

CANADA / JUDGMENT

Noble v. Hueson Pharmaceutical Corp.

2002 BCSC 1791

COURT

Supreme Court of British Columbia

DECIDED

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Citation: Noble et al. v. Hueson Pharmaceutical Corp. et al.

Date: 20021231
2002 BCSC 1791Docket: 55344
Registry: Kelowna
IN THE SUPREME COURT OF BRITISH COLUMBIABETWEEN: JOHN NOBLE, TRUSTEE FOR AND ON BEHALF OF JOHN JAMES RICKARD NOBLE
SECOND GENERATION FAMILY TRUST, ALLAN FORD GILL AND KOALA HOLDINGS
INC.
PLAINTIFFSAND: HUESON PHARMACEUTICAL CORPORATION, DONALD W. HUGHES,
PETER HUGHES AND BRYAN MOORE
DEFENDANTS

REASONS FOR JUDGMENT

OF THE

HONOURABLE MR. JUSTICE BARROW

Counsel for the Plaintiffs:

David M. Rush

Appearing on its own behalf:

Hueson Pharmaceutical Corp.

Appearing on his own behalf:

Donald W. Hughes

Appearing on his own behalf:

Peter Hughes

Appearing on his own behalf:

Bryan Moore

Date and Place of Trial:

April 3-5, 29, 2002

May 27 & 30, 2002

Kelowna, BC

Introduction:

- [1] The plaintiffs all invested in the defendant company, Hueson Pharmaceutical Corporation ("HPC"). Between November 30, 1996 and April 1, 1998 the plaintiff, Dr. Gill, made four separate purchases of shares in the company. Two of the purchases were made in Canadian funds and totalled \$69,000; two of the purchases were made in U.S. funds and totalled \$81,000.
- [2] The plaintiffs, Koala Holdings Inc. and Noble Family Trust, are entities through which Dr. Noble made investments in HPC. Between February 14, 1997 and October 1, 1998 these plaintiffs made four separate purchases of shares in the company. The first purchase was made in Canadian funds and totalled \$60,000. The other purchases were all made in U.S. funds and totalled \$803,000.
- [3] In this action, the plaintiffs argue that during the course of their dealings with the defendants, the latter made a number of fraudulent or negligent misrepresentations about the state of affairs of HPC and other matters. The plaintiffs argue that they relied on these misrepresentations in making their investment decisions and they seek rescission of all of the share purchase agreements they entered into. They claim rescission on the basis of the torts of fraudulent and negligent misrepresentation, on the basis of breach of contract, and on the basis of an allegation of breach of the Securities Act, R.S.B.C 1996, c. 418.

Suitability for Rule 18A:

- [4] The defendants argue that because of the complexity of the factual circumstances of this case it is not suitable for resolution pursuant to an application under Rule 18A. The factual background is not without some complexity but that is not a basis upon which to refuse to deal with the matter in this context. There are, as will become apparent, conflicts in the affidavit evidence. I am satisfied, however, that notwithstanding those conflicts the necessary facts can be found by reference to other evidence or common sense. Given the foregoing, the conflicts in the affidavit evidence are not a basis upon which to decline to deal with this matter under Rule 18A (Coast Wholesale Appliances Ltd. v. Armitstead, [1993])

B.C.J. No. 162 (C.A.)).

- [5] Moreover I am satisfied that there are no circumstances, including the complexities that the defendants rely on, that would make it unjust to deal with this matter under the rule.

Facts:

- [6] HPC is a company incorporated under the laws of the State of Washington. Its shareholders, as of August 1996, included the defendants Dr. Hughes and Dr. Moore. Dr. Hughes is both a dermatologist and a veterinarian. Dr. Moore is a retired veterinarian.
- [7] On September 10, 1996 Dr. Moore and Dr. Hughes circulated a document on the letterhead of HPC offering for sale shares in that company. This offering was initially made exclusively to "veterinarians and/or their families, relatives or close friends". The curriculum vitae of Dr. Hughes and Dr. Moore formed part of the mailing. The document indicated that, as of April 1996, 5,000,000 shares had been issued by the company at \$1 US each. The share offering was for 100 blocks of 6,000 shares each at \$1 Cdn per share. It was open for acceptance until November 30, 1996.
- [8] The September 10th share offering set out the background of HPC indicating that it had "acquired, through licensing and invention, 42 pharmaceutical products - consumer and professional - Veterinary and Human". It further stated that the company had an asset base in excess of \$10,000,000 US and that it expected to be listed on the NASDAQ exchange within two to four months. It anticipated an opening bid for its shares of \$8 to \$10 US per share. The offering also contained an outline of the proposed corporate structure of HPC. It explained that Dr. Moore and Dr. Hughes were going to be consolidating all of the Hueson Group of Pharmaceutical Companies Canada into one Canadian company to be known as Consolidated Hueson. That company would in turn be acquired by HPC "by way of share exchange". Existing shareholders in the Hueson Group of Pharmaceutical companies would, in exchange for their shares, receive shares in HPC.
- [9] The Hueson Group of Pharmaceutical Companies Canada consisted of ten companies including Steven Jenter Laboratories Ltd., I.D.I., and E.P.X. Skin Care Systems Ltd. All of these companies had been founded by or with the involvement of Dr. Hughes. These companies had developed 42 products of which, at the time of the share offering, 11 were on the Canadian market, 19 were Health Protection Branch approved with Drug Identification Numbers ("DIN"), and 28 had been "qualified for sale" in the United States under the Food and Drug Administration Regulations. Further, the material stated that four products had been approved in Hong Kong and two were currently being exported from Canada presumably to that market. Moreover all of the products were "being approved" in the United Kingdom and the European Economic Community.

- [10] The new company (HPC as restructured) was going to launch an aggressive marketing program "world-wide". As part of that strategy, the company had "formed strategic alliances" with companies which specialized in various things including herbal medicines. An example of this, and one which is of particular importance to the case at hand, is a topical herbal medicine which, the defendants' materials claim "completely eliminates Psoriatic lesions in 1-4 weeks [with] no rebound and normal skin develops at the site".
- [11] Psoriasis is a chronic skin condition for which there is no known cure. It is characterized by itchy lesions on the skin. It is typically treated by topically applied steroid based creams. There are problems with this treatment in that some report that upon discontinuing the use of creams the condition not only recurs but sometimes in an aggravated state. This phenomenon is known as "rebound".
- [12] The plaintiff, Dr. Gill, is a veterinarian. He received the September 10th share offering, unsolicited, and became interested in the investment possibility. He knew Dr. Moore because Dr. Moore had previously been the president of the British Columbia Veterinarian Association. He knew of Dr. Hughes because he had used some of the veterinary products sold by some of the companies noted in the offering.
- [13] After receiving the share offering, Dr. Gill discussed it with his friend Dr. Noble. Dr. Noble is a radiologist and did not receive the September 10th share offering directly. On October 2, 1996 Dr. Gill telephoned Dr. Hughes and spoke to him generally about the company and the offering and asked him to set aside five blocks of shares (that is, 30,000 shares). He telephoned Dr. Moore on October 25, 1996 and also discussed the company generally.
- [14] On November 5, 1996, Dr. Gill received a letter, again on the HPC letterhead, dated October 28, 1996. It was addressed "Dear Colleague" and it indicated that 60 percent of the September 10th share offering had been taken up. It reiterated that the offer was open until November 30, 1996 and that the company was planning to list on the NASDAQ exchange within two to four months and anticipated an opening share price of \$8 to \$10 US per share. The letter was signed by Dr. Hughes. It identified Dr. Hughes as the Chairman of the company and Dr. Moore as the Vice President.
- [15] On November 1, 1996, Dr. Gill again telephoned Dr. Hughes to discuss his possible investment. They spoke about the company and the share offering and specifically about the herbal psoriasis cream. Dr. Gill was told by Dr. Hughes that the cream was an effective and safe treatment for psoriasis and, specifically, that no rebound was associated with its use. Dr. Gill was also told that clinical trials were ongoing in relation to the cream.
- [16] Enthused by the information he had received, Dr. Gill wrote to Dr. Hughes on November 5, 1996 explaining that he would be sending funds for seven units (that is 42,000 shares) within a week and further advising that he and a friend [Dr. Noble] were interested in purchasing a "good part" of the remaining 20 units. He indicated that they might want to do that by way of purchasing options exercisable over the following two or three years.

- [17] On November 21, 1996, before the completion of the purchase of the shares, Dr. Gill received another share offering from HPC. This offering was on HPC letterhead and was signed by Dr. Hughes. It is in precisely the same terms as the September 10, 1996 offering other than acceptance of it was extended until January 15, 1997 and it contained additional information about the herbal psoriasis cream. Specifically, it provided that HPC had formed strategic alliances with companies that specialize in:

Herbal Medicines. E.g.: a topical herbal medicine which completely eliminates Psoriatic lesions in 1-4 weeks-no rebound and normal skin develops at site. The company has acquired the exclusive North American rights to this product with an option for world rights. Approximately 3% of the population has this disease - a 10% market penetration of the US market over 5 years could achieve annual sales of \$80 million.

