

# In the Privy Council.

No. 5 of 1936.

## ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO.

BETWEEN

J. A. ALLEN, Trustee-in-Bankruptcy of the Estate of L. S. Clarke, and  
L. S. CLARKE in his capacity as a Trustee

*(Plaintiffs) Appellants,*

AND

F. O'HEARN AND COMPANY

*(Defendants) Respondents.*

## CASE FOR THE RESPONDENTS.

1. This is an appeal from the Judgment of the Court of Appeal for Ontario delivered April 16, 1935, allowing an appeal from the judgment of the Honourable Mr. Justice Kingstone delivered December 1, 1934. The trial judgment declared that the respondents, stock brokers in the City of Toronto, held certain stocks and money in trust for customers of the Appellant Clarke, a broker in the Town of North Bay, and that the customers were entitled to damages for wrongful sales of certain of the said securities and that the determination of which customers were so entitled, the amounts to which each were entitled and the assessment of damages be referred to the Local Master at North Bay.

Record.  
P. 248.  
P. 229.

10 2. The respondents carried on a stock and grain brokerage business in Toronto with seats on the Toronto Stock and Mining Exchange and other Exchanges.

P. 185,  
L. 7 to 21.

3. Up to January, 1931, a firm of stock brokers, Stewart, McNair and Company, had carried on a branch business in North Bay, managed by one L. J. Bayne. When this firm ceased to do business in North Bay, Bayne induced the appellant Clarke, a civil engineer without previous experience in the stock brokerage business, but a man of good reputation, to establish a stock brokerage business in North Bay. Clarke had been a resident in North Bay since 1907, was well known and highly regarded there and since 1913 had carried on and  
20 continued to carry on a successful lumber business known as Clarke and Lounsbury Limited.

P. 27, L. 13.  
P. 71, L. 5.  
P. 71, L. 16.  
to L. 22.  
P. 27,  
L. 2 to L. 15.

Record.  
P. 46, L. 15  
to P. 47, L. 41.

Ex. 19, P. 251  
to P. 253.  
P. 86, L. 34.

P. 72, L. 41.  
P. 87,  
L. 5 to L. 18.  
Ex. 26, P. 250.

4. At the request of Clarke, after receiving from him statements as to the standing and business history of Clarke and his employees and a very favourable financial statement of Clarke himself, the respondents agreed with Clarke to act as his "correspondents" in executing orders on the Exchanges. The respondents also for a consideration arranged to have Clarke's offices connected with their private wire for the purpose of taking orders and supplying market information. The respondents gave some assistance to Clarke in setting up his business by supplying him with standard customers' contract forms, information as to margin requirements, etc., for his guidance.

P. 47, L. 6.  
P. 48, L. 19.  
P. 50,  
L. 20 to L. 29.

P. 50, L. 38.  
P. 150, L. 6.

5. Clarke established his business under the name of L. S. Clarke, broker, and opened offices in North Bay and Sudbury. The capital for the business was supplied entirely by Clarke. He appointed one, Woods, as manager of the Sudbury office, and the said L. J. Bayne as Manager in North Bay. On all transactions to be executed on the Toronto Stock and Mining Exchange Clarke and the respondents were to divide commissions equally. On all other business the respondents charged the full commissions. The respondents were not in any way interested in the losses or profits made by Clarke.

Ex. 8, P. 256.  
P. 50, L. 11.  
P. 190, L. 32.  
to L. 39.

6. On the commencement of business, Clarke entered into an agreement with the respondents to govern their transactions on a printed form which the respondents ordinarily had signed by their customers. It was the basis upon which the respondents executed orders and carried shares for L. S. Clarke throughout their dealings. It gave the respondents the right to pledge and sell securities carried by the respondents for the account of L. S. Clarke.

P. 48,  
L. 19 to L. 35.

7. Bayne, as Manager of the North Bay office, was given full authority to deal with the respondents. He was given a power of attorney to sign cheques. Bayne settled and prepared the contract forms to be used in the transactions with the customers of Clarke, and all details were left in his hands, with no supervision or control by the respondents.

P. 133, L. 44.  
to  
P. 134, L. 43.  
P. 152, L. 30.  
to L. 39.

8. During 1931 and 1932 the account of Clarke with the respondents was fairly active, and until November, 1932, no difficulties arose. Margin calls made by the respondents were met promptly. In September, 1931, when there was a sudden break in the market, margin calls were met with the usual promptness. Even through this time of general depression Clarke led the respondents to believe that his financial position was sound.

