trust and fiduciary obligations to its customers when it pledged their fully paid and excess margin securities to Latimer pursuant to the terms of the Latimer Agreement and further that Latimer knew or ought to have known or should be found to have had constructive knowledge of the fact that Buckingham was pledging such securities in breach of its trust and fiduciary obligations to its customers. The Receiver therefore submits that the pledge of such securities to Latimer is void and that Latimer is required to return such securities to the Receiver on behalf of Buckingham's customers or to account to the Receiver for such securities.

[12] At the time of the transfer of Buckingham's account from Canaccord to Latimer in July, 2000, Mr. Sesto DeLuca ("DeLuca"), the President of Latimer, attended at Buckingham's office where he was advised as to Buckingham's "back office system" for processing orders from its customers and was advised that Buckingham used the ISM System for purposes of preparation of customers' monthly statements and for Segregation Allocation Reports, Segregation Control Reports and Security Position Reports. DeLuca's evidence is that he did not review any of such statements or Reports. Following such a visit, DeLuca wrote to Mr. David Bromberg ("Bromberg"), the President of Buckingham, to set out the terms of margin trading between Buckingham and Latimer including commissions to be charged by Latimer and the margin account facility to be provided by Latimer to Buckingham. In such letter, DeLuca stated "I would therefore request some assurance from you that your firm has the appropriate systems in place to ensure the proper segregation of your client's (sic) securities". Bromberg's reply of July 25, 2000, to DeLuca stated "securities are segregated into clients accounts as Certificates are received or trade tickets are executed". The reference in this letter from Buckingham to securities being segregated when the trade tickets are executed is not correct. Segregation takes place on the settlement date which is three days after the trade date in the vast majority of cases. At the request of DeLuca, Bromberg wrote a further letter of July 26, 2000, which stated "this is to confirm the following: all our clients accounts are segregated on a regular basis using the ISM Segregation System".

[13] It was Bromberg's evidence that he thought that the references in the correspondence to "segregation" meant having securities segregated by customer so that Buckingham would know which securities are held by which customers. It was also Bromberg's evidence that, for this purpose, he showed DeLuca a Security Position Report which showed which customers of Buckingham held shares of a particular security issuer. DeLuca denies that he saw any such Report. DeLuca did request and obtained a copy of the most recent renewal of registration of Buckingham with the OSC. DeLuca did not ask for or examine the financial statements of Buckingham and did not update the financial information from that given to Latimer by Buckingham when it initially opened an account with Latimer in 1997. The margin facility provided by Latimer to Buckingham was approximately $2,000,000 and the market value of

the securities in the Buckingham account transferred from Canaccord to Latimer was approximately $13,000,000. It was DeLuca's evidence that he assumed that Buckingham was entitled to pledge to Latimer the marginable securities in the Buckingham account and that they would have more than sufficient value to cover the margin facility of $2,000,000. It was also DeLuca's evidence that he did not know that Buckingham was not in fact segregating securities in its customers' accounts although he acknowledged that he could have determined this from Buckingham's monthly customer statements or from Buckingham's Segregation Allocation Reports, none of which were examined by him. DeLuca did receive a list of the securities being transferred from Canaccord to Latimer, which indicated that many of the securities being transferred were non-marginable.

[14] The opinion evidence of expert, Mr. Brian Sutton, called by the Receiver was that Regulation 1300.1 of the IDA, the "Know Your Client" rule required Latimer to satisfy itself as to the credit-worthiness of Buckingham and to ensure that Buckingham was properly segregating its customers' accounts and was not pledging to it securities which could not be pledged. His evidence was also that Latimer could determine the credit-worthiness of Buckingham by reviewing the Form 9 filed by Buckingham with the OSC. It was Mr. Sutton's opinion that it was not appropriate for Latimer to rely on the three-year old financial information from Buckingham when opening the margin account for Buckingham in July, 2000. Mr. Sutton's evidence was that in a cash account there is always a safekeeping agreement if the registrant is to hold the securities. Mr. Sutton conceded that for Latimer to know which securities of Buckingham's customers had to be segregated, it would have to know with respect to each customer which securities were fully paid, which were excess margin securities, which, if any, were in delinquent cash accounts not subject to a safekeeping agreement and which, if any, were in an under-margined customer margin account, as well as each Buckingham customer's account balance and the loan value of such account. Mr. Sutton also agreed that this information could change daily and would have to be tracked by Latimer.