(emphasis added)

- [18] No details of the other products either owned by or "strategically allied" with HPC were contained in the offering. The offering was for 200,000 shares at \$3 Cdn per share to be sold in blocks of 2,000 for \$6,000 Cdn per block. The offering indicated that as of November 25, 1996 (curiously some four days after the date of the letter) the company had 6,100,000 shares issued at \$3 Cdn each.
- [19] Also on November 21, 1996, Dr. Gill spoke with either Dr. Hughes or Dr. Moore. He was advised that the cream was an effective treatment for psoriasis and that they were selling it very quickly. On November 22, he spoke with Dr. Hughes and discussed the possibility of purchasing options. As to the psoriasis cream, Dr. Hughes told Dr. Gill that the FDA approvals had been obtained. Dr. Gill told Dr. Hughes that Dr. Noble was also interested in investing.
- [20] On November 27, 1996, Dr. Gill wrote to Dr. Hughes accepting an offer on behalf of himself and Dr. Noble, to purchase a two-year option for an additional 120,000 shares. The terms of the option were that the shares could be purchased in the first year at \$1.50 and in the second year at \$2 Cdn. The price of this option is not mentioned. In addition to the foregoing Dr. Gill sent a cheque for \$12,000 Cdn to Dr. Hughes for the purchase of 12,000 shares. Sale of these shares from HPC was completed on November 30, 1996. Dr. Gill also sent cheques totalling \$12,000 on behalf of other investors (not Dr. Noble) to Dr. Hughes with his November 27, 1996 letter.
- [21] Dr. Noble was, as noted above, a personal friend of Dr. Gill. Dr. Noble met Dr. Hughes and Dr. Moore for the first time at a meeting in Kelowna, British Columbia on January 17, 1997. This meeting was arranged so that Dr. Noble could obtain additional information about the company. Dr. Gill also attended. At the meeting, Dr. Hughes extolled the qualities of the herbal psoriasis cream describing it as "almost miraculous" in its effectiveness. He further said that he had conducted clinical trials on the product. Dr. Noble asked Dr. Hughes whether the product (which would eventually become known as "Miralex") contained steroids. Dr. Hughes responded that it did not. He said that it was an all natural herbal

cream.

- [22] On February 10, 1997 Dr. Gill spoke with Dr. Hughes by telephone. Dr. Hughes advised that the psoriasis cream was so effective that it would be able to sustain the company by itself for a significant period of time.
- [23] Following the meeting and the telephone conversation, both Dr. Gill and Dr. Noble received a "newsletter" dated February 10, 1997 on HPC letterhead and signed by Dr. Moore. The newsletter explained that listing of the company on the stock exchange had been delayed due to some technical matters but that it would be "finalized rapidly". The letter further states:

The psoriasis clinical trials that have been carried out by dermatologists have been deemed most satisfactory from their professional viewpoint and have been met with near ecstasy from their patients...

The letter also says:

Some of you have asked about the forty four products that Dr. Hughes has developed during his research years...To put forty four products into perspective, a significant pharmaceutical company would only attempt to market two or three products in any one year. Forty four products for a pharmaceutical company represents a cornucopia of riches sufficient to sustain it for years into the future with all the R&D accomplished and regulatory approval already obtained where necessary.

(emphasis added)

On February 14, 1997 Dr. Noble, on behalf of Koala Holdings Inc., and Dr. Gill, each purchased 60,000 shares for \$60,000 Cdn.

- [24] In June 1997, both Dr. Gill and Dr. Noble received another newsletter from HPC dated June 9, 1997 and signed by Dr. Moore. The newsletter stated that the ongoing clinical trials of the psoriasis cream "have produced extremely favourable results and it would appear as if Hueson could thrive just on this one 'star' product alone".
- [25] The letter closed with Dr. Moore expressing the expectation that listing of the company on the exchange would likely occur by the time of the next newsletter (for which no date was given).
- [26] The next newsletter sent to Dr. Noble and Dr. Gill was dated July 7, 1997. It contained yet another share offering. There are several representations in the letter of significance. Dr. Moore stated:

...Hueson signed a licensing agreement on May 27/97 for the exclusive rights to an exceptional world-class product for the topical treatment of Psoriasis...

He further advised that:

As you know Hueson has been responsible for the clinical trials and FDA/HPB government approvals of this product. These trials commenced in September '95 and were completed 1.5 years later.

(emphasis added)

The letter contained a share offering available exclusively to the existing shareholders of the company, their families and friends until August 20, 1997. The offering consisted of a further 300,000 shares available in blocks of 3,000 shares at a price of \$2 US per share. The letter promised that any further private share offerings would be at \$6 US or higher.

[27] In July, both Dr. Noble and Dr. Gill learned that because the cream was herbal in nature it did not require a drug identification number (DIN) from the Health Protection Branch. Based on the July 7, 1997 newsletter however they both understood that the necessary exemption had been approved by the regulatory authorities.

[28] In August, Dr. Noble and Dr. Gill met with Dr. Hughes in Kelowna to discuss the possibility of future investment in the company. Dr. Hughes repeated that Miralex was safe and extremely effective and that the clinical trials were proceeding exceedingly well.

[29] On September 12, 1997, Dr. Hughes wrote to Dr. Noble regarding the possibility of Dr. Noble purchasing options for the purchase of further shares. Dr. Hughes offered to allow Dr. Noble to purchase 150,000 of Dr. Hughes' shares (or shares owned by a company he controlled) at \$1 US per share for 75,000 shares valid for 6 months and \$2 US per share for 75,000 shares valid for one year. In addition, the letter invited Dr. Noble to join the Board of Directors of the company in light of his significant investment. Finally Dr. Hughes asserted "[a]s previously stated we agree not to make any major changes in the business mandate of the company without your consideration and input". Dr. Noble sought this assurance about the mandate of the company because he wanted to ensure that it continued to operate as he had been advised. No similar offer was made to Dr. Gill.

[30] On September 25, 1997, Dr. Gill purchased a further 36,000 shares at \$2 US per share for a total of \$72,000 US. On the same day Dr. Noble, on behalf of Koala Holdings Inc., purchased 114,000 shares also at \$2 US per share for a total purchase price of \$228,000 US. Both Dr. Noble and Dr. Gill also purchased options from HPC on September 26, 1997. In the case of Dr. Gill, he acquired an option to purchase 18,000 shares at \$1 US per share, open to be exercised until March 26, 1998 and an option to purchase a further 18,000 shares at \$2 US, open to be exercised until September 26, 1998. In the case of Dr. Noble the option was in similar terms except it was for the purchase of 114,000 shares, half at \$1 US and half at \$2 US. It is not clear if either Dr. Gill or Dr. Noble paid anything for these options.

- [31] In early 1998 various marketing materials were made available by HPC. A brochure described Miralex as a safe, all natural, form of relief for psoriasis. The brochure cautioned patients who were already using a steroid based product not to suddenly discontinue use of that product because of the possibility of "steroid - rebound - phenomenon". A newspaper ad described Miralex as a "unique natural substance, free of potentially damaging steroids like cortisone". Miralex was being marketed primarily by way of direct sales.
- [32] HPC prepared a Business Plan dated January 20, 1998, which it sent to both Dr. Gill and Dr. Noble. The plan covered the five-year period ending February 2003. In it, the company advised that it owned the "exclusive licence to manufacture and market 44 original products" designed to treat 80 percent of the skin diseases of animals and man. It repeatedly described Miralex as the "flagship" product of the company. It reconfirmed the corporate structure outlined in the September 1996 share offering, that is, that HPC would own the various Hueson Group Canada companies as well as a further company, Miralex Inc., which was incorporated to market Miralex. It also stated that HPC owned "the exclusive rights to forty-four (44) dermatological products..." Further, it indicated that HPC had the "world rights" to three Miralex products (the cream, a shampoo and a scalp lotion). The plan stated that HPC had completed "clinical and market testing" of the three Miralex products. The plan identified Dr. Hughes as the Director, CEO and President of the company; Peter Hughes, Dr. Hughes' son, as the Vice President of Marketing and Sales and a director, and Dr. Moore as the Vice President of Shareholder and Customer Relations. The plan also contained some general financial information which was said to be contingent upon raising further capital by way of yet another share offering
- [33] On January 20, 1998 a newsletter on the corporate letterhead and over the signature of Dr. Moore, was issued. In it Dr. Moore emphasized the excellent prospects of the company particularly in light of Miralex (testimonials from patients were included with the letter). He stated that the company shares could be realistically valued at between \$12 and \$16 US. He announced that a further share offering would be forthcoming in which 100,000 shares would be offered at \$12 US per share. He encouraged the existing shareholders to take up this offer in order that the company might remain in the hands of as few people as possible.
- [34] On January 30, 1998, Dr. Hughes, Dr. Moore, and Peter Hughes came to Kelowna and met at the Capri Hotel with Dr. Noble, Dr. Gill and other potential investors. Peter Hughes made a presentation about the company and many of the earlier claims regarding Miralex were repeated. Samples of the cream were distributed to potential investors.
- [35] In January or early February of 1998, both Dr. Gill and Dr. Noble were invited by Dr. Hughes to sit on a newly formed management committee of HPC. This committee met four to five times over the next 18 months until it was dissolved by Dr. Hughes in October 1999. According to Dr. Noble and Dr. Gill, they received no financial information about the company despite repeated requests. They were, however, told that substantive information about Miralex, including the results of the clinical trials, were secret corporate information to which they were not privy.