P. 150, L. 46.  
P. 47, L. 3  
to L. 27.  
Exs. 20 and 21.  
P. 258 and  
P. 260.

9. The respondents had no knowledge of how Clarke's capital was apportioned between the Sudbury and North Bay offices. Payments were made to the respondents from North Bay to be applied to both branch accounts.

P. 151, L. 3.  
P. 185, L. 36.  
P. 87, L. 15.

10. When orders were given to the respondents, the names of Clarke's customers were never disclosed. The respondents were not told upon what terms Clarke was dealing with his customers.

P. 17, L. 18.  
to P. 18, L. 20.

11. The respondents for convenience carried eight ledger accounts for

- L. S. Clarke: North Bay Canadian Account; North Bay American Account; North Bay Canadian Grain Account; North Bay American Grain Account; Sudbury Canadian Account; Sudbury American Account; Sudbury Canadian Grain Account; Sudbury American Grain Account. His account was treated exactly as the accounts of other customers. Transactions, classified as above, were recorded in their chronological order. Each transaction was confirmed to Clarke by bought and sold notes. Clarke confirmed them to his Customers in similar manner. Record. P. 151. L. 5 to L. 18. P. 150, L. 22. P. 151, L. 48 to P. 152, L. 18. P. 161, L. 30. Ex. 46, P. 263. P. 73, L. 19 to L. 29.
12. In September, 1932, unknown to the respondents, Bayne entered into certain transactions with one, Barkell, a person unknown to the respondents. Barkell spoke highly of low-priced oil shares in a company known as Peninsular Petroleum, referred to in the evidence as "Pen Pete," and he induced Clarke and several others to join a "pool" for the purchase of these shares, with the result that about 150,000 shares were purchased. The respondents had no interest of any kind in this stock, owned no shares of that company, and knew little about the company. Bayne delivered to Barkell certificates for 150,000 shares apparently held for the "pool." Barkell then sold these shares through Toronto brokers, and Bayne, on behalf of Clarke, purchased them through the respondents, and carried them on Clarke's books in two fictitious accounts under the names of Smith and Greenwood. Upon receipt of the certificates for shares purchased he would deliver them again to Barkell, who would repeat the process, as a result of which the market price of the shares rose with the volume of transactions. P. 158, L. 36 to P. 159, L. 15. P. 195, L. 32. P. 97, L. 11. P. 139, L. 17 to L. 28. P. 195, L. 17. P. 89, L. 24 to P. 97, L. 13. P. 346 and P. 350. Ex. 35.
13. Pen Pete shares, selling on the exchange for less than one dollar a share, were shares which, according to By-laws Nos. 38 and 41 of the Standard Stock and Mining Exchange, should not be carried on margin—that is, a broker carrying them for a customer, in calculating the margin requirements of the customer should not place any value on them. P. 354, Ex. 11. P. 132, L. 3. P. 180, L. 10 to L. 14. P. 181, L. 18 to P. 184, L. 38. P. 188, L. 34 to P. 189, L. 11. P. 94, L. 3.
14. Bayne was able to carry out these transactions with the respondents because Clarke's account with them was always well margined. P. 134, L. 44 to P. 136, L. 10. P. 152, L. 46 to P. 153, L. 5. P. 325, to P. 345. Ex. 22. P. 264, Ex. 36. P. 97, L. 13.
15. During September and October, Clarke frequently visited the respondent's offices in Toronto, spoke highly of Pen Pete, was aware of the increasing volume of transactions in these shares, and at no time gave the impression that there was any irregularity in the dealings in it. In September, 447,000 shares were purchased on Clarke's account, and in October 75,350 shares, the prices ranging from 7c to 17½c. During heavy purchases in September the respondents sent a message to Clarke: "Watch your step on Pen Pete."
16. In November, 1932, the purchases of Pen Pete became heavy. On November 4, a cheque from Clarke for \$7500 was not met, and Gardner, a partner of the respondents, telephoned to Bayne, who assured him that it would be met in the morning, and it was honoured the next day. P. 153, L. 23 to L. 34.
17. In this telephone conversation, Bayne asked Gardner to send him some envelopes, bearing a printed form of draft on the exterior, in which brokers P. 266. Ex. 2