[15] The opinion evidence of expert witness, Ms. Joni Alexander called by Latimer, was that Latimer did comply with the "Know Your Client" rule with respect to Buckingham. In her opinion, the suitability requirement is not relevant, the credit- worthiness and identity was satisfied because Latimer had dealt with Buckingham before, had reviewed Buckingham's current registration with the OSC and had the Application of Buckingham and a Customer Account Agreement with Buckingham on file. With respect to business conduct, Latimer had reviewed the account to be transferred from Canaccord to ensure that there was adequate collateral for the margin facility that was to be provided to Buckingham. It was also the evidence of Ms. Alexander that Latimer did not need to look through Buckingham to each Buckingham customer account to determine whether the securities pledged by Buckingham to Latimer were eligible to be pledged and that, in any event, this would be impractical in view of the detailed knowledge which Latimer would have to have of each of Buckingham customer account. Ms. Alexander testified that each cash account does not require a safekeeping arrangement. That is a specific type of custody arrangement between a registrant and a customer. She was also of the opinion that the number of "penny stocks" in the Buckingham account should not necessarily have triggered Latimer to enquire as to whether securities were being improperly pledged by Buckingham as these stocks could have been inventory of Buckingham, could have been in delinquent cash accounts or, could have been in under-margined margin accounts. It was Ms. Alexander's evidence that it would not be the normal practice for a "jitney broker" such as Latimer to inquire whether its registrant/client had

authority from its customers, or whether it was entitled to pledge the securities in its account to the jitney broker or to ask for the Segregation Allocation Reports of its registrant/customers.

[16] Where there was a conflict in the evidence between that of Bromberg and that of DeLuca, I preferred the evidence of DeLuca. He has extensive knowledge of the brokerage business and his evidence was straightforward, consistent and logical. He conceded that he could have made further inquiries to determine whether Buckingham was segregating its clients' securities and that an examination of certain of Buckingham's statements and reports would have indicated a failure to segregate. Bromberg's evidence, on the other hand, was confused, inconsistent and unresponsive. He either has an abysmal lack of knowledge about the brokerage business or his evidence is simply not credible. This is particularly true of his evidence that he thought the reference to segregation of accounts in his letters to Latimer referred to accounts being segregated as among Buckingham's customers. Anyone with any familiarity with the regulation of the securities industry would be aware of the requirement to segregate securities for margin purposes based upon securities being fully paid or excess margin securities. Accordingly, in my view, Bromberg's evidence in this regard is not credible and the statements made in the letters from Buckingham to Latimer are either negligent or intentional misrepresentations made by Buckingham to Latimer. It was, in my view, reasonable for Latimer to assume that these statements indicated segregation as required by the Regulation under the OSA and the IDA by-laws. Latimer was aware that Buckingham used the ISM System and clearly had the information available to it to determine what securities must be segregated.

[17] With respect to the expert evidence, I preferred the evidence of Ms. Alexander where there was a conflict. Her evidence with respect to compliance with the "Know Your Client" rule in a situation where a jitney broker is dealing with a registrant/customer appeared to me to be more practical than that of Mr. Sutton as did her evidence that it would not be practical for a jitney broker to look through the account of its registrant/ customer to the customers of that registrant to determine whether the securities in the account were properly segregated. Mr. Sutton conceded that in order for Latimer to do that it would have to have very detailed knowledge of the securities of each customer of Buckingham which could change daily and which would have to be tracked by Latimer.