- [36] On February 6, 1998, Dr. Gill met with Dr. Hughes and Peter Hughes in Vancouver. He specifically asked who the supplier of Miralex was and whether the product was secure. Dr. Hughes advised him that he knew more about the product than he could say and that the supplier was secure. Dr. Gill was advised that the product was coming from Israel and that the composition of it was difficult to determine. This was, in the context of the conversation, considered a good thing in that the parties were concerned, not so much with what was in the product but rather with whether others would be able to duplicate it.
- [37] On February 13, 1998, Dr. Gill and Dr. Noble received a newsletter, a further share offering, and a "Business Overview". The share offering was in the terms that had been outlined in the newsletter of January 20, 1998. In the offering, investors were encouraged to contact Dr. Moore if they had questions. The newsletter, over the hand of Dr. Hughes, announced the formation of the management committee consisting of Dr. Moore, Dr. Noble, Dr. Gill, Dr. Hughes, Dr. Moore, and Peter Hughes.
- [38] The "business overview" was entitled "Miralex - Nature's Psoriasis Solution - Business Overview". While the document deals with HPC generally, the dominant focus of it is Miralex and the "potential for explosive growth in share value" that this "natural, botanical product" represented. It advised that the value of Hueson's shares was based on the company's product and cash flow projections. It stated "the replacement value for Miralex cream is estimated at \$200 million. Therefore, with 7.5 million shares outstanding, Hueson's current minimum share value is estimated to be \$26.66 (US)."
- [39] In April 1998, both Dr. Gill and Dr. Noble exercised a portion of the options that they had acquired on September 26, 1997. Dr. Noble purchased 75,000 shares at \$1 US per share and Dr. Gill purchased 9,000 shares also at \$1 US per share. This was the last time Dr. Gill purchased shares.
- [40] Dr. Noble had discussions regarding a possible further investment in HPC during the spring of 1998. A meeting was held on July 30, 1998, in Richmond, British Columbia between Peter Hughes, Dr. Hughes and Dr. Noble to discuss the possibility of a further equity investment in the company. Dr. Noble wanted to obtain information at this meeting including, specifically, information regarding the clinical trials to which Miralex had been subjected. At the meeting, he was told by Dr. Hughes that clinical trials had been completed on "50 or more patients", that he had undertaken lab work on each patient and that the results of the clinical trials were being held in the United States. Dr. Noble was further told that HPC had the "world rights" to Miralex and had agreements with the suppliers of the raw materials of the cream. Finally, he was told that the formula for Miralex was very complicated and had proven "virtually impossible" to detect by the three chemists Dr. Hughes had retained for that purpose.
- [41] Following the meeting, Dr. Noble wrote to Dr. Hughes and confirmed what he had been told. In the letter, Dr. Noble said that "shareholders have invested largely on the basis of Miralex, not in [sic] historical products". Further he wrote "whether we like it or not this company is

still in its embryonic stages and this remains a very high risk investment". Dr. Noble wanted the personal commitment of Dr. Hughes and Peter Hughes prior to making a further investment in the company. To that end, he wanted them to sign and return his letter of August 3, 1998. His letter closed with the following: "My investment will be for product development, marketing, insurance, and development of the above divisions." The "above divisions" is a somewhat cryptic reference to a proposed veterinarian division and presumably a Miralex division. Accompanying his letter, Dr. Noble set out the financial terms of a potential further investment in the share capital of the company.

- [42] On August 13, 1998, Dr. Noble received a further share offering. It made available 84,000 shares at \$12 US per share in four blocks of 21,000 shares each to the four members of the management committee.
- [43] On August 14, 1998, Dr. Hughes replied to Dr. Noble's letter of August 3, 1998 on his own behalf and on behalf of Peter Hughes. In the letter, Dr. Hughes acknowledged that Dr. Noble had been hesitant about further investments. He stated that two of the four blocks of shares mentioned in the August 13, 1998 offering had been spoken for (the only other people eligible to purchase these shares were Dr. Hughes, Dr. Moore, and Peter Hughes). He further said that if Dr. Noble agreed to take the remaining two blocks then HPC would "immediately become more aggressive in marketing Miralex". In response to Dr. Noble's request to have Dr. Hughes and Peter Hughes sign a copy of his notes, Dr. Hughes wrote "Peter and I have no problem making a 'signed statement of fact' which would comfort all your concerns as to the financial position of the company, product world rights (veterinary and human), clinical trials, sales, call center, supply of product, analysis status,...".
- [44] On August 26, 1998, Dr. Hughes, Peter Hughes, Dr. Gill and Dr. Noble met in Kelowna. Dr. Hughes and Peter Hughes provided, in furtherance of their letter of August 14, 1998, a document entitled "Confidential Statement of Facts". This document is of significance. It described the nature of the clinical trials that had been undertaken to that point, about which more will be said later. The document also stated that Miralex had two active ingredients between which there is "some synergism" but both of which were difficult to analyze. Further, it stated that a "financial statement is pending" (it is worthy of note that up to this point no financial statements of the company had been provided to the plaintiffs).
- [45] There were two further significant statements in the document:

Hueson USA also owns the world rights to 42 other dermatological products...

And:

If you should complete the financing as discussed the capital will be used for product development, marketing, liability insurance, key-man insurance, and advertising and development of new business and new divisions or subsidiaries.

The document is signed by Peter Hughes and Dr. Hughes in their personal capacities.

- [46] On September 3, 1998, Dr. Hughes wrote to Dr. Noble and offered a share purchase arrangement that in many respects paralleled the arrangement that Dr. Noble had proposed in his letter of August 3rd. The offer was for 84,000 shares. As part of the offer, Dr. Noble was offered a seat on the board of directors of HPC. It contained a number of further conditions regarding the development of the veterinary division of the company.
- [47] On September 3, 1998, Dr. Hughes told Dr. Noble that he had sent a letter to the Psoriasis Foundation and to Dr. Solly Domingo, a doctor in South Africa, who wanted to license Miralex for South Africa. He provided Dr. Noble with a copy of that letter. In it, he stated that when he first heard of the product he reviewed the medical literature on psoriasis and then clinically tested the product in the manner he earlier described in the "Confidential Statement of Facts". The results of these trials were the best Dr. Hughes had seen in 30 years. Again he reiterated that there were no "systemic or topical side effects". He described Miralex as a "miracle cream" that was "harmless, non-toxic, non-staining, non-allergenic, non-photosensitizing and without rebound as seen in fluorinated corticosteroid treatment".
- [48] Before purchasing more shares, Dr. Noble required that Dr. Hughes and Dr. Moore make matching investments. In response to that condition, Dr. Hughes wrote to Dr. Noble on September 17, 1998 stating "Bryan and I have committed."
- [49] On the strength of all of the foregoing Dr. Noble, on behalf of Koala Holdings Inc., and the Noble Family Trust, purchased a further 84,000 shares for \$500,000 US during October 1998. This was the last share purchase by Dr. Noble.
- [50] In April 1999, a further newsletter was issued by HPC over the signature of Dr. Hughes. Among other things, the letter advised that the company was not able to obtain liability insurance because they were "not willing" to disclose the formula for Miralex. It further stated that "after many attempts through 6 qualified labs, chromatography and mass spectrometry, no one has been able to identify the active ingredients" in Miralex.
- [51] On July 29, 1999, the Health Protection Branch wrote to Dr. Hughes after receiving inquiries about the safety and efficacy of Miralex. Dr. Hughes was advised that under the Food and Drugs Act, R.S. 1985, c. F-27, a "drug" included any product that is promoted for the treatment of a disease or disorder or its symptoms. Since the promotional material for Miralex fell within that description, the Health Protection Branch considered it a drug and as such a number of labelling requirements had to be met including listing the medicinal ingredients of the product. The Health Protection Branch also advised that certain traditional herbal remedies enjoyed some exemption from the requirements of the Food and Drugs Act. In order to clarify the nature of the product, the Branch asked for a quantitative list of the active ingredients in the product and for a sample of it. In due course a sample was forwarded.

- [52] On September 23, 1999, the Health Protection Branch wrote to Dr. Hughes advising him of the results of their analysis of Miralex. They found that it contained Clobetasol 17-Propionate in concentrations of 0.1 percent. The presence of this form of steroid rendered the product incapable of being lawfully marketed as contemplated by HPC. The active ingredient was required to be sold by way of prescription.
- [53] On October 4, 1999, the final meeting of the management committee of HPC took place in Vancouver. In attendance were Dr. Hughes, Dr. Moore, Peter Hughes and Dr. Noble. At this meeting Dr. Hughes advised that the management committee would be disbanded and replaced by a Board of Advisors which would consist of, at least, Dr. Noble, Dr. Gill, Peter Hughes, Dr. Moore, and Dr. Hughes. This was confirmed in a letter from Dr. Hughes dated October 18, 1999. In that letter Dr. Hughes discussed ways of compensating Dr. Gill for his time and trouble in conducting tests on animals in his veterinary practise. Dr. Hughes suggested that instead of money he be offered shares in the company. Neither at the meeting nor in the correspondence was any mention made of the findings of the Health Protection Branch.
- [54] On November 14, 1999, Dr. Hughes wrote to Dr. Noble advising him of the fact that the Health Protection Branch had detected the presence of a steroid in Miralex and as a result the product had been withdrawn from the market and the product that was already in circulation was being recalled. Upon Dr. Gill learning of this development he sent four samples of Miralex to the Enviro-Health Research Laboratories Inc. in Richmond, British Columbia for analysis. On December 3, 1999, the lab replied advising that all four samples tested positive for Clobetasol in varying concentrations.
- [55] The plaintiffs contend that they have lost their entire investment as a result of the failure of the Miralex product.

