A. B. ZACKS (DEFENDANT).....APPELLANT;

AND

C. A. GENTLES & COMPANY (PLAINTIFFS).....RESPONDENTS.

1938

* June 8, 9.
* Dec. 5.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

*Brokers—"Short" sale for customer—Non-compliance by customer with brokers' requirements to protect speculative margin account—Purchases by brokers to cover—Claim by brokers against customer for debit balance in the account.*

In the case of a "short" sale of shares of stock by a broker for his customer, if the customer fails to comply with the broker's reasonable requirements to protect his speculative margin account against an adverse balance, the broker is entitled from time to time to do what is reasonable under the existing circumstances to protect the account against loss, having regard to the prevailing prices of the stock. (*Samson* v. *Frazier*, [1937] 2 K.B. 170, and *Morten* v. *Hilton* therein cited and reported in foot-note).

In the present case, the judgments at trial and on appeal for recovery by the brokers of balance of account, on the basis of the loss represented by subsequent purchases by the brokers to cover the short sale and charged to the customer, were sustained.

APPEAL by the defendant from the judgment of the Court of Appeal for Ontario dismissing his appeal from the judgment of Rose C.J.H.C. by which the plaintiffs recovered against him the sum of $2,413.72 (and interest from date of the writ) claimed by the plaintiffs (stock brokers) as being the balance owing by the defendant to them on purchases made by them to cover the defendant's short sale of shares of stock. The material facts of the case are sufficiently stated in the judgment of Davis J. now reported. The appeal to this Court was dismissed with costs.

*L. M. Singer K.C.* for the appellant.

*J. R. Cartwright K.C.* and *G. D. Watson* for the respondents.

THE CHIEF JUSTICE.—I have had the advantage of reading and considering the judgment of my brother Davis and I fully concur in his conclusion as well as his reasons.

* PRESENT:—Duff C.J. and Cannon, Crocket, Davis and Hudson JJ.

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On the hearing of the appeal, I was impressed by the force of Mr. Singer's argument touching the purchases of Bidgood Kirkland Gold stock on the 23rd of January, 1936. I think the tenor of the judgment of Rose, C.J.H.C., shows he had concluded that the subsequent purchases charged against the appellant were in fact purchases made by the broker on the appellant's account; that such, in other words, was the real nature of these transactions.

It would seem that the learned Chief Justice must have been satisfied that the purchases of the 23rd of January were on account of other customers and that the Court of Appeal must have agreed with the conclusions of the Chief Justice on both these points.

CANNON J.—I would dismiss the appeal with costs.

The judgment of Crocket, Davis and Hudson JJ. was delivered by

DAVIS J.—This appeal involves a short selling transaction in an unlisted mining stock. The appellant was the customer; the respondents were his broker. The stock rose rapidly in price when the customer expected it would go down, with the result that when the account was closed it showed a loss to the customer of $2,413.72, for which amount with interest the respondents sued in this action. Judgment was delivered at the conclusion of the trial of the action by Rose, C.J.H.C., in favour of the respondents for the full amount of the claim. That judgment was unanimously affirmed by the Court of Appeal for Ontario. The customer appealed further to this Court.

The respondents carry on business as stock brokers in the city of Toronto and are members of the Toronto Stock Exchange. They also deal in unlisted mining shares. On January 16th, 1936, the appellant instructed the respondents to sell short for his account and risk 4,000 shares in Bidgood Kirkland Gold Mines, Limited. The stock at the time was not listed on any stock exchange and dealings were effected between brokers who were dealing in unlisted securities. It is plain that both parties knew and intended that the transaction was to be a short sale; that the appellant did not own or possess any of the shares of the com-

pany; and that the respondents would lend or obtain the necessary shares to complete the sale.

On the said 16th of January, 1936, the respondents sold, pursuant to the appellant's instructions and for his account, 4,000 shares of the Bidgood stock to another Toronto broker, Stratton, Hopkins & Company, at 34 cents per share. That that was a genuine sale is really not disputed. The price of the Bidgood shares shortly thereafter began to rise and kept up at a substantially higher price at all material times. The range of the prices of the stock is indicated by the evidence:

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|---|---|
| January 30th, 1936 | .52 - .55 |
| February 6th | .70 |
| " 19th | .82 |
| " 24th | 1.00 |
| " 25th | 1.15 - 1.21 |
| March 3rd | .93 |
| " 4th | 1.03 - 1.05 |
| " 9th | .86 |
| April 3rd | .96½ |
| " 8th | 1.00 |
| " 17th | 1.25 |
| " 18th | 1.52 |

and subsequently went as high as $2.10. At the date of the trial, March 16th, 1937, the price was $1.50.

