

Can Investors Sue the IDA?

by Albert S. Frank, LL.B.

Can investors sue the Investment Dealers Association of Canada, the "IDA?" The Court of Appeal for Ontario recently considered this in the case of ***Morgis v. Thomson Kernaghan & Co.***, (2003) 65 O.R. (3d) 321.

Background and Proposed Claims

Thomson Kernaghan & Co. Limited, "TK Co.," is a brokerage firm that carried on business in Toronto.

In March 1999, the appellants (plaintiffs – the Morgis side) opened two margin accounts with TK Co.. Mr. Morgis instructed TK Co. concerning the accounts and was authorized to make and approve trades. The appellants allege, among other things, that TK Co. advocated risky and speculative steps, allowed trades to be made in contravention of TK Co.'s own margin requirements, and that trades were made and money withdrawn without the appellants' authorization. Starting around March of 2000, the appellants suffered substantial losses.

On January 8, 2001, the appellants sued for damages of \$5.75 million for breach of contract, negligence, and other matters. On July 11, 2002, the IDA suspended TK Co.'s membership in the IDA. The next

day, TK Co. was petitioned into bankruptcy.

On July 22, 2002 the appellants brought a motion to court to amend their claim so as to add various parties related to the Defendant TK Co. as defendants. They got the necessary permission.

In the same motion, however, they sought to add the IDA and various related persons as defendants. They alleged that the IDA was negligent and breached a duty of care owed to them by:

- failing to ensure that TK Co. complied with IDA rules, regulations and by-laws,
- failing to ensure that TK Co.'s employees were of good character,
- failing to investigate and discipline in a timely and effective manner, and so on.

The motions judge ruled that, even if the facts alleged were true they did not show a legally sound basis for suing the IDA and the related persons. The motions judge therefore refused to add the IDA and related parties. The plaintiffs appealed.

IDA

The IDA is an unincorporated, voluntary association of Canadian securities dealers. The members make a contractual commitment to abide by the constitution,

regulations, rules and by-laws of the association.

The IDA was not created by any statute of parliament or any legislature, but rather operates under the authority of its own constitution. On the other hand it is recognized under some securities legislation, such as, in Ontario, under section 21.1 of the **Securities Act**, R.S.O. 1990, c. S. 5. This recognition is renewed from time to time and is subject to certain terms and conditions, including the requirement to enforce compliance with IDA rules and to report to the Ontario Securities Commission any misconduct – or apparent misconduct – by IDA members.

In the words of the Court of Appeal at page 333 of the appeal decision, the IDA is supposed to help “provide protection to all investors in Canada from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets.”

Earlier Cases

The proposed claim depended on whether the IDA owed the individual investors a “duty of care.” According to earlier case law, whether there is a duty of care depends on proximity and policy.

Proximity requires that the relationship between the plaintiff and defendant is such that it is reasonable to say that there is such a duty. If it appears that there is a duty, the question is whether there are

policy considerations outside the relationship of the parties that would prevent the court from imposing a duty of care.

In two recent decisions the Supreme Court of Canada applied this law and ruled that statutory bodies could not be sued. The Registrar of Mortgage Brokers in British Columbia could not be sued: **Cooper v. Hobart**, [2001] 3 S.C.R. 537. The Law Society of Upper Canada could not be sued: **Edwards v. Law Society of Upper Canada**, [2001] 3 S.C.R. 562. Statutory regulators owe no private law duty of care to individual members of the public who deal with the individuals or organizations whose conduct is overseen by the regulators.

But what about the IDA, which is not a statutory body or regulator?

Proximity

The Court of Appeal found that the duty alleged was very broad, and in effect would amount to "a duty of care to all investors who lodge complaints, without regard to the merits of the complaints, any subsequent action taken by the regulator, or the nature or the interaction between the regulator and the complainants." For this and other reasons, the Court found that there was not the necessary proximity.

Policy

Moreover, there were policy reasons not to impose a duty of care. For example, the duty alleged would raise the potential for indeterminate liability in an indeterminate amount being imposed on the IDA, which has no way of controlling how many investors engage the services of IDA members or how much they invest or how many of them complain. Imposing the duty would indirectly create "an insurance scheme for dissatisfied investors who have paid the IDA nothing."

Moreover, when deciding to suspend a dealer the IDA is supposed to consider the consequences for both the member and the clients, not just the clients. It is supposed to balance the interests.

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Research has NOT been done to see if this article is still good law. Also, this is general information that might not apply to your particular situation.

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