Analysis:

- [56] The tort of negligent misrepresentation has five elements. In *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87 Sopinka and Iacobucci JJ. said at para. 33, on behalf of the majority, that:

...The decisions of this Court cited above suggest five general requirements: (1) there must be a duty of care based on a "special relationship" between the representor and the representee; (2) the representation in question must be untrue, inaccurate, or misleading; (3) the representor must have acted negligently in making said misrepresentation; (4) the representee must have relied, in a reasonable manner, on said negligent misrepresentation; and (5) the reliance must have been detrimental to the representee in the sense that damages resulted.

- [57] The issue of whether a "special relationship" existed between the representor and the representee was not before the court in *Queen v. Cognos Inc.*, supra. It was, however, recently considered by the Supreme Court of Canada in *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165. La Forest J. at para. 20, affirmed the test for determining whether a "special relationship" exists as being that which was initially articulated by Wilson

J. in *City of Kamloops v. Nielsen*, [1984] 2 S.C.R. 2. It was there held at pp. 10-11 that the issue is to be resolved by answering the following questions:

- (1) is there a sufficiently close relationship between the parties (the [defendant] and the person who has suffered the damage) so that, in the reasonable contemplation of the [defendant], carelessness on its part might cause damage to that person? If so,
 - (2) are there any considerations which ought to negative or limit (a) the scope of the duty and (b) the class of persons to whom it is owed or (c) the damages to which a breach of it may give rise?
- [58] La Forest J. held at para. 24 that a sufficiently close relationship will be found to exist when "(a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation; and (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable." Although there is some debate about whether these limitations on the reach of negligent misrepresentation ought to be viewed within the first or the second part of the test in *City of Kamloops v. Nielsen*, *supra*, in the case at bar that issue is of no consequence.
- [59] I find that both aspects of the test are clearly met on the circumstances of this case. Although initially the share subscriptions were mailed to all veterinary doctors in the province, prior to any investment being made by the plaintiffs, the defendants Dr. Hughes and Dr. Moore both knew of the plaintiffs' existence and knew that they were specifically considering investing in HPC. The plaintiff, Dr. Gill, had spoken directly to both Dr. Moore and Dr. Hughes about the prospect of investing. Further he had written to Dr. Hughes. The plaintiff, Dr. Noble, before investing in the company, met with Dr. Moore and Dr. Hughes in January 1997 and specifically discussed the prospect of investing. It would have been within the reasonable contemplation of the defendants Dr. Moore and Dr. Hughes, that carelessness on their part might cause damage to the plaintiffs. Further it was reasonable on the part of the plaintiffs to rely on the information they received from the defendants in making their investment decisions.
- [60] There are no circumstances arising from the facts of this case which would serve to limit the scope of the duty in a manner which would place the plaintiffs outside its reach, nor are there any considerations which ought to limit the damages that might otherwise result from any negligent misrepresentation by the defendants. I find therefore that a "special relationship" existed between the defendants, Dr. Hughes and Dr. Moore, and the plaintiffs sufficient to give rise to a duty of care on the part of the defendants towards the plaintiffs.
- [61] Peter Hughes is in a somewhat different position. On the evidence, the first time his name was ever mentioned in relation to the company was in the business plan that was circulated on January 20, 1998. That document identified him as a founding member of the company, a Director, the secretary and the Vice President of Marketing and Sales. His first direct involvement with the plaintiffs was at the meeting in Kelowna on January 30, 1998. He thereafter met with Dr. Gill in Vancouver on February 6, 1998. He was on the management

committee with the plaintiffs from its inception in January 1998. I am satisfied that the plaintiffs have established that his role was such that a "special relationship" as that phrase is used in this context, existed with Peter Hughes from early February 1998.

- [62] The nature of the standard of care that arises from that relationship must be determined in light of a variety of circumstances. In *Queen v. Cognos Inc.*, supra, Sopinka and Iacobucci JJ. held at para. 55 as follows:

The applicable standard of care should be the one used in every negligence case, namely the universally accepted, albeit hypothetical, "reasonable person". The standard of care required by a person making representations is an objective one. It is a duty to exercise such reasonable care as the circumstances require to ensure that representations made are accurate and not misleading [citations omitted]. Professor Klar provides some useful insight on this issue (at p. 160):

An advisor does not guarantee the accuracy of the statement made, but is only required to exercise reasonable care with respect to it. As with the issue of standard of care in negligence in general, this is a question of fact which must be determined according to the circumstances [page122] of the case. Taking into account the nature of the occasion, the purpose for which the statement was made, the foreseeable use of the statement, the probable damage which will result from an inaccurate statement, the status of the advisor and the level of competence generally observed by others similarly placed, the trier of fact will determine whether the advisor was negligent.

- [63] Aside from any question of negligence, the plaintiffs allege in this case that the representations made by Dr. Hughes and the other defendants were fraudulent. In *Armstrong v. London Life Insurance Co.*, [1999] O.J. No. 3507 (Ont.S.C.) Flinn J. cited with approval at para. 34 the following excerpt from Perell & Engell, *Remedies and the Sale of Land*, 2d ed. (Toronto: Butterworths, 1998), at pp. 92-93:

A person makes a fraudulent misrepresentation when he or she makes a false statement without belief in its truth and with the intent to deceive. Fraud involves intentional dishonesty, the intent being to deceive. Thus, to succeed in an action for deceit or for fraudulent misrepresentation, the plaintiff must show not only that the defendant spoke falsely and contrary to belief, but that the defendant had the intent to deceive, which is to say he or she had the aim of inducing the plaintiff to act mistakenly. There is an element of proximity associated with the intent to deceive; the plaintiff must show that the defendant's design was directed at the plaintiff or at a class of persons that includes the plaintiff.

- [64] The elements of the tort of deceit are four in number: first, there must be a false representation of fact; second, the representation must be made with knowledge of its falsity; third, it must be made with the intention that it should be acted on by the plaintiff; and fourth, it must be established that the plaintiff acted upon the statement and in doing so sustained damage (*Diamond v. Bank of London & Montreal Ltd.*, [1979] Q.B. 333 at p. 349).

[65] As to the burden of proof required to establish an allegation of fraud, I am mindful of the remarks of Laskin C.J.C. in *Continental Insurance Co. v. Dalton Cartage Co. Ltd. et al.* (1982), 131 D.L.R. (3d) 559 at p. 563 where he held as follows:

There is necessarily a matter of judgment involved in weighing evidence that goes to the burden of proof, and a trial Judge is justified in scrutinizing evidence with greater care if there are serious allegations to be established by the proof that is offered. I put the matter in the words used by Lord Denning in *Bater v. Bater*, [[1950] 2 All E.R. 458] [at p. 459]:

It is true that by our law there is a higher standard of proof in criminal cases than in civil cases, but this is subject to the qualification that there is no absolute standard in either case. In criminal cases the charge must be proved beyond reasonable doubt, but there may be degrees of proof within that standard. Many great judges have said that, in proportion as the crime is enormous, so ought the proof to be clear. So also in civil cases. The case may be proved by a preponderance of probability, but there may be degrees of probability, within that standard. The degree depends on the subject-matter. A civil court, when considering a charge of fraud, will naturally require a higher degree of probability than that which it would require if considering whether negligence were established. It does not adopt so high a degree as a criminal court, even when it is considering a charge of a criminal nature, but still it does require a degree of probability which is commensurate with the occasion.

[66] The plaintiffs claim against HPC and Dr. Hughes, Dr. Moore and Peter Hughes personally. It is settled law that directors and officers of companies may be personally liable for their negligent or fraudulent misrepresentations (*NBD Bank, Canada v. Dofasco Inc. et al.* (1999), 181 D.L.R. (4th) 37 (Ont.C.A.); *Knight's Mineral Exploration & Co. v. Corcoran & Co.*, [1995] B.C.J. No. 278 (S.C.); *Olorenshaw v. International Chem-Pro Industries Inc.*, [1989] B.C.J. No. 1227 (S.C.)).

[67] I will deal with the material representations individually and determine whether any of them amount to misrepresentations and, if so, whether they were negligently or fraudulently made.

Representations, Misrepresentations, Negligence and Fraud:

[68] There are five representations that the plaintiffs allege are misrepresentations, specifically they are as follows: representations about the qualifications and experience of Dr. Hughes; representations about the "clinical trials" that were undertaken; representations about whether Miralex had been approved by the Health Protection Branch and the Drug Enforcement Agency; representations about the steroid-free nature of the product; and finally representations about the matching investments that Dr. Hughes and Dr. Moore were to have made.

