

Ali v Hartley Poynton Limited

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I. Introduction

In the decision of *Ali v Hartley Poynton Limited*¹ the Supreme Court of Victoria awarded a small investor over \$1 million in compensatory and exemplary damages from a major stockbroking firm for irresponsible trading, reckless promises, and deceptive and manipulative behaviour. In awarding such an extreme amount for what was deemed gross negligence on the part of the firm, the court has created a precedent that will reshape the responsibilities of stockbrokers towards their clients. The case provides an insight into the activities that constitute rogue trading, and the potential ramifications of such conduct.

II. Material facts

Between September 1997 and February 1999, the defendant, Hartley Poynton Limited, through its broker, Christopher Martin, conducted trading on the Australian Stock Exchange in several accounts bearing the name of the plaintiff, Rahmat Ali. These accounts were established by the plaintiff's son, Liyakat Ali, with the intent of building up a retirement fund for the plaintiff. An initial amount of \$101,818.54 was provided to the defendant for use in trading on the share market. A further \$195,000 was provided to purchase Telstra shares.

During the period of the retainer, the defendant traded over \$39 million worth of shares and derivatives, earning brokerage of at least \$134,061.32 and incurring stamp duty of at least \$41,923.65. Trading losses of \$825,899.62 outweighed trading profits of \$523,540.96. By February 1999, the monies provided had been dissipated and the defendant claimed outstanding brokerage fees of \$67,017.10.

The plaintiff brought an action in the Supreme Court of Victoria, arguing that there were two aspects to the retainer that gave rise to claims for damages — the 'trading aspect' and the 'Telstra aspect'. In relation to the trading aspect, the plaintiff claimed damages from the defendant for loss of initial investment and lost opportunity arising from:

- (1) negligent misrepresentation, false and misleading conduct and a want of reasonable care on the part of Martin in giving advice and in conducting the trading; and
- (2) want of reasonable care on the part of other officers of the defendant in their supervision and control of Martin.

In relation to the Telstra aspect, the plaintiff claimed damages for breaches of the agreement. The plaintiff also sought exemplary damages arising out of the conduct of the defendant. The defendant counterclaimed for outstanding brokerage.

III. Decision

Smith J held that the plaintiff was entitled to judgment for compensatory damages amounting to \$846,818.54, and furthermore was entitled to \$260,000.00 in exemplary damages.

In addition, his honour determined that there was contributory negligence on the part of the plaintiff due to his failure to take control or terminate the retainer, resulting in a reduction by 15% of the damages otherwise payable by the defendant. The defendant was also found to be entitled to its counterclaim for unpaid brokerage fees and was entitled to an order setting off that amount against the damages awarded to the plaintiff.

1 [2002] VSC 113.

IV. Reasons for decision of Smith J

Due to the extremely detailed and lengthy submissions by the parties regarding a multitude of issues, Smith J limited his judgment to an identification and adjudication of what his Honour perceived to be the 'critical issues'.²

1. Credibility of key witnesses

Smith J determined that a detailed analysis of the credibility of the key witnesses was necessary in order to resolve several substantive issues, including the correct identity of the defendant's client, and the representations and terms of the agreement.³

His honour found that both Martin, the broker employed by the defendant, and Liyakat Ali, the plaintiff's son, were seriously flawed as witnesses and that their evidence should only be accepted if supported by independent reliable evidence.⁴ In comparison, the plaintiff was concluded to be an impressive witness,⁵ and evidence provided by Dominic Barba, an accountant involved in advising the plaintiff and corresponding for the plaintiff with Martin, was determined to be reliable.⁶

2. The Identity of the Client

Although the defendant originally admitted a retainer with the plaintiff, it subsequently argued that its client was not the plaintiff but was in fact Liyakat Ali or, alternatively, a 'club' of people with which Liyakat Ali was associated in the mind of Martin.⁷

His honour concluded that the client of the defendant was the plaintiff. However, the plaintiff did, at all times, deal with the defendant through his son Liyakat Ali, who acted as his agent. His Honour accepted that Martin was fully informed of this arrangement and was therefore not deceived as to the identity of the client.⁸

