Privy Council Appeal No. 69 of 1936.

Isaac W. C. Solloway and another - - - *Appellants*

v.

J. P. McLaughlin - - - - - - *Respondent*

J. P. McLaughlin - - - - - - *Appellant*

v.

Isaac W. C. Solloway and another - - - *Respondents*

Consolidated Appeals.

FROM

THE SUPREME COURT OF CANADA

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 29TH OCTOBER, 1937.

Present at the Hearing:

LORD ATKIN.
LORD MACMILLAN.
LORD WRIGHT.
LORD MAUGHAM.

[*Delivered by* LORD ATKIN.]

These are an appeal and a cross appeal from decisions of the Supreme Court of Canada in an action brought in the High Court of Ontario by the present respondent against two companies named Solloway Mills and Co., Ltd., one registered in Ontario and the other in the Dominion and against the present appellants Mr. Isaac Solloway and Mr. Harvey Mills, two of the directors of the companies. The action was tried before an assistant Master, Mr. Lennox, who reported that there was due to the plaintiff from the Ontario company and the appellants the sum of $65,129.92. The Dominion company had dropped out of the proceedings. On appeal by the present appellants from the Master's report, Kerwin J. confirmed the report with an arithmetical correction of the amount found to be due to $55,922.98. On appeal the Court of Appeal dismissed the action as against the present appellants, Macdonnell J.A. dissenting. On appeal by the plaintiff the Supreme Court allowed the appeal but reduced the amount of the judgment to $28,281.40 and interest. The two director defendants appeal and the plaintiff cross appeals.

The claim of the plaintiff arose out of transactions which he had with the Ontario company in 1929 and 1930. The company purported to carry on business as stock brokers

having acquired in 1928 the business of that nature which had been started by the two appellants in 1927. The company were members of the Standard Stock and Mining Exchange in Toronto. On 16th October, 1929, the plaintiff instructed the company to buy for him 7,000 shares of Sudbury Basin Mines, Ltd., on margin at market price, then $7 a share. He at the same time deposited 3,500 shares of Sudbury Basin Mines, Ltd., as margin. He duly received a contract note purporting to show that the transaction had been carried out in accordance with the rules of the appropriate Stock Exchange which in the present case was the Standard Stock and Mining Exchange in Toronto. The shares steadily declined in value: requests were made from time to time by the company for further margin or cash: the plaintiff duly complied with these requests so that in the course of the transactions between October and December inclusive he deposited with the company a further 10,500 shares of the Sudbury Company and paid $8,000 cash. He received monthly statements showing the shares as being carried for him. On 13th January, 1930, the plaintiff decided to close the account. The balance against him on that date appeared to be $42,334.92. He paid that sum and was given delivery of 21,000 shares, i.e., 7,000 originally bought, 3,500 originally deposited and 10,500 subsequently deposited. It now appears that the transactions as far as the company were concerned were part of a fraudulent system of business and were themselves fraudulent in their inception, continuance and completion. The company purporting to buy and in fact making valid contracts of purchase for their clients contemporaneously sold shares of the same company, and used their client's shares to complete these sales. The shares are in the form familiar in American companies and with a blank transfer endorsed pass in a similar manner to bearer shares. A broker is not considered to be under an obligation to retain for his client the specific shares which may be delivered to him under the contract made for his client. But he has, of course, to get into his possession and retain an equivalent number of shares. Under the fraudulent system of the company they were throughout the course of this transaction "short" of these Sudbury Basin shares by about 100,000 shares, involving no doubt similar frauds on other clients. In other words they were bears when their clients were bulls: they correctly anticipated the fall of the market: and when their clients demanded the shares they went into the market and bought them at the fallen price to their own substantial profit. The same course was adopted with the shares deposited as margin. The company sold them as soon as they were deposited, without any lawful excuse even if the transaction had been in every other respect regular: when they were claimed by the plaintiff an equivalent number was bought in the market and delivered to the plaintiff with further profit to the Company. It was disputed that the two appellants were parties to the fraud. Their Lordships agree with the assistant Master, Kerwin J. and Macdonnell J.A. and the learned Judges of the Supreme

Court that it was established that both the appellants were privy to and took part in the fraud throughout. They find it unnecessary for them to discuss this contention.

What then are the rights of the plaintiff in this state of facts? The assistant Master gave him the full amount at which he had been charged for the 7,000 shares bought, and also the price at which the company had realised the deposited shares, crediting the defendants with the market value of the shares at the time when they were delivered to the plaintiff. The Supreme Court agreed with the claim so far as it related to the 7,000 shares: but as to the deposited shares they took the view that the plaintiff had made his claim in respect of them for secret profits: that he had affirmed the transaction by taking and keeping the shares delivered to him when the account was closed: and that as he had claimed in contract or quasi-contract against the company he could not claim against the directors unless he had shown against them some perception of the profits: and this he had failed to establish. They therefore reduced the amount of the judgment to the amount charged to the plaintiff for the 7,000 shares less their value when delivered.