1. The experience and expertise of Dr. Hughes

- [69] The plaintiffs claim that they relied on the experience and expertise of Dr. Hughes in developing various pharmaceuticals in making their investment decisions. The representations of this nature are contained in the various newsletters and the curriculum vitae of Dr. Hughes. The representations are to the effect that the Hueson Group of Companies had "developed 42 products Human and Veterinary". Of those products, 11 were being sold in Canada; 19 were Health Protection Branch approved and 28 had been approved under the Food and Drug Administration in the United States.
- [70] The plaintiffs argue that in fact Dr. Hughes' research and development experience consisted almost exclusively of simply reconstituting existing products and presumably marketing those.
- [71] I am not satisfied that the plaintiffs have established that the representations in the newsletters or Dr. Hughes' curriculum vitae about his qualifications are false or misleading. All Dr. Hughes said was that his companies had "developed" 42 dermatological products and most of them were classified as "new drugs", presumably by the Health Protection Branch. There is no evidence that he did not do just that. Whether that was done by mixing existing products or developing new products was not specified in the material.
- [72] Dr. Noble had no prior association with Dr. Hughes and thus to the extent he relied at all on his reputation and the representations he made about his past achievements, they are to be found in the material itself.
- [73] Dr. Gill had purchased products that Dr. Hughes' companies sold and from that considered that Dr. Hughes had extensive experience in the development of products. There is no evidence that those products did not work satisfactorily nor is there any evidence that they were not "developed" by Dr. Hughes.
- [74] I am not satisfied that anything said by any of the defendants about Dr. Hughes' qualifications or experience amounted to a misrepresentation.

2. Clinical Trials

- [75] The plaintiffs argue that the defendants, and in particular Dr. Hughes, claimed to have conducted "clinical trials" when in fact the testing they had done did not approach a "clinical trial" as that phrase is understood in the context of pharmaceutical research. One of the difficulties with this aspect of the plaintiffs' claim is the general lack of precision as to what the parties meant by the phrase "clinical trials". The plaintiffs contend that they understood it was being used in the sense that it is used by the regulatory authorities, namely, implying very sophisticated testing under highly controlled circumstances. The defendants argue that they were using it in a much more general way and if understood in that light, their statements were not misleading or inaccurate.
- [76] Before turning to the issue directly, there are two matters surrounding the claims made by Dr. Hughes regarding the clinical testing that bear on his credibility generally. First, the evidence is clear that with very few exceptions, no tests were conducted on the trial

participants to determine the systemic effects, if any, of use of the cream. Notwithstanding this, Dr. Hughes and Peter Hughes stated in the "Confidential Statement of Facts" that "there were no adverse effects topically or systemically". The same claim was repeated by Dr. Hughes in the letter of September 3, 1998 to Dr. Domingo, which he provided to Dr. Noble. It is difficult to understand how this claim could be made absent the necessary testing to support it.

- [77] Second, Dr. Hughes maintained at one point during his examination for discovery that he was of the view that the tests he was conducting were sufficient to ground an application for approval of a new drug by the regulatory authorities. Shortly thereafter, he swore that he knew the tests or trials were not sufficient for that purpose. It is impossible to reconcile his evidence on this point. In my view, it was clear to Dr. Hughes that the sort of tests he had conducted would not satisfy officials at either the Health Protection Branch or the Food and Drug Administration were the results of them to be submitted in support of an application for approval of a new drug. His evidence was that an application to obtain regulatory approval would cost in excess of a million dollars and that much of that cost would be incurred in the testing of the drug. The tests he conducted were without any of the scientific rigor required by the regulatory authorities and were, as a result, very inexpensive to undertake.
- [78] Turning to the main issue, the testing that was done by Dr. Hughes was described in the August 1998 "Confidential Statement of Facts" noted above. It stated that "initial clinical trials" were done on 30 recalcitrant cases in which the candidates had used several of the traditional treatments for psoriasis. All had suffered from the condition for over 20 years; all responded excellently. Some had remissions of up to five months. There were no adverse effects "topically or systemically" and the records of these trials were safely stored by HPC. Finally, the format used to record data was described as "standard clinical trial procedures". Some 70 further cases of less severe psoriasis patients were tested after the initial 30 patients were studied.
- [79] As noted above, I am satisfied that Dr. Hughes did not systemically test the results of the patients involved in his trials. I am not satisfied however that if he had, the results would have been any different. There is no evidence that systemic testing would have detected the presence of steroids in Miralex. The plaintiffs' contention is, however, that by using the phrase "clinical trials" much more was being conveyed. They point to the requirements of the Health Protection Branch when considering a new drug submission. The protocols required by that organization are rigid and costly.
- [80] I am not satisfied that the plaintiffs have established that the phrase was being used in the manner they now contend. There are several reasons for my conclusion in that regard. First, the plaintiffs knew in some detail what the trials in fact consisted of. They were described in the "Confidential Statement of Facts". They had been earlier described more generally in the February 10, 1997 newsletter in the following terms:

Just to explain a little. In a clinical trial, when treating an area of skin for example, applying treatment to one half of a lesion and leaving the other half untreated, graphically displays the effectiveness of the treatment. There is no trying to remember what it looked like before treatment started.

It is clear that these descriptions of the trials that were being undertaken do not accord with the more formal meaning of "clinical trials" that the plaintiffs argue they understood was being used. Moreover, when the trials were described neither Dr. Gill nor Dr. Noble queried Dr. Hughes about the matter. Neither asked about the seemingly casual nature of the trials being undertaken. Dr. Noble continued to invest.

- [81] Second, on October 30, 1998, after all of the investments by the plaintiffs had been completed, a newsletter was issued by the HPC in which Dr. Moore wrote "[a]fter initial investigation involving some clinical cases, we have received confirmation from Dr. Hughes who has now initiated a formal clinical trial". The clear implication of this statement is that the earlier trials were not "formal clinical trials". Neither of the plaintiffs raised any concern about this disclosure. Their failure to do so supports the notion that they did not understand that the earlier references to "clinical trials" meant anything more than that which had been described to them.
- [82] Finally, Dr. Noble himself used the term "clinical trials" in the casual sense that the defendants contend they understood the term. Dr. Gill was, in the spring and summer of 1998, testing Miralex in a veterinary context. In a letter dated August 3, 1998 Dr. Noble wrote to Dr. Hughes about these tests stating "Allan needs our support in his enthusiasm to continue clinical trials" (emphasis added). There is no suggestion that the tests that Dr. Gill was undertaking were "clinical trials" within the meaning of that phrase as the plaintiffs now contend.
- [83] In summary while there is no doubt that Dr. Hughes and Dr. Moore repeatedly claimed that clinical trials had been undertaken in relation to Miralex, I am not satisfied that in doing so they were being inaccurate, misleading or untruthful.

3. HPB and FDA Approvals

- [84] The plaintiffs argue that the defendants misrepresented the state of affairs as to the status of Miralex in relation to the Health Protection Branch and the Food and Drug Administration.
- [85] Dr. Gill swore that Dr. Hughes advised him during a telephone conversation on November 21, 1996 that Food and Drug Administration approval had been obtained in relation to Miralex. This was of sufficient significance to Dr. Gill that he made note of it in recording the substance of his conversation with Dr. Hughes. Dr. Hughes in effect admits that the conversation took place as Dr. Gill recalled it but argues that Dr. Gill misinterpreted what Dr. Hughes told him. Dr. Hughes explains his remarks as follows: "Again, clearly Dr. Gill has misinterpreted what he is hearing - FDA approval was based on FDA "not requiring" herbal medicine approvals at that time and by deduction, approved for sale by FDA" (emphasis in

the original).

- [86] In the July 7, 1997 newsletter Dr. Moore wrote, on behalf of the corporation, in relation to Miralex - "as you know Hueson has been responsible for the clinical trials and the FDA/HPB government approvals of this product". Dr. Hughes' explanation for this statement is that "at this time according to our expert on regulatory affairs, herbal products did not require DIN's [drug identification numbers] or approval by FDA in the US." Dr. Moore explained his statement in argument by asserting that Miralex had the "tacit" approval of the Food and Drug Administration and the Health Protection Branch because it was a botanical product and did not require approval.
- [87] While it may be that the Food and Drug Administration and the Health Protection Branch did not require approval of herbal remedies, the representation does not say that. Nor does it say that "tacit" approval had been obtained. The representation does not reasonably bear either of the foregoing interpretations in my view. Indeed, elsewhere in HPC's own materials it is apparent that when they meant that approvals were not required, they said so. For example in the company's February 10, 1997 newsletter, when discussing the other 44 products of HPC, Dr. Moore wrote (on behalf of the company) that in relation to those products "regulatory approval already obtained where necessary" (emphasis added).
- [88] As of November 21, 1996 neither plaintiff had purchased any shares in HPC. Dr. Gill had indicated in his November 5, 1996 letter that he was going to send funds for the purchase of shares within a week. He did not do that. It was not until November 27, 1996, after receiving the impugned assurances from Dr. Hughes, that he formally accepted the offer to purchase shares.
- [89] The statements as to the regulatory status of Miralex as made initially in the conversation with Dr. Hughes on November 21, 1996 and repeated in the July 7, 1997 newsletter are misleading. They are misrepresentations.
- [90] All of the statements made by Dr. Moore and Dr. Hughes regarding the status of Miralex as "Health Protection Branch and Drug Enforcement Agency approved", were made when they knew that Dr. Gill and Dr. Noble were contemplating making significant investments in HPC. They knew, indeed they promoted the notion, that the company's primary asset was its ability to market Miralex. I can only conclude that the statements about the regulatory status of Miralex were made to both encourage investors to invest and to allay any concerns they might otherwise have as to the company's ability to sell this product. In these circumstances, to make this claim when it was so obviously misleading was to fall well below the standard of care necessary. It is no answer for the defendants to say they received expert advice that regulatory approval was not needed. First, they did not say that regulatory approval was not needed. They said that it had been obtained. Second, the "expert" referred to has not been identified nor has any evidence been led as to his or her qualifications. I find it odd that if that advice had been received that nothing was put before the court in the way of communications with that expert after the Health Protection Branch advised that an

exemption did not exist in light of the medicinal claims being made by the company.