[18] There was some conflict in the expert evidence before the court as to whether Latimer was required in accordance with the "Know Your Client" rule under the IDA rules to inquire as to Buckingham's financial position and to update the information with respect to Buckingham from that provided when Buckingham first opened an account with Latimer in 1997. The evidence is that DeLuca did not ask for an updated financial statement of Buckingham or an update of the financial information provided in 1997 but simply obtained a copy of the latest renewal of Buckingham's registration with the OSC. The "Know Your Client" rule is contained in Regulation 1300 of IDA and provides in part as follows:

"Identity and Creditworthiness

(a) Each Member shall use due diligence to learn and remain informed of the essential facts relative to every customer and to every order or account accepted.

Business Conduct

(b) Each Member shall use due diligence to ensure that the acceptance of any order for any account is within the bounds of good business practice.

Suitability Generally

(c) Subject to Regulation 1300.1(e), each 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 situations, investment knowledge, investment objectives and risk tolerance".

[19] On both these issues, it was the opinion of Ms. Alexander, whose evidence I preferred., that Latimer had complied with industry standards in establishing the margin account for Buckingham. It was her evidence that a jitney broker would not be expected to obtain further information with respect to credit-worthiness when it is satisfied as to its registrant/customers registration status with the OSC and where it already had on file an Application and a Customer Account Agreement with the registrant/customer.

[20] With respect to business conduct, it was her opinion that Latimer had satisfied this requirement by reviewing the securities in the account to be transferred from Canaccord to ensure that there was adequate collateral for the margin facility being provided to Buckingham and that a jitney broker would not be expected to look through Buckingham to the accounts of Buckingham's customers to determine whether securities had been segregated or were qualified to be pledged to the jitney broker to secure the margin account in view of the impracticality of the detailed knowledge which Latimer would have to have of each Buckingham customer account. She conceded that if Latimer had made further inquiries and had reviewed Buckingham's documents such as customer monthly statements or Segregation Allocation Reports, it would have become aware that securities were not being properly segregated by Buckingham.

<u>Issues</u>

[21] The issues in this proceeding are as follows:

(1) Did a trust relationship exist between Buckingham and its customers pursuant to the Client Account Agreements entered into between Buckingham and its customers or pursuant to the OSA?

(2) If a trust relationship did exist, was Buckingham in breach of its obligations to its customers in pledging its customers' fully paid and excess margin securities to Latimer?

(3) If Buckingham was in breach, did Latimer have actual or constructive notice of Buckingham's breach?

I will deal with the issues in the above order.

Reasons

[22] Did a trust relationship exist between Buckingham and its customers pursuant to the Client Account Agreements entered into between Buckingham and its customers or pursuant to the OSA?

Section 117 of Regulation 1015 (R.R.O. 1990) under the OSA provides:

> "(1) Securities held by a registrant for a client that are unencumbered and that are either fully paid for or are excess margin securities but that are not held pursuant to a written safekeeping agreement shall be,
>
> a) segregated and identified as being held in trust for the client; and
>
> b) described as being held in segregation on the registrant's security position record, client's ledger and statement of account.
>
> (2) Segregated securities may be used by the registrant, by sale or loan, whenever a client becomes indebted to the registrant but only to the extent reasonably necessary to cover the indebtedness.
>
> (3) Bulk segregation of securities described in subsection (1) is permissible".

[23] Latimer has submitted, based on the authority of Cheseborough v. Willson [2001] O.J. 940 (S.C.J.), that the Regulations under the OSA are administrative and directory only and do not create a trust relationship between a broker and its customers and that, even if a trust relationship is established, the provisions of the Client Account Agreements entered into between Buckingham and its customers specifically permit the pledging of the customer securities in support of loans to Buckingham for its own account. Latimer does concede, however, that there is a duty on Buckingham to protect and safeguard fully paid and excess margin securities and to deliver them in specie when directed. The court in Cheseborough, *supra*, concluded that Regulation 1015, at a minimum, required registrants to protect and safeguard fully paid or excess margin securities and deliver them in specie when required, even if it did not have the effect of establishing a trust relationship and imposing upon the registrant all the duties and obligations of a trustee at law. In the case at bar, Buckingham was clearly in breach of both these obligations to its customers.