3. Representations and Terms of the Agreement

Smith J recognised that an accurate understanding of the representations and terms of the retainer was important to facilitate findings regarding liability on the part of the defendant, and that this analysis was complicated by the lack of common ground between the parties regarding representations and terms.⁹

a. Representations and Terms Relevant to the Trading Aspect of the Retainer

His Honour determined that the retainer agreement was concluded when the trading account was provided with funds. The agreement contained oral, written and implied terms, with oral terms prevailing over written terms where an inconsistency arose.¹⁰

The plaintiff wanted to build up a fund for his retirement and was therefore concerned that any trading should occur with minimum risk. His Honour was satisfied that the defendant, through Martin, made representations regarding returns on the basis of which the parties agreed that the defendant would invest in the share market for the plaintiff and attempt to achieve an agreed target return of 15% to 20% compound on the initial investment over a period of at least six to eight months (later extended to twelve months). The plaintiff had proceeded on the basis of representations made by Martin that the agreed target of 15% to 20% could be achieved within the allocated timeframe. Furthermore,

2 Note 1 at para 28.

3 Note 1 at para 28, 29.

4 Note 1 at para 72.

5 Note 1 at para 78.

6 Note 1 at para 101.

7 Note 1 at para 104.

8 Note 1 at para 120.

9 Note 1 at para 122.

10 Note 1 at para 189.

Smith J found that the plaintiff had proceeded on the basis of representations made by Martin that he had access to privileged information, and that there would be no risk due to this privileged information, the risk minimisation strategies which Martin would employ, and Martin's skill and expertise.¹¹

His honour also accepted that initially there was an agreement in which the defendant, through Martin, was invested with a discretion to determine what to buy or sell, subject to the right of the plaintiff to give instructions.¹² This resulted in a potential conflict over control and responsibility. However, his Honour was satisfied that early in the retainer, by 15 January 1998, it was agreed that Martin would have both responsibility and control during the period of the retainer.¹³ A discretionary account agreement executed by the plaintiff in August 1998 did not alter that arrangement.¹⁴ As long as the retainer was on foot and Martin, for the defendant, was attempting to achieve the agreed targets and was responsible for the outcome, he was the person with the ultimate control to make the trading decision and, therefore, was entitled to reject the plaintiff's instructions.¹⁵

b. Representations and Terms Relevant to the Telstra Aspect of the Retainer

His Honour found that the parties agreed that 100,000 Telstra shares would be held by the plaintiff and used with margin lending to build up the holding to 500,000 shares and then to add blue chip shares. His Honour was satisfied that Martin represented, prior to acquisition of the Telstra shares, that the shares would be held by the defendant as a long-term investment for the plaintiff. It was concluded that Martin had clear instructions not to sell the Telstra shares and was obliged to implement those instructions.¹⁶

4. Liability Arising Out of the Trading Aspect of the Retainer

In order to assess any liability arising out of the conduct of Martin or the defendant directly, Smith J canvassed the well-established principles of the obligations of a stockbroker to a client, emphasising the fiduciary nature of the relationship between the defendant and the plaintiff. His Honour highlighted the high standards of integrity expected from a stockbroker due to the position of trust and responsibility in which they are placed.¹⁷ In addition, the stockbroker owes a common law duty of care to their clients in respect of their professional services.¹⁸

With regard to the matter at hand, his Honour found that there was also an implied term in the retainer that the stockbroker would exercise such reasonable care, skill and diligence as might be expected of a reasonably competent stockbroker. His Honour was also satisfied that the defendant owed a duty of care to the plaintiff in accordance with the Hedley Byrne principle due to the representations made by Martin, and therefore knew or ought to have known that the plaintiff would rely upon the skill of Martin and the exercise of care by him.¹⁹

a. Liability Arising Out of Martin's Conduct

His honour dealt with several allegations arising out of Martin's conduct in relation to the trading aspect of the retainer.

11 Note 1 at para 468.

12 Note 1 at para 190.

13 Note 1 at para 468.

14 Note 1 at para 224.

15 Note 1 at para 225.

16 Note 1 at para 264–265.

17 *Bonds and Securities (Trading) Pty Ltd v Glomex Mines N.L. and Ors* [1971] 1 NSWLR 879 at 891 per Street J, and *Daly v The Sydney Stock Exchange Limited* (1986) 160 CLR 371 at 385 per Brennan J, in note 1 at para 266–267.