Record.  
P. 103, L. 46  
to  
P. 104, L. 24.  
P. 20,  
L. 22 to L. 32.  
P. 153, L. 32  
to  
P. 154, L. 11.  
P. 163,  
L. 4 to L. 23.  
P. 166, L. 25.  
P. 101, L. 31  
to  
P. 103, L. 1.  
P. 111, L. 34  
to  
P. 114, L. 37.  
P. 113, L. 27.

might enclose shares for delivery to a customer's bank, so that the bank might deliver shares to the customer upon the customer's acceptance of the draft. Bayne says that these drafts were for convenience to him and not intended to affect Clarke's responsibility. Gardner says that he concluded these drafts to be for the purpose of covering shares already purchased, for which the cheque for \$7500 had been sent, and states that no mention was made of any later purchase to which they were to be applied. Bayne says that he gave no particulars as to what shares the documents were to be applied, and that Gardner might quite well have reached this understanding of the conversation. Bayne maintains that his intention was to use these drafts to apply to an unusually heavy 10 purchase which he contemplated. Gardner sent several of these forms of draft. On November 8, Bayne wired for more forms. On that day the orders for Pen Pete were for 78,000 and on November 9th 247,000 shares.

P. 166, L. 17.

18. The orders on November 9th had been executed by employees of the respondents in the ordinary routine of business and came to Gardner's attention at noon after 197,000 shares had been purchased. These orders were regarded by the parties as being in the ordinary course of business. Calls for margin had not yet been met, and the margin requirement had reached \$15,000. Gardner attempted unsuccessfully to reach Clarke personally by telephone, but was reassured by Bayne, who promised a cheque that night, and consequently a further order was executed for 50,000 shares. That evening, Marks, a partner of the respondents, spoke to Clarke by telephone and informed him of the number of shares purchased, and Clarke showed no surprise.

P. 155, L. 8.  
P. 117.  
L. 2 to L. 7.

P. 155, L. 28.  
P. 137, L. 8.

P. 155, L. 35.  
P. 274, Ex. 24  
P. 269 to  
P. 280, Ex. 37.

19. On the following days, the respondents were reassured as to payment. On November 14th, Clarke wrote, "I am using every means in my power to raise funds . . . . I will leave it to your discretion as to whether you will sell this stock tomorrow or not." Reassuring messages followed, but no margin was forwarded.

P. 155, L. 40.  
P. 193, L. 32.  
to L. 39.

20. On November 16, the respondents sold 126,000 shares of Pen Pete on Clarke's account, and Clarke then by telephone requested Richardson, a partner 30 of the respondents, not to make further sales and promised to make arrangements for collateral.

P. 156,  
L. 1 to 20.  
Ex. 3, P. 281  
P. 22, L. 45.  
P. 83, L. 15.

P. 106, L. 42  
to  
P. 107, L. 5.

21. On November 19, Clarke and Bayne met Richardson and Gardner to make arrangements for the carrying of the account. They offered to deposit 500,000 shares of Pen Pete as collateral on terms embodied ultimately in a written agreement, dated November 19, 1932. For the purpose of facilitating the bookkeeping required by this agreement, Mr. W. J. P. Jenner, a solicitor who appeared at this interview on behalf of certain third parties who were supplying the collateral, requested that a separate account be kept on the respondent's books for the Pen Pete shares. This account was accordingly opened 40 on the ledger and called "Canadian Account Special." Subsequently, monthly statements were remitted to Clarke showing the standing of this account.

P. 66, L. 27.  
to L. 44.  
P. 157, L. 5.

22. During the following months Clarke made active attempts to improve the condition of the Peninsular Petroleum Company.