- [91] In my view the statements were negligently made by Dr. Hughes and Dr. Moore.
- [92] I am not satisfied that the statements were fraudulently made by Dr. Moore. I accept Dr. Moore's evidence that he believed that what he had written fairly bore the interpretation that he maintains he intended. In light of that, one of the elements necessary to ground a finding of fraud is lacking.
- [93] Nor am I satisfied that the same representations made in this regard by Dr. Hughes were fraudulent. While in several respects I find the evidence of Dr. Hughes wanting I accept that he believed, albeit negligently, that an herbal product which he thought Miralex was, could be marketed without Health Protection Branch or Food and Drug Administration approval. I recognize that the representations he made conveyed more than this limited conclusion. Nevertheless, I am not satisfied that he made those representations knowing them to be false.

4. Presence of Steroids

- [94] There is no dispute that Dr. Hughes and Dr. Moore repeatedly asserted that Miralex was steroid-free. The issue is whether these assertions were misleading, inaccurate or untruthful and if so, whether they were negligently or fraudulently made.
- [95] The steroid-free nature of Miralex was central to its value. According to Dr. Hughes, the only effective treatments for psoriasis up until he became aware of Miralex were steroid based creams. These products were only partially successful and they had unfortunate side effects. Miralex, on the other hand, achieved results that Dr. Hughes and Dr. Moore repeatedly described in superlative terms. They claimed that it was better than the steroid based treatments and that it did not have any of the negative side effects.
- [96] In determining whether the claims made by Dr. Hughes and Dr. Moore were inaccurate or misleading, it is necessary to examine what each of them knew of the product.
- [97] Dr. Hughes, on examination for discovery, stated that he met Mr. Zamir, the president of Manon Pharmaceuticals & Cosmetics and the supplier of Miralex, in connection with his attempts to market his other products in the Middle East. He knew that Mr. Zamir was an economist and he doubted, from the outset, his understanding of psoriasis and the manner in which Miralex worked. The marketing and distribution agreement that was reached between Manon Pharmaceuticals & Cosmetics and HPC in May 1997 provided as follows:

We [HPC] will have the right to test and evaluate and have tested and evaluated the Product to determine its content and properties for the purpose of assisting us in our internal analysis of the Product...

And further:

You [Manon Ltd.] will provide HPC on request with available product information required for HPC to obtain and maintain product approvals and/or filings, notwithstanding that the information may be confidential.

- [98] It is clear that neither Dr. Hughes nor HPC were relying on any representations made by Mr. Zamir or Manon Pharmaceuticals & Cosmetics as to the constituent elements of Miralex. All Dr. Hughes knew from Manon Pharmaceuticals & Cosmetics is that Mr. Zamir claimed the product was herbal in origin. He knew that Manon Pharmaceuticals & Cosmetics was not the manufacturer of the product. There is no evidence that he knew anything about the manufacturing of it. He knew from his own observations that the product produced markedly varied results on patients and that at least in some cases the affected skin "responded as if the herbal action was similar to a fluorinated steroid". As a result Dr. Hughes asked Mr. Zamir what Miralex was made of. He did not, on the evidence adduced, receive a response. It was not until April 1999 that Dr. Hughes received a written response from the lab that he had requested analyze the product. To categorically assert in this context, at least prior to being informed of the results of the laboratory analysis, that the product was steroid-free was misleading.
- [99] Before turning to the question of whether either Dr. Moore or Dr. Hughes acted negligently or fraudulently in making these statements it is worth noting the relationship between them in relation to Hueson Pharmaceutical Corporation. It is apparent that Dr. Moore was involved primarily in a public relations role. There is no evidence that he made any of the significant decisions in relation to the company. All of the negotiations regarding the purchasing of shares were conducted without Dr. Moore's involvement. He had nothing to do with Mr. Zamir the principal of Manon Pharmaceuticals & Cosmetics the company that supplied HPC with Miralex. Indeed he did not know until long after the fact of significant decisions being made by the company, for example the related party transactions referred to below. He did not sign the "Confidential Statement of Facts" and was not requested to by Dr. Noble. He had no background in pharmaceuticals; he was, as of December 1996 a retired veterinarian.
- [100] Dr. Hughes was clearly the leader of the defendant company. The name of the company is a reference, at least apparently, to him and his son. Dr. Hughes was the one with pharmacological expertise. He was the one with the relationship with Mr. Zamir. He was the one that had developed or helped to develop the Hueson Group of Companies. He was the one that made the significant financial decisions in relation to the company, including specifically the sale of shares. There are several instances in which his evidence does not make common sense or is otherwise inconsistent with the other uncontroverted evidence.

- [101] I will deal first with the issue of fraud as it relates to these statements. I am not satisfied that Dr. Moore made these statements fraudulently. Indeed I accept his evidence that to this day he believes the product is steroid-free. It is his view, unreasonably but honestly held, that the testing that has been done to date is in some way wanting or it reflects such a small portion of the product that the results are both unreliable and largely unimportant.
- [102] I am not satisfied that Dr. Hughes knew the product contained steroids. The plaintiffs point to two pieces of evidence that they argue establish that Dr. Hughes knew that Miralex contained steroids. The first is the letter of February 21, 1997 referred to above. In that correspondence he specifically asked about the presence of steroids and he never received a reply. The second and more significant matter involves Dr. Hughes' dealings with a report he received from Enviro-Health Research Laboratories Inc. dated April 12, 1999. In the first version of the report the following sentence appears: "It is possible that these compounds may be plant sterols and bound to isoprenoids." At Dr. Hughes' direction the lab reissued the report without the sentence noted. He said that he did this because the statement was speculative and added nothing to the substance of the report. I am suspicious of his actions and I reject his explanation for them. The report appears to have been intended for the management of the company and if that is so, there would be no reason for Dr. Hughes to be concerned about any of them being misled or unduly alarmed by the sentence that was expunged. On the contrary, it may well have been helpful for them to know the laboratory's musings on the nature of Miralex and the limitations of their analysis. On the other hand there is no evidence that "sterols" are "steroids". I accept that the report, as initially drawn, was a matter of concern to Dr. Hughes but not for the reasons that he suggests. I am not prepared to find however on that basis that he knew that Miralex contained steroids. It follows that I do not accept that he made the assertions he did fraudulently.
- [103] It remains to be determined whether in making these misrepresentations, either Dr. Moore or Dr. Hughes were negligent. For the very reasons the statements were misleading I find that Dr. Hughes was negligent in making them. He did not know the product was steroid-free. Mr. Zamir did not know what was in the product. Dr. Hughes was suspicious that it might contain a steroid and yet he made the assertions he did before his suspicions were quelled. Even after receiving the report from the lab which concluded that the one sample they had been asked to analyze was steroid free it was negligent for Dr. Hughes to continue to make the statements he did. He knew that patients responded differently to the product. He knew nothing about its manufacture. I am not satisfied on the evidence that the report that was received would have allayed or did allay his concerns. In these circumstances the standard of care requires more than simply testing one sample, and receiving a troubling if not ambiguous report at that.
- [104] I am not satisfied that Dr. Moore was negligent in relation to these statements. He has sworn that he was not aware that the product behaved like a steroid. He was not, after all, the person who was conducting the clinical trials. He never expressed any doubt that the product was steroid-free. There is no evidence to suggest that he had any dealings with Mr.

Zamir or Manon Pharmaceuticals & Cosmetics. It has not been established that he knew or ought to have known anything about the circumstances of the products' manufacture. He relied, I find, on the assurances of his colleague Dr. Hughes. In doing so, it has not been established he was negligent.

5. Failure to Match Funds

- [105] As is noted above Dr. Noble was not prepared to make a further investment in HPC in the fall of 1998 unless Dr. Hughes and Dr. Moore made similar matching investments. Dr. Hughes wrote to Dr. Noble in response to his request stating "Bryan and I have committed". Dr. Noble reasonably took that statement to mean that Dr. Hughes and Dr. Moore had committed to making a matching investment. Dr. Noble states in his affidavit that no matching investment was ever made by Dr. Hughes or Dr. Moore. This is not denied by Dr. Hughes, Dr. Moore, or Peter Hughes. Indeed none of them have addressed this issue at all in their material.
- [106] It is important to note that there is no evidence that Dr. Moore knew of Dr. Hughes' correspondence or of the requirement that he make a matching investment in the company.
- [107] During argument Dr. Hughes explained his version of this agreement. He said that the matching investment was to be made with the money he received from Dr. Noble or Dr. Gill when they exercised the options they owned to purchase some of the shares that Dr. Hughes owned. If Dr. Hughes' version of the meaning of this statement is accepted then it does not amount to a misrepresentation. On the other hand, if he did not intend the statement in the manner he maintains, the statement is a misrepresentation.
- [108] There are several difficulties with Dr. Hughes' argument regarding his interpretation of the statement. First, the interpretation he suggests is not in accord with his own words. He did not respond by saying that "I will commit once you exercise your options". He did not say his commitment was contingent on any future event. He wrote "Bryan and I have committed". Second, it would not make any business sense for Dr. Noble to agree to such an arrangement. If, as must have been obvious to Dr. Hughes, Dr. Noble's intention was to ensure that Dr. Hughes and Dr. Moore were both at risk to the degree that he would be upon completing the contemplated investment, that would not be accomplished on Dr. Hughes' view of the arrangement. On Dr. Hughes' version there would be no matching of the additional investment by Dr. Noble because in order for Dr. Hughes to invest Dr. Noble would have to exercise his options on Dr. Hughes shares, thus reducing Dr. Hughes' exposure and increasing his own exposure. Third, there is no evidence that Dr. Noble ever acquired any options from Dr. Moore and thus, unless the arrangements for Dr. Hughes and Dr. Moore were different, they could not be accomplished on Dr. Hughes' interpretation. He made no distinction between himself and Dr. Moore in his reply.

