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Buy, sell or hold: the duty to mitigate

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In two recent cases,[1] the Court of Appeal for Ontario clarified the extent of an investor's duty to mitigate when a stockbroker fails to follow instructions. As the breach relates to the purchase or sale of marketable securities, an investor must act quickly to mitigate any losses. The investor may decide to hold a security, but he does so at his own risk.

After discovering a broker's mistake, an investor must take reasonable steps to avoid or minimize losses (*e.g.*, re-entering the market). He cannot recover compensation for losses that could reasonably have been prevented; but, as a necessary corollary, he may retain inadvertent profits flowing from the broker's error or omission. The principle of mitigation is a "basic principle of fairness… rooted in causation."[2] The broker is only liable for losses *caused* by her breach. She is not liable for losses caused by the investor's failure to take reasonable steps to avoid further losses. However, the duty imposed on the investor to avoid losses is not triggered until such time as the investor learns of the broker's mistake or within a reasonable time thereafter.[3]

What is a reasonable time? In the context of marketable securities, the answer is not long. The mitigation period is relatively short because of the nature of the asset. A marketable security is a liquid asset. In addition, its price may be volatile. Accordingly, upon discovering the broker's error or omission, the investor must act with promptness or be regarded as having elected to maintain the *status quo* (*e.g.*, retain the security). In the latter case, damages will be assessed based on the price of the security at the end of the mitigation period.

The rule is understandable in the case of a falling market. There ought to be a reasonable cut-off date.[4] But it is less intuitive when the market rebounds and the price of the security rises. If the investor still owns the security, he reaps gains that were unanticipated because he originally intended to sell it. The anomaly of an investor both recovering damages and retaining unplanned profits was addressed by an English court nearly a century ago:

> If the seller retains the shares after the breach, the speculation as to the way the market will subsequently go is the speculation of the seller…; the seller cannot recover from the buyer the loss below the market price at the date of the breach if the market falls, nor is he liable to the purchaser for the profit if the market rises.[5]

The Court of Appeal reached the same conclusion in *Goodman v. Scotia Capital Inc.* In that case, the investor held onto the security. The Court upheld a lower court ruling that a reasonable mitigation period was six business days. After the mitigation period, the investor was speculating at his own risk and, therefore, did not have to account for subsequent profits: "Once the cut-off date for purposes of mitigation was determined, the fact that the respondent retained the shares… was irrelevant to the damage calculation."[6]

In *Hunt v. TD Securities Inc.*, the Court of Appeal emphasized that the mitigation "period must be a reasonable one, in light of all of the circumstances."[7] In that case, the Court held that the investors had seventeen days within which to avoid further losses: "To impose a duty to mitigate on the Hunts at a date later than that would be to permit them to speculate at the broker's expense."[8]

In summary, an investor on notice of his broker's error or omission has a duty to mitigate his losses. He has two options: buy or sell the security, as the case may be, and claim damages for any losses incurred thereby; or stand still, in which case his losses will be deemed to have crystallized after the expiry of a reasonable mitigation period.

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[1] *Goodman v. Scotia Capital Inc.*, [2004] O.J. No. 4447 (C.A.) and *Hunt v. TD Securities Inc.* (2003), 66 O.R. (3d) 481, 229 D.L.R. (4th) 609 (C.A.)

[2] *Hodgkinson v. Simms*, 3 S.C.R. 377 (S.C.C.), at p. 452

[3] *Asamera Oil Corp. v. Sea Oil & General Corp.*, [1979] 1 S.C.R. 633 (S.C.C.), at p. 674

[4] *Goodman v. Scotia Capital Inc.*, *supra*, note 1, at para. 9

[5] *Jamaal v. Moola Dawood, Sons & Co.*, [1916] A.C. 175 (P.C.), at p. 179

[6] *Supra*, note 4

[7] *Hunt v. TD Securities Inc.*, *supra*, note 1, at para. 96

[8] *Ibid.*, at para. 105