Although repeated demands were made upon the customer for margin, either by cash or collateral, it is plain that the account was never at any time adequately margined within the requirements of the broker. The learned trial judge found as a fact that the appellant's account was insufficiently margined and that the appellant knew that the respondents were not satisfied with its position. The respondents say that under these circumstances, for the protection of their customer as well as of themselves, they bought in Bidgood shares for the appellant's account as follows: on February 25th, 1936, 200 shares at 1.14 and 100 shares at $1.20; on April 18th and 20th, 2,000 shares in eight lots at prices ranging from 1.48 to 1.58; and on April 25th, 1,700 shares in fourteen small lots at prices ranging from 1.42 to 1.45. Confirmations of these purchases were sent to the appellant as the same were made. The appellant never at any time instructed the respondents to purchase shares of the stock to cover his short sale and endeavoured to repudiate the purchases, on the ground that he had neither instructed the purchases nor consented

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to them. The net loss in the appellant's account was $2,413.72. The appellant declined to pay this sum and this action followed.

In a short sale, brokers are entitled to do what is reasonable having regard to the interests of their customer as well as to their own interests and if a customer fails to comply with the reasonable requirements of his broker to protect his speculative margin account against an adverse balance, the broker is entitled from time to time to do what is reasonable under the existing circumstances to protect the account against loss, having regard to the prevailing prices of the stock. *Samson* v. *Frazier* (1), where a decision in the House of Lords in 1908, *Morten* v. *Hilton* (2), in a case involving a short sale of speculative securities, was relied upon and a report of the case appended as a foot-note. Lord Loreburn in the House of Lords in the *Morten* case (2) said that he thought brokers, left without proper instructions, would be entitled to do what was reasonable in their own interests and those of their principal, which were largely identical, and that in a speculative account when their principal would not close the account, or give security, or even attempt to transfer the account to some other broker's care, their action ought not, if in good faith, to be lightly condemned.

But what is said here, and with great force in the able argument of Mr. Singer on behalf of the appellant, is that the respondents on January 23rd, 1936, within a few days of the sale of the 4,000 shares, purchased the same number of shares for the appellant's account at a loss of only $440 and that the respondents' right of indemnity, if any, is fixed and limited by the purchase made that day. Moreover, the appellant charges that when he instructed the respondents to sell short 4,000 shares of the Bidgood stock, Charles A. Gentles, one of the respondents, and S. J. Zacks, the respondents' manager, attracted by what appeared to be an opportunity to make some profit themselves in the stock, sold short on the same day they sold for the appellant 500 and 2,000 shares for their own respective accounts, and that on January 23rd, 1936, when the respondents bought 6,500 shares of the stock they were

(1) [1937] 2 K.B. 170.

(2) [1937] 2 K.B., foot-note at 176, 177, 178.

in reality covering not only the appellant's but their own accounts. It was proved in evidence that the respondents did purchase 6,500 of Bidgood on January 23rd, 1936. If the purchase of 4,000 of those shares was actually made by the respondents for the appellant's account, the respondents were not justified at that time in buying back 4,000 shares to close the appellant's account, but in any case the loss to the appellant would only have been $440. Neither were the brokers entitled, as against the appellant, to go out into the market as purchasers for themselves of Bidgood shares, if such purchases had the effect of raising the price of the stock, adverse to the interest of their principal. But the respondents' evidence was directed to show that there were several customers other than the appellant, some of them individuals and some of them well-known stock exchange brokers in Toronto, who were dealing at the time in this unlisted mining stock through the respondents and that the purchases which were made on January 23rd, 1936, were made for some of these other customers who were in fact buying the stock for an expected upward rise. The whole evidence is rather loose and unsatisfactory but the learned and experienced Chief Justice who heard the case went into the matter with his usual care and I think the result of his judgment is that he treated these purchases on January 23rd, 1936, as having been made in the ordinary course of business by the respondents for other customers and that the subsequent purchases, charged up to the account of the appellant as above set forth, represented real purchases made and intended to be made to close the appellant's account. This is at least a reasonable implication from all the facts that were put in evidence. Unless that was in substance the finding of the learned trial judge, he could not, and of course would not, have given judgment in favour of the respondents for the balance of the account on the basis of the loss represented by the subsequent purchases charged to the appellant. The evidence is by no means as clear and convincing as it might well be in a case such as this, but the Court of Appeal reviewed the evidence and came to the same conclusion as the learned trial judge and unanimously dismissed the appeal. We have not the advantage

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of any written reasons. In my opinion, we would not be justified in taking a different view of the case.

The appeal should be dismissed with costs.

*Appeal dismissed with costs.*

Solicitor for the appellant: *Louis M. Singer.*

Solicitors for the respondents: *Smith, Rae, Greer & Cartwright.*