[109] I reject Dr. Hughes' explanation that he meant the statement in the manner he suggested. I find that the statement was intended to mean what it says, namely, that Dr. Hughes and Dr. Moore had made or were committed to make investments matching those being contemplated by Dr. Noble. It was a misrepresentation. It was made by Dr. Hughes when he knew it to be false. There was no matching investment in the sense that Dr. Noble required and Dr. Hughes knew that. I do not accept that he honestly intended his response to mean anything other than that which the words fairly convey. The statement was made for the purpose of convincing Dr. Noble to make a further investment in the company. It was fraudulently made.

Reliance:

[110] It is a necessary element of the torts of deceit and negligent misrepresentation that the plaintiff establish that he or she relied, reasonably, on the statements said to ground the torts. As the plaintiffs state in their written submissions, it is sufficient to establish reliance if it can be demonstrated that the impugned assertions were one of a number matters relied upon. In *Kripps v. Touche Ross & Co.*, [1997] B.C.J. No. 968, Finch J.A. (as he then was) wrote on behalf of the majority of the Court of Appeal at para. 103:

It is sufficient, therefore, for the plaintiff in an action for negligent misrepresentation to prove that the misrepresentation was at least one factor which induced the plaintiff to act to his or her detriment. I am also of the view that where the misrepresentation in question is one which was calculated or which would naturally tend to induce the plaintiff to act upon it, the plaintiff's reliance may be inferred. The inference of reliance is one which may be rebutted but the onus of doing so rests on the representor.

[111] It is clear that the plaintiffs relied on all of the misrepresentations in making their investment decisions. The misrepresentations all would naturally tend to induce the plaintiffs to act on them. There is no doubt that other factors influenced their decisions to invest but I am satisfied that the misrepresentations were at least one of the factors upon which their decisions were founded. There has been no evidence led by the defendants that would suggest otherwise.

[112] The defendants argue that even if the plaintiffs did rely on their statements they did not act reasonably in so doing. In support of this argument the defendants point to Dr. Noble's own statement in his August 3, 1998 letter in which he commented "whether we like it or not this company is still in its embryonic stages and this remains a very high risk investment." I accept that this was an investment fraught with risks. The risks did not include however the risk of being misled by the principals of the company in which the investment was being made. The defendants to a greater or lesser degree held themselves out as having particular knowledge and qualifications in relation to the matter they were promoting. It was not unreasonable, in my view, for the plaintiffs to rely on their statements in making their investment decisions.

Related Party Transactions:

- [113] Aside from the foregoing allegations, the plaintiff Dr. Noble argues that the defendants breached an implied term of one of the contracts of purchase and sale by entering into what are described as "related party transactions".
- [114] In January 2000, Dr. Gill and Dr. Noble received an annual report and financial statements for HPC. These were the first financial statements that the plaintiffs had received. The unaudited financial statements were for the period from January 1997 to June 30, 1999.
- [115] There were two notes to the statements that deal with the "related party transactions". The first stated that HPC had paid \$278,390 US of the \$350,000 US purchase price to acquire the "world rights" (except Canada, Australia and the U.K.) to 11 products of Steven Jenter Laboratories Ltd., International Dermatologicals Inc., and E.P.X. Skin Care Systems Ltd. These are all companies identified as being part of the Hueson Group Canada in the first September 10, 1996 share offering. The financial statements do not indicate when this transaction was entered into but they do state that the balance of the purchase price would be due January 1, 2002. The statements do however indicate that the companies that form part of the Hueson Group Canada were owned by companies that were controlled by an officer and director of HPC.
- [116] The second note to the statements relates to the purchase of an option to purchase all of the issued and outstanding shares of Discovery Health Care Ltd., by HPC for \$150,000 US. The price of the shares, should the option be exercised, was \$360,000 US. Again the statements do not indicate when this transaction was entered into but the option was to be exercised, if at all, by May 1, 2001. The statements indicate that Discovery Health Care Ltd. was owned by "an officer and director" of HPC.
- [117] I will deal separately with each of these transactions.
1. The Acquisition of Rights to Products
- [118] As noted above HPC entered into an agreement to acquire the world rights (except Canada, Australia and the U.K.) to 11 products owned by Steven Jenter Laboratories Ltd., International Dermatologicals Inc., and E.P.X. Skin Care Systems Ltd. The price for this acquisition was \$360,000 US and by the time the financial statements were first seen by the plaintiffs, \$278,390 of that price had already been paid.
- [119] The financial statements show the acquisition of these rights as an asset. The statements reveal that payment for the rights was made partly in 1997 and partly in 1998.
- [120] The plaintiffs take the position that these rights were already represented by HPC as being the property of that company when the first share transactions were entered into. The fact that the company was paying for them later establishes that the initial representations were false or in the alternative the company was buying something it already owned.

- [121] The defendants argue that neither scenario is the case. Dr. Hughes asserts that HPC had the marketing rights for the United States for these products and that the acquisition of the rights for the remainder of the world (except Canada, Australia and the U.K.) was done to increase the value of HPC. Peter Hughes asserts that the rights being acquired through this transaction were different than the original rights owned by HPC. They relate to the same products but deal with different geographic locations. The purpose of the transaction was to bolster HPC's "product rights inventory". Dr. Moore has not responded at all to this allegation perhaps because, according to his examination for discovery evidence, he was never consulted about it and the first he learned of it was at the annual general meeting of the company held in January 2000.
- [122] The September 10, 1996 share offering document is not entirely clear on what the status of the rights associated with these products were. It initially states, "Hueson USA has acquired, through licensing and invention, 42 pharmaceutical products - consumer and professional - Veterinary and Human..." The document further provides that "Hueson USA by these product rights has acquired an asset base of [more than] \$10,000,000 US". The next reference to these products states "we have developed 42 products Human and Veterinary and incorporated ten pharmaceutical companies (Hueson Group Canada)..." and it then lists the companies. Included in the list are all the companies named as the vendors of the rights being purchased for \$350,000. The document then describes how all of these companies were to be consolidated into one company, Consolidated Hueson Canada, which company would then be acquired by HPC. This acquisition was to be accomplished "by way of a share exchange". The document notes that "if you are a previous investor of the Canadian Companies (e.g., Care Vet) your shares will be converted to shares in Hueson USA. A formal offer to tender your shares will be sent to you in the very near future."
- [123] The September 10, 1996 share offering was accompanied by a corporate structure document schematically representing how HPC would look following the transactions described in the offering. Specifically the document provides that HPC would own Consolidated Hueson Canada, which in turn would own the very companies noted in the financial statements. In the box on the organizational chart occupied by HPC, the only other words are "World Marketing Rights".
- [124] On examination for discovery, Dr. Moore acknowledged that he thought the various Canadian companies that were to be acquired by HPC would be acquired, as the document implies, by "share swap".
- [125] In my view the only reasonable interpretation to be placed on the September 10, 1996 share offering documents is that HPC would be acquiring, through a share exchange, the Canadian companies and all that they owned, that is including specifically the rights to market the 42 products they had developed. There is nothing in the documents to suggest that these marketing rights would be limited to the United States or any other geographic location. Indeed the organizational chart can only be interpreted to mean that once the share transactions were complete, HPC would own the "world marketing rights".

[126] I expressly reject the evidence of Peter Hughes and Dr. Hughes in which they state that the rights being purchased were different than the rights that the company already owned. Their assertions cannot be reconciled with the plain meaning of the company's own promotional material. Moreover, I find it odd in the extreme that an acquisition of this sort would not have been raised with the management committee of the company never mind with Dr. Moore. Further this transaction, which is of some significance given its size, is not mentioned in the January 1998 five-year business plan nor is it mentioned in the Business Overview that accompanied the February 1998 newsletter.

[127] While this transaction is telling in relation to Peter and Donald Hughes' credibility, it is not otherwise relevant to this action. I find that the company owned what it said it owned in the promotional material referred to above. In the result there was no misrepresentation. If the transaction is fraudulent or is otherwise improvident, then the remedy for it belongs to the company not the individual plaintiffs in this action.

2. The Acquisition of Discovery Health Care Ltd.

[128] Discovery Health Care Ltd. was not one of the Hueson Group of companies. It owned, according to the financial statements of HPC, the rights to six products and specialized in direct marketing of health care products. The financial statements further disclose that the company was owned by an officer and director of HPC.

[129] The transaction at issue involved the purchase by HPC, of an option to acquire all of the outstanding shares of Discovery Health Care Ltd. for a total of \$360,000 US. The cost of this option was \$150,000 and if the option was exercised, this amount would be applied towards the purchase price. The option was open to be exercised until May 1, 2001. The option was acquired by HPC in 1998. Peter Hughes could not recall when in that year the transaction was settled.

