Court File No. 01-CV-203394

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

CHRISTOPHER MORGIS, JOANNE MORGIS AND CM HOLDINGS INC.

Plaintiffs

-and-

THOMSON KERNAGHAN & CO. LIMITED AND PAT TEGGART

Defendants

FACTUM OF THE RESPONDING PARTIES, INVESTORS DEALERS ASSOCIATION OF CANADA, TERRANCE K. SALMAN, G.F. KYM ANTHONY AND JOSEPH J. OLIVER

GOODMAN AND CARR LLP
Barristers and Solicitors
Suite 2300
200 King Street West
Toronto ON M5H 2W5

Gary H. Luftspring
Tel: 416.595.2326
Fax: 416.595.0567

Solicitors for the Proposed Defendants, the Investment Dealers Association of Canada, Terrance K. Salman, G.F. Kym Anthony and Joseph J. Oliver

TO: **McCARTHY TÉTRAULT**
Barristers & Solicitors
Box 48, Suite 4700
Toronto Dominion Bank Tower
Toronto ON M5K 1E6

Darryl A. Cruz
Tel: 416.601.7812
Fax: 416.601.8246

Solicitors for the Plaintiffs

Court File No. 01-CV-203394

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

CHRISTOPHER MORGIS, JOANNE MORGIS AND CM HOLDINGS INC.

Plaintiffs

-and-

THOMSON KERNAGHAN & CO. LIMITED AND PAT TEGGART

Defendants

FACTUM OF THE RESPONDING PARTIES, INVESTORS DEALERS ASSOCIATION OF CANADA, TERRANCE K. SALMAN, G.F. KYM ANTHONY AND JOSEPH J. OLIVER

PART I – NATURE OF THE MOTION AND THE RESPONDING PARTIES' POSITION

1. The Plaintiffs are seeking an order to add the Investors Dealers Association of Canada (the "IDA"), Terrance K. Salman, G.F. Kym Anthony and Joseph J. Oliver (collectively the "IDA Defendants") as Defendants to the within action.

2. The IDA Defendants oppose that motion because the proposed amendments do not disclose a reasonable and tenable cause of action.

PART II – THE FACTS

3. The Plaintiffs are claiming damages against Thomson Kernaghan & Co. Limited ("TK") and various persons associated with TK for breach of contract, negligence, breach of fiduciary duty and misrepresentation. The Plaintiffs held two brokerage accounts at TK.

Schedule "A" to Notice of Motion dated July 22, 2002, paras. 11, 16 and 37

4. The Plaintiffs allege that the Investment Dealers Association of Canada

> "is an unincorporated voluntary Association of Canadian Securities Dealers governed by a constitution, bylaws and regulations which deal with the conduct, management and control of the Association's affairs including the conditions of membership, the rights and duties of and standards to be maintained by members, the investigation of complaints against members and the imposition of discipline for the misconduct of its members."

and that Terrance K. Salman is its Chair, G. F. Kym Anthony is its Vice-Chair and Joseph J. Oliver is its President and Chief Executive Officer.

Schedule "A" to Notice of Motion dated July 22, 2002, paras. 11 - 14

5. The Defendants allege that

(a) "The IDA is responsible for regulating investment dealers ...to protect the investing public",

(b) "the IDA Defendants owed a duty of care to the Plaintiffs, as investors of TK to ensure that the TK Defendants complied with the IDA's rules, regulations and by-laws", and

(c) "the IDA Defendants were negligent and breached their duty to the Plaintiffs" because they did not

(i) "ensure [the] competence of the TK Defendants",

(ii) "ensure that TK's employees, particularly Mr. Teggart and Mr. Grand were of good character",

(iii) "ensure that TK maintained sufficient capital to protect the Plaintiffs in the circumstances",

(iv) "ensure that the TK Defendants conducted their business in accordance with the IDA's rules, regulations and by-laws",

(v) "ensure that TK had effective procedures in place to supervise the handling of client accounts", and

(vi) "investigate and discipline TK, Mr. Teggart and Mr. Simpson in a timely or effective manner".