[24] For a trust to come into existence, there must be three certainties: certainty of intention, certainty of subject matter and certainty of object. In the relationship between Buckingham and its customers with respect to their segregated securities which the Receiver submits

constitutes a trust relationship, there is certainty of subject matter in that it is the fully paid or excess margin securities of Buckingham's customers which must be segregated and "identified as being held in trust". The fact that the components of the subject matter of the trust may fluctuate is not relevant. In any investment trust, the subject matter of the trust fluctuates as investments are purchased and sold. There is also certainty of object in that the beneficiaries of such trust are the customers of Buckingham who hold such securities. With respect to certainty of intention, the trust relationship is imposed upon the parties by virtue of Regulation 1015 pursuant to the OSA.

[25] In Chesebrough, *supra*, Sheppard J. concluded with respect to such Regulation and similar statutory provisions and institutional by-laws as follows at paragraph 41:

> "Yet counsel contends that this statutory and regulatory regime requiring a registrant to hold customer's fully-paid securities separate and apart from their own and others created and imposed upon it (the registrant) a trust relationship such that the registrant (Midland Walwyn) stood in a trust relationship to the plaintiff, that Midland Walwyn became a trustee for the plaintiff and in some way was then duty-bound to act as a trustee at law in its dealings with the plaintiff. I have considerable difficulty in accepting that proposition. In my view, all the cited regulations and by-laws do nothing more than to regulate registrants or members and direct them how they shall deal with a customer's securities like the shares owned by the plaintiff. Regulations whether passed under a statute or by an association cannot create and impose a trust relationship between two parties, imposing on the party holding the securities all the duties and responsibilities which the law imposes on a trustee created by deed or by-law. These regulations are administrative and directory only; they do nothing more than direct a registrant or member how prescribed securities are to be handled and recorded.
>
> Again, I repeat one must distinguish between a trust relationship between the trustee and beneficiary with all attendant duties and responsibilities and an administrative trust created for the proper dealing with other people's property, which I suggest creates no further obligation than a duty on the person holding the property to protect and safeguard it and deliver it in specie when required. Certainly, if the securities are misappropriated and cannot be returned, a breach of trust arises entitling the customer to an award of damages ....
>
> Characterizing the shares as being impressed with a trust for industry regulatory requirements does not a fortiori make the registrant a trustee with all the attendant duties and responsibilities of a trustee except for being obliged to deliver the trust property in specie when directed"....

[26] With great respect, I am unable to adopt this distinction between a trust created by deed or law and a statutory trust. The authorities dealing with or interpreting trust or deemed trust provisions of statutes do not draw any distinction between the duties imposed upon a trustee of a statutory trust as opposed to a trustee of a trust created by deed or law. In Ward-Price v. Mariners Haven Inc. (2001) 57 O.R. (3rd) 10 (Ont. C.A.), in considering the statutory trust

created under the *Condominium Act* R.S.O. 1990 ch. c-26 Borins, J.A. made reference to the expressed statutory trust created under that Act and stated at page 419:

> "Although it may be argued that this trust lacks, in some respects, the three certainties of intention, object and subject-matter, this does not affect its essential character as a trust". As McLachlin J. pointed out in British Columbia v. Henfrey Blair Ltd., [1989] 2 S.C.R. 24 at p. 35, 59 D.L.R. (4th) 726, at p. 742: "the provinces may define "trust" as they choose for matters within their own legislative competence....".

(See also Commercial Union Life Assurance Co. of Canada v. John Ingel Insurance Group Inc. (2002) O.J. No. 3200 (Ont. C.A.) with respect to the statutory trust created under Subsection 402(1) of the *Insurance Act* R.S.O. (1990) ch. I-8; D.E. and J.C. Hutchinson Contracting Co. v. Placer Dome Canada Ltd. (1998) O.J. No. 4999 (Gen. Div.) with respect to the statutory trust created pursuant to Part 2 of the *Construction Lien Act* R.S.O. (1990) ch. c-30).