[130] Peter Hughes was the President of Discovery Health Care. He was one of four shareholders in the company. One of their other shareholders was a company in which Dr. Hughes had an interest. The entire \$150,000 purchase price of the option was paid to Peter Hughes. This transaction was negotiated, according to Peter Hughes, on behalf of HPC by Dr. Hughes, and on behalf of Discovery Health Care Ltd., by Peter Hughes. Dr. Moore was not involved and indeed did not learn about the transaction until he read the financial statements in which it was disclosed. Discovery Health Care Ltd., at the time the option was purchased, had one employee, Peter Hughes. It had one product of any significance, an anti-inflammatory called Arthroflex. For the period ending December 1999, the sales of that product were less than \$20,000 US. For the period ending December 1998, Peter Hughes was unsure if the sales of that product exceeded \$10,000 US.

[131] The allegation of the plaintiff Dr. Noble is that this transaction contravened the "Confidential Statement of Facts" that was a precondition to his investment of October 1998. Prior to making that purchase, Dr. Noble requested various assurances from Peter Hughes and Dr. Hughes. On August 3, 1998 Dr. Noble wrote to Dr. Hughes stating, among other

things, "my investment will be for product development, marketing, insurance, and development of the above divisions". In response to this letter Dr. Noble received the "Confidential Statement of Facts" signed by Peter Hughes and Dr. Hughes. It contained the following statement:

If you should complete the financing as discussed the capital will be used for product development, marketing, liability insurance, key-man insurance, and advertising and development of new business and new divisions or subsidiaries.

[132] The issue posed by the transaction involving the purchase of the option to acquire the Discovery Health Care Ltd. shares, is whether that transaction falls within the scope of the terms of Dr. Noble's investment. Put another way, did it violate the ongoing representation contained in the "Confidential Statement of Facts"?

[133] While Dr. Noble's letter is not entirely clear, what is clear is that the entire focus of his concern was Miralex in both its human and veterinary applications. Miralex is the "product" being referred to in the phrase "product development". There is nothing in his correspondence, or in the meeting that generated it, to suggest that HPC was going to branch out into other products or other endeavours at least in the near term. It is clear that Dr. Hughes understood the letter in that way. In his August 14, 1998 response he wrote:

If you would consider taking 2 of the remaining blocks we could immediately become more aggressive in marketing Miralex now that the "bugs" have been worked out and the newspaper ads have given us the template to achieve success.

We are particularly anxious to proceed with a Veterinary wholly-owned subsidiary. With the financing completed we would have a meeting with you and Allan regarding Miralex Vet to identify a "management team" (Allan & John?) and arrange formal agreements, budgets, equity opportunities, and inventory to be agreed upon and "go for it".

(emphasis added)

There is no mention any other products or any other contemplated endeavours in the letter.

[134] Later in August the "Confidential Statement of Facts" was forwarded to Dr. Noble. The entire focus of that document was Miralex. While there is passing reference to the 42 other products owned by HPC, the reference to "new business and new divisions or subsidiaries" can only mean new Miralex divisions, such as the veterinary division, the new business means the new applications of Miralex to other skin disorders, such as eczema and dermatitis.

[135] In my view, Peter Hughes and Dr. Hughes agreed by the terms of the "Confidential Statement of Facts" that they would use Dr. Noble's investment only for the purposes noted above. By causing the company to purchase the option for the outstanding shares in Discovery Health Care Ltd., they were in breach of this term. I am fortified in this conclusion by the secrecy that surrounded this transaction. Dr. Moore was not advised of it;

the management committee was never consulted about it; the company's business plan and business overview, issued the year the transaction was entered into are both silent on the matter.

[136] The investment by Dr. Noble to which the "Confidential Statement of Facts" related was made on October 1, 1998. I find that as of that date that both Peter Hughes and Dr. Hughes were actively negotiating for that sale, or were at least contemplating the sale. In either case the representation at the time it was made was misleading and was misleading about the existing state of affairs in relation to the purchase and sale of this option.

[137] It was, I find, fraudulently made. Peter Hughes knew that limitations on the use of funds that Dr. Noble was demanding. So did his father. They both knew, I am satisfied, that the purchase of the option from Discovery Health Care Ltd. was in contravention of that agreement. They both had that transaction in contemplation if it was not under active negotiation at the time the representation was made.

[138] The plaintiffs have also claimed, in the alternative, relief based on alleged breaches of the Securities Act. I will not deal with that issue in that, to a considerable degree, the foregoing findings would, at best, do no more than ground relief under that Act similar to that which follows at common law or equity.

Damages:

[139] The plaintiffs contend that they have lost their entire investment as a result of the failure of Miralex. Whether their claims are viewed from the perspective of breach of the contracts of purchase and sale of the shares or from the perspective of the tort of negligent or fraudulent misrepresentation, they take the position that the measure of their damages is the same. They seek to be put in the position that they would have been in but for the misrepresentations, that is, they seek judgment in the amount of their investment.

[140] The defendants argue that the plaintiffs have not proven that HPC is, in fact, worthless. This submission however misses the point. Throughout the promotional period during which the company was attempting to raise money, its own materials indicated that its primary value was the promise of Miralex. It is clear on the evidence that HPC is certainly worth substantially less than it would have been had the representations about Miralex been true. To the extent there is a diminution in the value of the company as a result of the misrepresentations the plaintiffs have suffered a detriment and are entitled to relief.

[141] The damages they are entitled to in tort is that which is necessary to put them in the position they would have been in had the misrepresentations not been made. I am satisfied that they would not have made the investments they did but for the representations and hence they are entitled to the return of their investments. The company is of course entitled to the return or cancellation of its shares.

- [142] The first misrepresentations predate the first share purchase by Dr. Gill. He is therefore entitled to judgment against HPC for the entire amount of his investment. His damages consist of \$12,000 as of November 30, 1996; a further \$60,000 as of February 14, 1997; the Canadian dollar equivalent of \$72,000 US as of September 24, 1997; and the Canadian dollar equivalent of \$9,000 US as of April 1, 1998. Similarly, the plaintiff, Koala Holdings Inc., is entitled to judgment against HPC for the entire amount of its investment. Its damages consist of \$60,000 as of February 14, 1997; the Canadian dollar equivalent of \$228,000 US as of September 25, 1997; and the Canadian dollar equivalent of \$250,000 US as of October 1, 1998. The plaintiff, Noble Family Trust, is entitled to judgment against HPC for the amount of its investment, being the Canadian dollar equivalent of \$75,000 US as of April 2, 1998 and the Canadian equivalent of \$250,000 as of October 1, 1998.
- [143] With respect to the individual defendants, the plaintiff, Dr. Gill, is entitled to damages as against Dr. Hughes for the entire amount of his investment as set out above, because the misrepresentations made by Dr. Hughes were made prior to the first investments by the plaintiffs. Similarly the plaintiffs, Noble Family Trust and Koala Holdings Inc., are entitled to judgment against Dr. Hughes for the entire amount of their respective investments as set out above. Finally they are entitled to recover on the basis of fraud, their respective losses in relation to their October 1998 investments; namely, they are each entitled to judgment in the amount of the Canadian equivalent of \$250,000 US as of October 1, 1998.
- [144] As to the defendant, Dr. Moore, his negligent misstatements relate only to the claims he made about the approved status of the product. Those statements were not made by him until July 1997. His liability is for those share purchases which were made subsequent to that date. In relation to the plaintiff, Dr. Gill, Dr. Moore is liable for the Canadian dollar equivalent of those purchases made on September 25, 1997 and April 1, 1998. In relation to the plaintiffs, Koala Holdings Inc. and the Noble Family Trust, his liability is for the entirety of their investments less the \$60,000 investment made in February 1997 by Koala Holdings Inc.
- [145] As to Peter Hughes, he was not in a "special relationship" with the plaintiffs until February 1998. Although a "special relationship" existed from that point, the only negligent or fraudulent misstatements that were made and for which he is liable are those relating to the uses to which the October 1998 investments would be put. The plaintiffs, Koala Holdings Inc. and Noble Family Trust, are accordingly entitled to recover damages on the basis of fraudulent and negligent misrepresentation against Peter Hughes in relation to those investments that were made in October 1998.
- [146] The plaintiffs are entitled to prejudgment interest pursuant to the Court Order Interest Act, R.S.B.C. 1996, c. 79.

[147] I have not heard from the defendants on the issue of contribution as between themselves. In the event they are unable to agree on that matter, they are at liberty to apply for a determination of their respective contributions as contemplated by s. 4(2) of the Negligence Act, R.S.B.C. 1996, c. 333.

[148] The plaintiffs are entitled to costs on Scale 3 as against each defendant.

"G.M. Barrow, J."

The Honourable Mr. Justice G.M. Barrow

January 27, 2003 - Corrigendum to the Reasons for Judgment issued by Mr. Justice G.M. Barrow advising that the first page of the Reasons for Judgment inadvertently omitted the trial dates of April 3, 4, and 5, 2002. These dates should have been indicated in addition to the April 29, May 27 and May 30, 2002 dates.

Further, paragraph 58 on page 28 is amended in the seventh line by changing the word "breach" to "reach".

The Reasons for Judgment are amended accordingly. In all other aspects, the Reasons stand.

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