Schedule "A" to Notice of Motion dated July 22, 2002, paras. 38, 46 and 47

PART III – THE LAW

Failure to Disclose a Reasonable Cause of Action

6. It is respectfully submitted that a court should not grant an amendment to a pleading if that amendment does not disclose a reasonable and tenable cause of action. The following statement of Rosenberg J. in *Vaiman et al v. Yates*, [1987] 20 C.P.C. (2d) 33 (High Court of Justice), has been followed extensively:

> "Why should the defendant be faced with an amendment and then have to move to strike it out on the grounds that it discloses no cause of action? If the Master is of the opinion that it discloses no cause of action, he should not allow the amendment and [should] state his reasons."

***Vaiman et al v. Yates* (1987), 20 C.P.C. (2d) 33 (H.C.J.), at p. 36**

No Duty of Care Owed

7. In three very recent cases, the Supreme Court of Canada and the Ontario Court of Appeal have refused to recognize any duty of care owed by a supervising regulatory body to individual members of the public harmed by members of the regulated association or profession.

***Cooper v. Hobart* (2001), 206 D.L.R. (4th) 193 (S.C.C.)**
***Edwards v. Law Society of Upper Canada* (2001), 206 D.L.R. (4th) 211 (S.C.C.)**
***Rogers v. Faught* (2002), 212 D.L.R. (4th) 366 (Ont. C.A.)**

8. The plaintiffs base a duty of care on the allegation that the "IDA is responsible for regulating investment dealers ... to protect the investing public". This is the very proposition rejected by the Supreme Court of Canada and the Ontario Court of Appeal.

9. The IDA Defendants do not owe a private law duty of care to individual members of the investing public for alleged negligence in failing to properly oversee the conduct of IDA members because

   (a) there is no relationship of sufficient proximity between the Plaintiffs and the IDA Defendants to create a *prima facie* duty of care in tort law; and

   (b) even if a *prima facie* duty of care were established, such duty is negated by overriding policy considerations.

***Cooper v. Hobart* (2001), 206 D.L.R. (4th) 193 (S.C.C.), at pp. 209-10**

10. In determining whether a relationship of "sufficient proximity" exists, the Supreme Court of Canada has accepted that the first step of the analysis is to consider whether the relationship in question fits within the existing categories of sufficiently proximate relationships:

> The starting point for this analysis is to determine whether there are analogous categories of cases in which proximity has previously been recognized. If no such cases exist, the question then becomes whether a new duty of care should be recognized in the circumstances. Mere foreseeability is not enough to establish a *prima facie* duty of care. The plaintiff must also show proximity - that the defendant was in a close and direct relationship to him or her such that it is just to impose a duty of care in the circumstances. Factors giving rise to proximity must be grounded in the governing statute when there is one, as in the present case.

***Edwards v. Law Society of Upper Canada* (2001), 206 D.L.R. (4th) 211 (S.C.C.), at p. 218**

11. The existing categories are:

(a) foreseeable physical harm to the plaintiff (including nervous shock) or the plaintiff's property,

(b) negligent misstatement,

(c) misfeasance in public office,

(d) a duty to warn of a risk of physical harm,

(e) the duty of a municipality to prospective real property purchasers to inspect housing developments without negligence,

(f) a duty of care of governmental authorities who undertake road maintenance to do so in a non-negligent manner, and

(g) relational economic loss in certain circumstances.

***Cooper v. Hobart* (2001), 206 D.L.R. (4th) 193 (S.C.C.), at pp. 205-6**

12. The relationship between the IDA and Plaintiffs does not fall into the established categories, nor is it analogous to those categories. Apart from the statutory regime in which the IDA operates, there are no other factors that can establish the required proximity. The IDA is merely "an unincorporated voluntary Association of Canadian Securities Dealers governed by a constitution, bylaws and regulations which deal with the conduct, management and control of the Association's affairs".

***Cooper v. Hobart* (2001), 206 D.L.R. (4th) 193 (S.C.C.), at p. 207-8**

13. Although the IDA is not a statutory body, it does operate within a statutory regime. An examination of that statutory regime confirms that no duty of care arises from that regime.

14. The IDA has been recognized as a self-regulatory body by the Ontario Securities Commission ("O.S.C.") pursuant to section 21.1 of the *Securities Act* (the "Act").

***In the Matter of the Investment Dealers Association of Canada* (1995), 18 O.S.C.B. 5293 (Ont. Sec. Comm.)**

15. Section 21.1(3) of the Act sets out the statutory mandate for self-regulatory organizations such as the IDA:

> A recognized self-regulatory organization shall regulate the operations and the standards of practice and business conduct of its members and their representatives in accordance with its by-laws, rules, regulations, policies, procedures, interpretations and practices.