[27] In addition, it appears to me to be clear from such authorities that certainty of intention can be established by the intention of the legislature to create a trust relationship being evidenced by the wording of a statute or Regulation.

[28] Accordingly, in my view, the relationship between Buckingham and its customers holding fully paid or excess margin securities was a trust relationship with all the attendent duties and responsibilities of a trustee applicable.

If a trust relationship did exist, was Buckingham in breach of its obligations to its customers in pledging its customers' fully paid and excess margin securities to Latimer?

[29] The pledging by Buckingham of its customers fully paid and excess margin securities to Latimer was, in my view, clearly a breach of Buckingham's obligations as a trustee to its customers. I am not satisfied that the provisions of the Client Account Agreements entered into by the majority of Buckingham's customers permitted Buckingham to breach such obligations. Subsection 1(1) of the OSA defines "Ontario securities law" as the OSA, Regulations made under the OSA and any decision of the Commission or a Director with reference to a particular person or company. Subsection 122(1) of the OSA provides that every person or company that contravenes Ontario securities law is guilty of an offence. It would be clearly contrary to public policy to permit a registrant and its customers to contract out of the obligation of the registrant to comply with Ontario securities law. In any event, the Buckingham Client Account Agreements provide:

> "All Transactions in Securities for the Account shall be subject to the constitutions, by-laws, rules, rulings, regulations, customs and usages of the exchanges or markets and their clearing houses, if any, where made and to all laws, regulations and orders of any applicable governmental or regulatory authorities (all collectively referred to as "Applicable Rules and Regulations")"
> or
>
> "All transactions shall be subject to the constitution, by-laws, rule, rulings, regulations, customs and usages of the exchange or market, and its clearing

house, if any, where made, and to all laws and all regulations and orders of any governmental or regulatory authority that may be applicable".

[30] Accordingly, I am of the view that Buckingham was in breach of the above provisions and of its statutory trust obligations in pledging to Latimer securities of Buckingham's customers which were required to be segregated and that the provisions of the Client Account Agreements permitting pledging of such securities do not negate such contractual and statutory obligations.

If Buckingham was in breach of its obligations to its customers, did Latimer have actual or constructive notice of Buckingham's breach?

[31] It is not alleged by the Receiver that Latimer had actual knowledge of Buckingham's breach of its trust obligations to its customers or of its breach of Ontario securities law. In the case at bar, the only basis upon which Latimer could be found to have constructive knowledge of the breach of trust by Buckingham would be under the line of cases establishing liability on third parties for "knowing receipt" of property transferred to them in breach of trust. The basis for liability of a third party in the "knowing receipt" cases is summarized by La Forest J. in Citadel General Assurance v. Lloyds Bank of Canada (1997) 152 D.L.R. (4th) 411 (S.C.C.) at pg. 434 as follows:

> "However, in "knowing receipt" cases, which are concerned with the receipt of trust property for one's own benefit, there should be a lower threshold of knowledge required of the stranger to the trust. More is expected of the recipient, who, unlike the accessory, is necessarily enriched at the plaintiff's expense. Because the recipient is held to this higher standard, constructive knowledge (that is, knowledge of facts sufficient to put a reasonable person on notice or inquiry) will suffice as the basis for restitutionary liability. Iacobucci J. reaches the same conclusion in *Gold, supra*, where he finds, at para. 46, that a stranger in receipt of trust property "need not have actual knowledge of the equity [in favour of the plaintiff]; (constructive?) notice will suffice.
>
> [49] This lower threshold of knowledge is sufficient to establish the "unjust" or "unjustified" nature of the recipient's enrichment, thereby entitling the plaintiff to a restitutionary remedy. As I wrote in *Lac Minerals, supra,* at p. 670, "the determination that the enrichment is 'unjust' does not refer to abstract notions of morality and justice, but flows directly from the finding that there was a breach of a legally recognized duty for which the courts will grant relief". In "knowing receipt" cases, relief flows from the breach of a legally recognized duty of inquiry. More specifically, relief will be granted where a stranger to the trust, having received trust property for his or her own benefit and having knowledge of facts which would put a reasonable person on inquiry, actually fails to inquire as to the possible misapplication of trust property. It is this lack of inquiry that renders the recipient's enrichment unjust".