Regarded from this point of view their Lordships have no criticism to pass on the judgment. But the plaintiff before the Board put his claim on a broader basis which is sufficiently revealed by the pleadings and which their Lordships are disposed to accept. The company were employed as agents. If they had honestly fulfilled their mandate they would have been entitled not to the price of the 7,000 shares but to an indemnity against the price which they had paid to the sellers. But agents who engage in a fraudulent scheme to defraud their principal forfeit their right to an indemnity in respect of transactions which form part of the fraud. The company therefore were never entitled to an indemnity: and the principal on discovering the fraud was entitled to recover back the money paid on the footing of an honest transaction giving credit, of course, for any benefit which he received, in this case the value of the 7,000 shares at the time he received them. As to the deposited shares in the circumstances of the case the company never had any right to deal with them. If the transaction had been originally honest the company would only have had a special property which on the facts of the case even had the transaction been honest throughout would not have given them the right to dispose of the shares, for there never had been default. But on the actual facts of a mandate accepted for the express purpose of being fraudulently misused by the agent, the agents never had the right to claim or to hold security still less to dispose of it. Their disposal of the deposited shares amounted to nothing short of conversion: and the client on each occasion on which the shares were sold had vested in him a right to damages for conversion which would be measured by the value of the shares at the date of the conversion. How then is his position affected by the fact that not knowing of the conversion he received from the wrongdoer and has

retained the very goods converted or their equivalent? It appears to their Lordships that the only effect is that he must give credit for the value of what he has received at the time he received it, and that the damages are reduced by this amount. In *Edmonson* v. *Nuttall* (1864) 17 C.B. (N.S.) 280, the plaintiff had placed his looms with the defendant who was to supply standing room and power in his mill. The plaintiff demanded the return of his looms, the defendant refused, (thereby being guilty of conversion), and the next day the goods were seized and subsequently sold under an execution from the County Court on a judgment obtained by the defendant against the plaintiff. The question was whether the fact that the liability of the plaintiff on this judgment had been apparently satisfied by the seizure and sale of the looms could be taken into account in estimating damages for the conversion. The Court of Common Pleas, Vaughan Williams, Willes and Byles JJ. decided against the defendant.

> " The measure of damages for the conversion of goods " said Willes J. at p. 294, " is prima facie their value . . . ." " Then there is the case in which the goods wrongfully seized have been afterwards returned. The cases of *Fouldes* v. *Willoughby*, 8 M. & W. 540 and *Harvey* v. *Pocock*, 11 M. & W. 740, afford a familiar illustration of the rule. The circumstances I have referred to have from very early times been considered admissible in mitigation of damages because the plaintiff has had part satisfaction for the wrong. If the goods have been restored and the plaintiff has consented to take them back in discharge of the claim, that might be pleaded by way of accord and satisfaction: if not, it would go in reduction of the amount of damages to which the plaintiff would be entitled for the wrongful conversion."

It does not require argument to show that the amount by which the damages are reduced must be the value of the goods when returned. In the result, therefore, the plaintiff appears to be entitled to retain the sum for which he recovered judgment under the order of Kerwin J. It is objected that this will be to put him in a better position than if he had not been defrauded at all: and this appears to have influenced the decision of the majority of the Court of Appeal in Ontario. All that this amounts to is to recognise that fraudulent brokers have often sounder judgment than their clients as to the future course of markets. If the shares had been converted and not returned there can be no question that the client would have been entitled to receive the proceeds of the conversion though he himself had planned and thought he had succeeded in holding the shares until a time when the value was nothing: fortunately for the commercial community the law has many effective forms of relief against dishonest agents: and no injustice is done if the principal benefits as he occasionally may by the superior astuteness of an unjust steward in carrying out a fraud.

In the course of the case a point has been made that the assistant Master under the Acts and rules of procedure in Ontario had no jurisdiction to entertain this case. It has not met favour in any of the Courts below. In the Supreme

Court, though it is mentioned in the factums, it was either not argued or met with little approval for it is not mentioned in the judgment. Their Lordships see no reason for interfering with the judgment on this ground.

The appeal will be dismissed and the cross appeal allowed: the judgment of Mr. Justice Kerwin dated 13th June, 1933, should be restored: and the respondent should have the costs of the appeal to the Court of Appeal in Ontario and to the Supreme Court. The appellants must pay the costs of the appeal and cross appeal to His Majesty in Council. Their Lordships will humbly advise His Majesty accordingly.

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In the Privy Council.

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DELIVERED BY LORD ATKIN

Printed by His Majesty's Stationery Office Press,
Pocock Street, S.E.1.

1937