***Securities Act*, R.S.O. 1990, c. S-5, as amended, s. 21.1(3)**

16. The O.S.C. recognition of the IDA as a self-regulatory organization established the framework for the IDA's role.

> "1. The IDA shall enforce as a matter of contract compliance by its members and their Approved Persons with the rules of the IDA, without prejudice to any discipline by the Commission under Ontario securities law.
>
> 2. The IDA must provide the Commission and CIPF with prompt notice of material or critical cases and reportable conditions, and the IDA shall promptly advise the Commission when any member has failed to file on a timely basis any required financial or operational report. For greater certainty, the Commission shall be notified forthwith of the triggering of all early warning thresholds ..., and in each case the Commission shall be advised of the circumstances and the IDA's response thereto ....
>
> 3. The IDA shall promptly report to the Commission misconduct or apparent misconduct by members and their Approved Persons and others where investors, clients, creditors, members , CIPF or the IDA may reasonably be expected to suffer serious damage as a consequence thereof, including where the solvency of a member is at

risk, serious fraud is present or there exist serious deficiencies in supervision or internal controls....

4(a) The public and the media shall be advised of any disciplinary or settlement hearing by way of press release not less than 10 days prior to the date of any such hearing ...

4(f) IDA disciplinary hearings shall be open to the public and media except where required for the protection of confidential matters....

5(a) The Commission shall be notified on a monthly basis of all new investigations, operational reviews and similar matters ....

5(f) The IDA shall keep a record of all complaints and shall provide to the Commission annually or more frequently upon request a summary of all complaints and the disposition thereof (for greater certainty including anonymous complaints), together with an analysis of any emerging problems or trends."

In the Matter of the Investment Dealers Association of Canada **(1995), 18 O.S.C.B. 5293, at pp. 5294-5 (Ont. Sec. Comm.)**

17. The nature of the relationship between the IDA and the O.S.C. was clearly described by the Ontario Securities Commission itself in the following recitals to the 1994 provisional order which recognized the IDA as a self-regulatory organization:

> "Whereas the IDA is an unincorporated association in which membership is voluntary. ... The IDA represents its members and is organized for the purpose of regulating the operations and the standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest. The IDA regulates the conduct of its members and their trading in securities through rules set forth in its by-laws and regulations ....
>
> Whereas the necessity for interaction between the IDA and the Commission results from:

a. specific provisions of the Act and other legislation which mandate or contemplate such interaction; and

b. the fact that the IDA regulates, by its by-laws and regulations, the conduct of its members and matters related to their trading in securities, areas which ultimately are the responsibility of the Commission."

***In the Matter of the Investment Dealers Association of Canada* (1994), 17 O.S.C.B. 5961, at p. 5961 (Ont. Sec. Comm.)**

18. It is respectfully submitted that given that there is no significant distinction between the Ontario Securites Commission - IDA regulatory scheme and the scheme analyzed in the *Cooper* decision, the following analysis would equally apply to the IDA:

> "The regulatory scheme governing mortgage brokers [securities dealers] provides a general framework to ensure the efficient operation of the mortgage [securities] marketplace, The Registrar [IDA] must balance a myriad of competing interests, ensuring that the public has access to capital through mortgage financing [the public markets] while at the same time instilling public confidence in the system by determining who is "suitable" and whose proposed registration as a broker is "not objectionable". All of the powers or tools conferred by the Act on the Registrar [IDA] are necessary to undertake this delicate balancing. Even though to some degree the provisions of the Act serve to protect the interests of investors, the overall scheme of the Act mandates that the Registrar's [IDA's] duty of care is not owed to investors exclusively but to the public as a whole."

***Cooper v. Hobart* (2001), 206 D.L.R. (4th) 193 (S.C.C.), at p. 209**

19. This statutory regime does not impose a duty of care on the IDA Defendants to investors of IDA members, as the IDA's duty is rather to the public, as a whole. A duty to individual investors would potentially conflict with the overarching duty to the public.