18 *Presser v Caldwell Estates Pty Ltd* [1971] 2 NSWLR 471 (CA) at 491 per Mason JA, in note 1 at para 268.

19 *Hedley Byrne and Co. Ltd. v Heller and Partners Ltd* [1964] AC 465, in note 1 at para 270.

In relation to allegations made by the plaintiff of negligent representations prior to the retainer, Smith J concluded that, on the basis of expert and witness opinion, there could be no doubt that Martin had been reckless in making the representations regarding possible returns. His honour also stated that the Martin's representation that there was no risk in relation to the investments was reckless in itself, because all brokers would, or should, know the equation between risk and return. His honour deemed Martin's conduct to be 'extraordinarily negligent', and that the two representations combined had compounded his recklessness.²⁰

These representations concerning returns and risk were also found by his honour to constitute false and misleading conduct under s52 of the *Trade Practices Act* 1974 (Cth) and s11 of the *Fair Trading Act* 1985. There were no reasonable grounds for making them, and the plaintiff relied upon the representations to enter and continue the retainer.²¹

As to advice given during the retainer, his honour determined that Martin had failed to discharge his obligation to exercise reasonable care. This was due to Martin's failure to take reasonable steps to ensure that the client was aware of, or informed of, relevant risks before using credit or embarking on any particular form of trading. His honour emphasised the fact that, in relation to trading in warrants and short selling, Martin had not simply failed to inform the plaintiff of risks, but had recklessly dismissed or ignored the risks involved.²²

Finally, his honour also found that Martin had been involved in negligent trading. A broker in the situation of Martin, and having regard to the plaintiff's profile, would have employed different techniques than those employed by Martin if exercising reasonable care.²³

b. Negligent Supervision

The defendant also owed an obligation directly to the plaintiff to exercise reasonable care to supervise and control Martin, which his Honour concluded had been plainly breached by the defendant.²⁴ Martin's failure to comply with Australian Stock Exchange Rules 3.4.1(1), 3.4.4, 8.14.1 and 8.14.2 and with s851 and s846 of the *Corporations Law* were seen as a result of the absence of any adequate system established by the defendant for supervising and controlling its brokers.²⁵ Instead, the defendant had adopted and encouraged the attitude that individual brokers such as Martin were conducting a business of their own within the business.²⁶ In addition, his honour held that the defendant was put on notice that Martin was someone requiring very close supervision and control due to his reckless conduct and deception.²⁷ This supervision and control was not provided. The only concern held by the defendant in relation to Martin's conduct was the adverse effects of such conduct on the defendant's financial position.²⁸

5. Liability Arising Out of the Telstra Aspect of the Retainer

Smith J was satisfied that Martin breached the retainer by selling the Telstra shares contrary to the instructions of the client. It was held that Martin had been aware that the Telstra shares could only be sold with the permission of the plaintiff.²⁹ No instructions to sell the shares had been given.

20 Note 1 at para 285.

21 Note 1 at para 287–289.

22 Note 1 at para 297–298.

23 Note 1 at para 339–340.

24 Note 1 at para 374.

25 Note 1 at para 373.

26 Note 1 at para 353.

27 Note 1 at para 368.

28 Note 1 at para 370.

29 Note 1 at para 378.

6. Defences

a. Illegality

The defendants argued that it should be inferred that Liyakat Ali and the plaintiff acted dishonestly in completing Telstra share application forms,³⁰ but his Honour found that the credibility of the testimony of the plaintiff was sufficient to defeat this defence.³¹