[32] In the case at bar, Latimer was clearly aware that Buckingham had an obligation to segregate its customers' securities. It would also have been aware that Buckingham's monthly statements to its customers and Segregation Allocation Reports prepared by Buckingham using

the ISM System would have indicated whether the securities of Buckingham's customers were in fact segregated. The evidence is that DeLuca made no effort to review customers' monthly statements or Segregation Allocation Reports of Buckingham and, in order to satisfy Latimer that Buckingham was segregating customers' securities, simply requested the two letters from Buckingham referred to above

[33] The obligation on the third party recipient in the "knowing receipt" cases is to make inquiries which a reasonable person in the circumstances of the recipient would have made. Once the recipient is put on notice that a breach of trust may have occurred by its acceptance of property transferred to it, as stated in Citadel General Assurance Co. *supra*, "relief will be granted where a stranger to the trust, having received trust property for his or her own benefit and having knowledge of facts which would put a reasonable person on inquiry, actually fails to inquire as to the possible misapplication of trust property".

[34] The Receiver has submitted the receipt by Latimer of the two letters from Buckingham with reference to segregation and should have put Latimer on inquiry with respect to segregation. In particular, the Receiver refers to the statement in the letter of July 25, 2000, that "securities are segregated into client accounts as certificates are received or trade tickets are executed", which statement is not correct, should have alerted Latimer. I am unable to accept this submission. Upon receipt of the July 25, 2000 letter, Latimer requested a further letter clarifying the statement with respect to segregation and was assured in the letter of July 26, 2000, that "all our clients accounts are segregated on a regular basis using the ISM Segregation System". In addition, it appears to me that a reasonable person in the brokerage business in the circumstances would have assumed that the reference to segregation was to segregation in accordance with the requirements of the OSA. Latimer was aware that Buckingham used the ISM System and had the ability to effect segregation in accordance with the requirements of the OSA.

[35] Accordingly, I am not satisfied that, on the facts of the case at bar, Latimer had knowledge of facts which would have put a reasonable person in Latimer circumstances on inquiry. In any event, even if one should conclude that Latimer ought to have put on inquiry, it was not required to conduct an impractical or extensive inquiry nor is it to be held to a standard of perfection. Latimer must only show that it acted reasonably under the circumstances. It is the opinion of Ms. Alexander that Latimer complied with industry standards and did all that was required to satisfy itself as to Buckingham's business conduct and to ensure that Buckingham was segregating its customers' securities. It appears to me that, if Latimer was in compliance with industry standards and practice and conducted itself in a manner consistent with that followed by other brokers in similar circumstances, it has satisfied the requirement of making reasonable inquiries. Although it may appear to this court that the industry practice as to due diligence and documentation in the establishment of customer accounts with brokers may be somewhat casual in the case of a registrant opening an account with a jitney broker and, although it is apparent that by making certain further inquiries, Latimer would have become aware that Buckingham was not complying with the segregation requirements of the Regulation under the OSA, I am unable to conclude that Latimer failed to make reasonable inquiries in all the circumstances of this case.