***Cooper v. Hobart* (2001), 206 D.L.R. (4th) 193 (S.C.C.), at p. 210**

20. The Supreme Court of Canada's analysis in the *Edwards* decision is also highly relevant given the similarity of roles of the Law Society and the IDA:

> "The Law Society Act is geared for the protection of clients and thereby the public as a whole, it does not mean that the Law Society owes a private law duty of care to a member of the public who deposits money into a solicitor's trust account. Decisions made by the Law Society require the exercise of legislatively delegated discretion and involve pursuing a myriad of objectives consistent with public rather than private law duties."

***Edwards v. Law Society of Upper Canada* (2001), 206 D.L.R. (4th) 211 (S.C.C.), at p. 219**

21. Even if a *prima facie* duty of care were established, such duty is negated by overriding policy considerations.

> "The decision of whether to suspend a broker involves both policy and quasi-judicial elements. The decision requires the Registrar to balance the public and private interests. The Registrar is not simply carrying out a predetermined government policy, but deciding, as an agent of the executive branch of government, what that policy should be. Moreover, the decision is quasi-judicial. The Registrar must act fairly or judicially in removing a broker's license. These requirements are inconsistent with a duty of care to investors. Such a duty would undermine these obligations, imposed by the Legislature on the Registrar."

***Cooper v. Hobart* (2001), 206 D.L.R. (4th) 193 (S.C.C.), at p. 210**

22. Factors to be considered include

> "the requirement in the governing statutes that the regulatory bodies balance public and private interests, the strong policy-making role of the regulators, the fact that some of their decisions were quasi-judicial in nature, the spectre of indeterminate liability ..."

***Rogers v. Faught* (2002), 212 D.L.R. (4th) 366 (Ont. C.A.) at p. 375**

23. It was never contemplated or intended that regulatory bodies, such as the IDA, be insurers of clients against the negligent practice of their members.

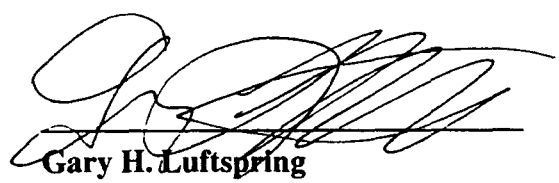
24. In any event, there is absolutely no alleged basis in the Statement of Claim for the addition of the individual IDA Defendants.

PART IV – ORDER REQUESTED

25. The responding parties request that the Plaintiffs' motion to add the IDA Defendants as Defendants in the within action be dismissed with costs to the IDA Defendants.

September 4, 2002

All of which is respectfully submitted,



Gary H. Luftspring

GOODMAN AND CARR LLP
Barristers and Solicitors
Suite 2300
200 King Street West
Toronto ON M5H 2W5

Tel: 416.595.2326
Fax: 416.595.0567

Solicitors for the Proposed Defendants, the Investment Dealers Association of Canada, Terrance K. Salman, G.F. Kym Anthony and Joseph J. Oliver

Schedule A - Authorities

Tab

1. *Vaiman et al v. Yates* (1987), 20 C.P.C. (2d) 33 (H.C.J.)

2. *Cooper v. Hobart* (2001), 206 D.L.R. (4th) 193 (S.C.C.)

3. *Edwards v. Law Society of Upper Canada* (2001), 206 D.L.R. (4th) 211 (S.C.C.)

4. *Rogers v. Faught* (2002), 212 D.L.R. (4th) 366 (Ont. C.A.)

5. *In the Matter of the Investment Dealers Association of Canada* (1995), 18 O.S.C.B. 5293 (Ont. Sec. Comm.)

6. *In the Matter of the Investment Dealers Association of Canada* (1994), 17 O.S.C.B. 5961 (Ont. Sec. Comm.)

Schedule B - Statutory Provisions

1. *Securities Act*, R.S.O. 1990, c. S-5, as amended, s. 21.1(3)

Christopher Morgis, et al.

Plaintiffs

and Thomson Kernaghan & Co. Ltd. et al.

Defendants

Court File No. 01-CV-203394

ONTARIO
SUPERIOR COURT OF JUSTICE
Proceeding commenced at Toronto

FACTUM

GOODMAN AND CARR LLP
Barristers and Solicitors
Suite 2300
200 King Street West
Toronto, ON M5H 3W5

Gary H. Luftspring LSUC#: 19972M
Tel: 416.595.2326
Fax: 416.595.0567

Solicitors for the Proposed Defendants,
the Investment Dealers Association of Canada,
Terrance K. Salman, G.F. Kym Anthony and
Joseph J. Oliver