b. Waiver, Acquiescence, Estoppel and Election

In response to a finding of breach of duties in the conduct of the trading aspect of the retainer, the defendant provided two arguments. Firstly, the defendant contended that all transactions occurred on specific instructions of Liyakat Ali, that the plaintiff had knowledge of all transactions and that no complaints of breach of the retainer were made. The argument was put forward as a complete defence.³² However, his Honour found that the plaintiff did make several complaints that Martin ignored, and the defendant had not shown that it relied upon the lack of complaint in situations in which the plaintiff failed to make a complaint. Therefore the estoppel argument failed.³³ Also, his Honour stated that the alleged acceptance of the refusal to follow instructions was based on a misunderstanding of the contract. Smith J reiterated that the plaintiff was obliged to allow Martin to act without or contrary to instructions, as long as the contract was on foot and the defendant, through Martin, remained responsible for the outcome. If there was a 'waiver' by the plaintiff it was strictly an election to allow Martin to proceed to attempt to achieve the agreed target, rather than an election not to terminate the agreement.³⁴ The defendant's second main argument was that by accepting the non-compliance with instructions and not terminating the retainer, the plaintiff should be denied relief for any breach of contract. His Honour rejected this reasoning, stating that the legal consequence of such an argument would be the affirmation of the contract, rather than the loss of the right to sue for damages.³⁵ His Honour therefore found that no such 'waiver' existed.³⁶

The other aspect of the 'waiver' defences related to the Telstra aspect of the retainer. These defences were predicated on the proposition that the Telstra shares were sold on instruction, which his Honour had already found not to be the case, and also on the proposition that there was no complaint made by the plaintiff before issue of the writ.³⁷ Smith J found that any acceptance of the sale by the plaintiff was conditional upon promises made by Martin to repurchase the Telstra shares and cover any losses.³⁸ Regarding the argument of estoppel, the defendant had not acted in reliance on any representation that might have flowed from the plaintiff's conduct.³⁹ Also, his Honour determined that by accepting the situation, the plaintiff had, at worst, elected not to terminate the contract at that time but rather on terms, or alternatively was not electing either way pending the performance of the agreement to repurchase.⁴⁰

c. False and Misleading Conduct

In relation to the Telstra aspect of the retainer, the defendant argued that the plaintiff had, by his conduct, represented to the defendant that the defendant acted in accordance with

30 Note 1 at para 423.

31 Note 1 at para 431.

32 Note 1 at para 438.

33 Note 1 at para 440–441.

34 Note 1 at para 442–444.

35 *Tramways Advertising v Luna Park* (1938) 38 SR NSW 632 at 641, 643, and *Russell Fraser Henderson v Amadio* [1995] 1029 FCA (23 November 1995), in note 1 at para 445.

36 Note 1 at para 445.

37 Note 1 at para 446.

38 Note 1 at para 450.

39 Note 1 at para 452.

40 Note 1 at para 453.

the plaintiff's instructions, and that the defendant had relied upon that representation. However, his Honour found that Martin, as the defendant's agent, was fully aware of the plaintiff's concerns, and that the plaintiff had only permitted the sale of Telstra shares to stand on receiving assurances from Martin that the stock would be repurchased and the losses covered. His Honour was also satisfied that the defendant had not relied on the plaintiff notifying the defendant of any breaches.⁴¹

d. Contributory Negligence

Smith J determined that the critical question in deciding the issue of contributory negligence was whether the plaintiff was negligent in failing to insist on his instructions being followed by Martin, thereby varying the retainer, or by failing to terminate the discretionary retainer.⁴² His Honour concluded that a client exercising reasonable care for his own financial interest should have considered the question of whether he should insist on his instructions being followed or terminate the retainer.⁴³ It was acknowledged that the choice for the plaintiff was a difficult one. For a long time, the plaintiff still held hope that Martin could ultimately realise profits. Later, as doubts about Martin's trading should have increased, the financial situation worsened, and taking over responsibility would have appeared daunting. His Honour stated that this uncertainty was significantly increased by Martin's manipulation of the situation in withholding vital information relevant to such choices and his persuasive skills in convincing the plaintiff to keep faith in his abilities as a broker.⁴⁴

His Honour concluded the plaintiff did contribute to his loss by his own negligence, but recognised the gross negligence on the part of the defendant's officers, including Martin, and the difficulty of the choice due to this gross negligence, Martin's deception and the persuasive manipulative pressure of Martin. Therefore, the damages otherwise payable to the plaintiff by the defendant were reduced by 15% due to contributory negligence.⁴⁵

Regarding the breach of contract in the selling of the Telstra shares, his Honour held that the issue of contributory negligence did not arise in law.⁴⁶