[36] Although having found that a trust relationship existed between Buckingham and its customers who held fully paid or excess margin securities, the issue may be moot, counsel for the Receiver did submit that, if a trust relationship did not exist between Buckingham and its

customers, there was clearly a fiduciary relationship between them. I do not agree that, in every instance, a fiduciary relationship exists between a broker and its customers. In Hodgkinson v. Simms et al (1994) 117 D.L.R. (4th) 161 (S.C.C.), La Forest J. at pg. 183, citing with approval the decision of Keenan J. in Varcoe v. Sterling 1992 7 O.R. (3rd) 204 (Gen. Div.), stated as follows:

> "Much of this case law was recently canvassed by Keenan J. in Varcoe v. Sterling (1992), 7 O.R. (3d) 204, 33 A.C.W.S. (3d) 1184 (Gen. Div.), in an effort to demarcate the boundaries of the fiduciary principle in the broker-client relationship". Keenan J. stated, at pp. 234-6:
>
> "The relationship of broker and client is not per se a fiduciary relationship ....Where the elements of trust and confidence and reliance on skill and knowledge and advice are present, the relationship is fiduciary and the obligations that attach are fiduciary. On the other hand, if those elements are not present, the fiduciary relationship does not exist ... The circumstances can cover the whole spectrum from total reliance to total independence. An example of total reliance is found in the case of Ryder v. Osler, Wills, Bickle Ltd. (1985), 49 O.R. (2d) 609, 16 D.L.R. (4th) 80 (H.C.J.). A $400,000 trust for the benefit of an elderly widow was deposited with the broker. An investment plan was prepared and approved and authority given to operate a discretionary account .... At the other end of the spectrum is the unreported case of Merit Investment Corp. v. Mogil, [1989] O.J. No. 429, Ont. H.C.J., Anderson J., March 23, 1989 [summarized at 14 A.C.W.S. (3d) 378], in which the client used the brokerage firm for processing orders. He referred to the account executive as an "order-taker", whose advice was not sought and whose warnings were ignored.
>
> The relationship of the broker and client is elevated to a fiduciary level when the client reposes trust and confidence in the broker and relies on the broker's advice in making business decisions. When the broker seeks or accepts the client's trust and confidence and undertakes to advise, the broker must do so fully, honestly and in good faith .... It is the trust and reliance placed by the client which gives to the broker the power and in some cases, discretion, to make a business decision for the client. Because the client has reposed that trust and confidence and has given over that power to the broker, the law imposes a duty on the broker to honour that trust and respond accordingly.
>
> In my view, this passage represents an accurate statement of fiduciary law in the context of independent professional advisory relationships, whether the advisers be accountants, stockbrokers, bankers, or investment counsellors. Moreover, it states a principled and workable doctrinal approach. Thus, where a fiduciary duty is claimed in the context of a financial advisory relationship, it is at all events a question of fact as to whether the parties' relationship was such as to give rise to a fiduciary duty on the part of the advisor".

[37] I would adopt the above statement of Keenan, J. as to the existence of a fiduciary relationship between a broker and its customers. In my view, there is no evidence before this

court to establish that the relationship between Buckingham and its customers was such as to give rise to a fiduciary duty on the part of Buckingham, apart from the statutory trust imposed upon Buckingham by Regulation 1015 under the O.S.A.

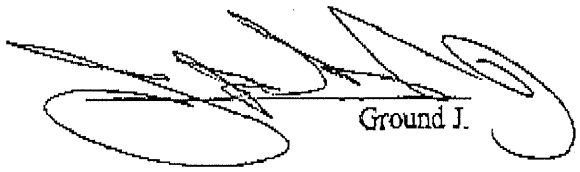
[38] Accordingly, on the issues to be tried in this proceeding, I find as follows:

1. A trust relationship did exist between Buckingham and its customers who held fully paid or excess margin securities.

2. Buckingham was in breach of such trust relationship in pledging its customers' fully paid and excess margin securities to Latimer.

3. Latimer did not have actual or constructive knowledge of such breach of trust.

[39] Counsel may make brief written submissions to me on the costs of this proceeding on or before November 15, 2002.



Ground J.

Released: October 17, 2002

COURT FILE NO.: 01-CL-4192
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ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

ONTARIO SECURITIES COMMISSION

- and -

BUCKINGHAM SECURITIES CORPORATION

REASONS

Ground J.

Released: October 17, 2002