23. In January and February there is some correspondence between Clarke and the respondents, and until January 25, 1933, he did nothing to repudiate the transaction, but, by retaining Bayne as manager with full powers, by endeavouring to raise money to pay the balance due, by approving of the agreement of November 19, he indicated that the Pen Pete transactions were on his account in the same way as all other transactions, and Bayne never told the respondents that the Pen Pete transactions were in a different position from the ordinary Clarke business. Record.  
P. 61, L. 33.  
to L. 36.  
P. 64, L. 14.  
Ex. 3  
P. 63, L. 21  
to  
P. 65, L. 26.  
P. 117, L. 2-7.
24. On February 7, the respondents sold shares from Clarke's general account. On February 28th, Clarke made an assignment and the Appellant, Allen, became the Assignee in bankruptcy. Further stocks were sold on February 28th, March 6th, 13th and 15th. Ex. 9, P. 315  
P. 317 and  
P. 321.  
Ex. 10 and 49
25. The Bankruptcy Act, R.S.C. 1927, Chap. 11, S. 23, provides: "The property of the debtor divisible amongst his creditors (in this act referred to as the property of the debtor) shall not comprise the following particulars: (i) Property held by the debtor in trust for any other person . . . ."
26. The action was tried before the Honourable Mr. Justice Kingstone. He was of the opinion that the respondents had no right to sell the securities carried on Clark's margin account to apply on the amounts owing on the Pen Pete shares, because the dealings in Pen Pete shares were not in the ordinary course of business, and because the Pen Pete shares, not being a margin stock within the rules of the exchange, should be purchased only for cash and separately from the general account. He also thought that, in the circumstances of these transactions, the respondents, knowing that Clarke was acting for undisclosed principals, should have been on their guard because of the unusual nature of the transactions. He held that the respondents were trustees for the customers of Clarke, and that the appellants were entitled to damages and an accounting for the benefit of the customers. P. 222, L. 25.  
P. 228, L. 10.  
P. 220, L. 11.  
P. 223, L. 42.  
P. 227, L. 13.  
P. 225, L. 17.  
P. 228, L. 35.
27. The respondents appealed to the Court of Appeal for Ontario (Riddell, Fisher and Macdonnell J.J.A.). Riddell J.A. thought everything indicated the real transaction to be that everything being carried on under the original agreement governing their transactions the purchases were made for Clarke, that Clarke bought these shares from the respondents to supply the requirements of his customers and not that he bought the shares as agent for undisclosed principals. Moreover, if the customers were undisclosed principals, they were bound by the terms of the contract made by their agent, unless quite beyond the agent's authority, which was not the case here. Ex. 8  
P. 234, L. 3.  
P. 234, L. 43.
- Fisher J.A. did not think that the circumstances put the respondents on enquiry as to any irregularities in the Pen Pete transactions, that the respondents were Clarke's brokers and bankers and that Clarke was the broker and banker of his customers. The respondents had a general lien. The subsequent negotiations, including the agreement of November 19, did not alter the position of the parties. The agreement of November 19 did not have the effect of releas- P. 242, L. 10.  
P. 242, L. 39.  
P. 243, L. 13.  
P. 243, L. 26.  
Ex. 3

Record. ing the securities in the general account from the liabilities created by the Pen  
 P. 244, L. 13. Pete transactions, nor was there any agreement to this effect. There is no evi-  
 P. 244, L. 17. dence of any creditor of Clarke that he did not act in accordance with instruc-  
 tions. The learned Justice of Appeal was also of opinion that the appellant  
 Allen had no right to maintain this action by reason of Section 23 of the Bank-  
 ruptcy Act, R.S.C. 1927, Chap. 11, and the appellant Clarke had no right to sue  
 P. 244, L. 21. because he was not a trustee.

Macdonnell J.A. thought that no customer looked beyond Clarke and that  
 the respondents meant to deal and were taken as dealing only with Clarke. Even  
 P. 245, L. 26. if the customers were held to be undisclosed principals they would be bound by 10  
 P. 247, L. 17. any acts of Clarke within the scope of his authority. The respondents were en-  
 titled to act upon the original agreement governing their transactions. The  
 Ex. 8 separation of accounts did not affect the respondents' rights. There was no  
 P. 248, L. 6. evidence of any misconduct on the part of the respondents.

28. The respondents submit that this appeal should be dismissed for the following among other

## REASONS

1. Because the relationship between Clarke and the respondents was that of broker and client.
2. Because the respondents' dealings with Clarke were fully justified by their agreement with him.
3. Because the respondents were entitled to deal with the securities as they did.
4. Because the respondents had no knowledge of any irregularities in the purchase of Peninsular Petroleum shares.
5. Because the respondents owed no duty under contract or otherwise to Clarke's customers that was violated.
6. Because the Trustee in Bankruptcy has no right to maintain an action for the relief sought.
7. Because the judgment of the Court of Appeal for Ontario is right and should be affirmed.

W. N. TILLEY.  
 D. H. PORTER.

# In the Privy Council.

No. 5 of 1936.

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*On Appeal from the Court of Appeal for  
Ontario.*

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BETWEEN

J. A. ALLEN, Trustee-in-Bankruptcy of  
the Estate of L. S. Clarke, and  
L. S. CLARKE in his capacity as a Trustee  
*(Plaintiffs) Appellants,*

AND

F. O'HEARN AND COMPANY  
*(Defendants) Respondents.*

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**RESPONDENTS' CASE.**

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S.W.1.