7. Damages

Smith J concluded that the plaintiff was entitled to compensation in the amount of the funds entrusted to the defendant for initial trading and purchasing Telstra shares. Compensation for the lost commercial opportunities was awarded where it arose out of negligent misrepresentation, false and misleading conduct and want of care in supervision by the defendant which led to the loss of the original trading funds. A separate sum was awarded for the lost opportunities resulting from the negligent trading.⁴⁷

His Honour also awarded damages for lost opportunities resulting from the breach of the agreement by the defendant in the sale of the Telstra shares.⁴⁸

The contributory negligence of the plaintiff reduced the amounts awarded to the plaintiff for damages for negligent misrepresentation and the want of care in trading and supervision on the part of the defendant. However, compensation awarded to the plaintiff in respect of false and misleading conduct did not require reduction.⁴⁹

41 Note 1 at para 454–455.

42 Note 1 at para 464.

43 Note 1 at para 481.

44 Note 1 at para 482–485.

45 Note 1 at para 487.

46 Note 1 at para 490.

47 Note 1 at para 587.

48 Note 1 at para 588.

49 Note 1 at para 589.

8. Counterclaim

His Honour held that the defendant was entitled to its counterclaim for outstanding brokerage and determined that the plaintiff was entitled to set off those damages against the damages awarded to the plaintiff.⁵⁰

9. Exemplary Damages

In determining whether exemplary damages should be awarded, Smith J provided a thorough discussion of both the principles pertaining to exemplary damages and the extreme nature of the defendant's conduct.

The defendant argued that exemplary damages could not be awarded for breach of contract or breach of fiduciary duty. His Honour accepted that this was correct as to breach of contract, but that the law in Australia is unclear as to breach of fiduciary duty. His Honour stated that the debate in the fiduciary context appears to turn on whether the plaintiff's claim for exemplary damages is being sought in the equitable or common law jurisdictions of the court. His Honour admitted that the present case fell into the common law jurisdiction, but went on to state that in considering the claim for exemplary damages:

The nature of the relationship in question and rights and duties attaching to the relationship are critical in assessing both the content of the duty of care and whether there has been a contumelious disregard of the plaintiff's rights.⁵¹

His Honour found that although the relationship between the plaintiff and defendant was defined by an agreement that gave rise to a contractual relationship, the agreement included obligations that made the defendant a 'fiduciary agent'. Therefore, the relationship was a fiduciary one for the purposes of the laws of equity.⁵²

His Honour emphasised that the purpose of awarding exemplary damages is to punish the defendant and deter the defendant, and persons in like positions, from repetition of the conduct in question.⁵³ His Honour also pointed out that there is an element of appeasement in awarding exemplary damages.⁵⁴ However, his Honour acknowledged the need for moderation, and the consideration of whether compensatory damages are sufficient.⁵⁵

As to awarding exemplary damages in a negligence case, his Honour considered that more than mere negligence was required. Instead, his Honour suggested that displaying a reckless disregard for the welfare of the plaintiff was required.⁵⁶ His Honour relied on the majority High Court judgment of *Gray v Motor Accident Commission*,⁵⁷ which confirmed that exemplary damages could be awarded in cases 'framed in negligence, in which the defendant can be seen to have acted consciously in contumelious disregard of the rights of the plaintiff'.⁵⁸

His Honour also determined that the law imposes vicarious liability for exemplary damages upon the defendant for the misconduct of the defendant's employees.⁵⁹

Applying this understanding of the law relating to exemplary damages, Smith J assessed the behaviour of the defendant and its officers, including Martin. His Honour stated that

50 Note 1 at para 590, 592.

51 Note 1 at 601.

52 Note 1 at para 599–601.

53 *Broome v Cassell & Co* [1972] AC at 1130 per Diplock L cited in *XL Petroleum (NSW) Pty Ltd v Caltex Oil (Australia) Pty Ltd* (1985) 155 CLR 448 at 471, and *Lamb v Cotogno* (1987) 164 CLR 1 at 6–10 in note 1 at para 603.

54 *Lamb v Cotogno*, note 53 at 9, in note 1 at para 603.

55 *Backwell v AAA* [1997] 1 V.R. 182, in note 1 at para 604.

56 *Lamb v Cotogno*, note 53, as discussed in *N Micalco Pty Ltd v Rabenalt* [1989] V.R. 461 at 476 per Fullagar J, in note 1 at para 605.

57 (1998) 196 CLR 1.

58 Note 56 at 9 per Gleeson CJ and McHugh, Gummow and Hayne JJ, in note 1 at para 606.

59 Note 1 at para 610.

Martin's conduct at every stage had been reckless.⁶⁰ The evidence showed that Martin deliberately manipulated the plaintiff for his own purpose of making his mark as a trader by showing that he could achieve the represented return, despite the fact that such an attitude was inconsistent with the plaintiff's interests and objectives. His Honour remarked that 'it may fairly be said that prior to and during the retainer he consciously treated the plaintiff's rights and interests with contempt while claiming to have the plaintiff's best interests at heart.'⁶¹ His Honour also found that the defendant had created a situation in which Martin was able to do so, by failing to have an effective system in place to monitor or control the conduct of brokers and encouraging high risk trading. Finally, his Honour was satisfied that the conduct of the other officers of the defendant constituted a conscious contumelious disregard for the rights of the plaintiff and that 'their conduct was the antithesis of that which the plaintiff was entitled to expect.'⁶² They ignored the rights and interests of all clients, and public promises made to all clients, including the plaintiff.⁶³

His Honour determined that the gross compensatory damages already awarded were not sufficient to punish, deter and assuage.⁶⁴ His Honour stated that the plaintiff's own negligence did not excuse the defendant's conduct.⁶⁵ Smith J concluded that it would be appropriate to award exemplary damages on the basis that the defendant should not retain any benefit from its wrongdoing, and that an award of exemplary damages in the amount of the total commission would ensure this. However, his Honour found this amount to be insufficient and ordered a further amount of exemplary damages equal to the brokerage earned, because:

The defendant, through its officers, consistently acted for the duration of the retainer contrary to its obligation to act in the interests of its client and only succeeded in doing so by misrepresentation, deception and manipulation.⁶⁶

V. Conclusion

This case has significant implications for the stockbroking industry and investment advisors in general. The reckless negligent conduct of the defendant and its agent, although extreme, can be found throughout the investment world. As a result, the decision is likely to encourage brokers to adopt a more cautious understanding of their obligations to clients. Although the plaintiff clearly contributed to his own losses by allowing such reckless conduct to continue without varying or terminating the retainer, this did not exonerate the defendant from its responsibilities. The case shows that brokers must place primary importance on looking after the interests and rights of their clients. The defendant's agent consistently deceived and manipulated the plaintiff, encouraging the plaintiff's continued reliance on his skill and expertise in order to pursue personal objectives that were inconsistent with the plaintiff's interests. The defendant had created a situation that facilitated such conduct by failing to have an effective system in place to monitor or control the conduct of its brokers. The case also illustrates that the ability and willingness of small investors to challenge the quality of service being provided by their stockbroker should not be underestimated. As Smith J commented in his concluding remarks, this was 'the hardest fought and most hostile civil case' he had ever experienced as a practitioner and

60 Note 1 at para 614.

61 Note 1 at para 616.

62 Note 1 at para 620.

63 Note 1 at para 618.

64 Note 1 at para 621-622.

65 Note 1 at para 624.

66 Note 1 at para 625.

a judge.⁶⁷ The case acts as a warning to traders that would seek to involve small investors in high-risk, reckless trading without proper regard to the interests and rights of the client.

Postscript:

Currently, the award of exemplary damages in this matter is under contention, as it has recently been revealed that the plaintiff died three months before the decision of Smith J was handed down. An application has been made by the defendant for the money from the judgment to be paid into a court fund and for a permanent block on the exemplary damages being paid to the plaintiff's son, as the sole executor of the plaintiff's estate. The defendant is arguing that exemplary damages cannot be awarded to a dead person.⁶⁸ However, this application does not affect the conclusions reached on any substantive legal issues by Smith J in the case.

⁶⁷ Note 1 at para 627.

⁶⁸ Crawford B, 'Dead Man May Lose Damages' *The Australian*, 4 June, 2002 at 3.