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LEGAL LIABILITY FOR FINANCIAL ADVISORS IN CANADA

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I. INTRODUCTION:

Canadians care deeply about money management. Whether investing for retirement, education, or purchases, the goal of investment generally remains the same – to achieve a rate of growth and preserve the capital investment. Investing and managing finances can be a complicated arena. Professionals, such as investment advisors, financial advisors, and stockbrokers abound with methods and ways of managing capital and investments.

This paper will address a variety of liability issues relating to financial advisors. While we focus on financial advisors, the reader will note many references to investment advisors and brokers. This is because many of the principles involving these related professions guide us on financial advisors' duties and responsibilities to their clients.

As will be seen below, there is surprisingly little *statutory* regulation of the financial advisor industry. Beyond the basic requirements arising from securities legislation across Canada, a wide range of *industry-based* rules and principles guide financial advisors. This paper will address the statutory and regulatory regimes governing financial advisors, and will address the manner in which the Canadian judiciary makes use of those regulations when a financial advisor is sued by a client.

This paper also addresses the duties and obligations financial advisors owe to their clients – contractual, tort, and fiduciary. The nature and scope of the advisor's duties are governed by the extent to which the client "relies" on the financial advisor to provide advice. This paper addresses the "continuum" of reliance client may place in a financial advisor and how the Courts have translated that "continuum" into the duties owed by the financial advisor.

Lastly, this paper discusses recent jurisprudence with reference to the well-documented "Knowledge House" litigation and recent class actions which have targeted financial advisors and related professionals.

II. STATUTORY FRAMEWORK FOR FINANCIAL ADVISORS:

There exists a myriad of legislative, regulatory, and administrative "rules" which govern the conduct of financial advisors in Canada. Each province and territory in Canada regulates financial advisors independently, though there is a movement to harmonize the regulatory regime. Thus, notwithstanding the fact that regulation varies from province to province the management and standard of conduct of financial advisors across Canada is relatively uniform.

The initial statutory framework for financial advisors arises from the various "*Securities Acts*" enacted for each province and territory. Securities legislation is administered by the following provincial and territorial regulatory authorities:

- British Columbia Securities Commission
- Alberta Securities Commission
- Saskatchewan Financial Services Commission
- Manitoba Securities Commission
- Ontario Securities Commission
- Autorité des marchés financiers (Quebec)
- New Brunswick Securities Commission
- Nova Scotia Securities Commission
- Newfoundland & Labrador - Department of Government Services Consumer & Commercial Affairs Branch
- Prince Edward Island – Securities Office
- Northwest Territories – Office of the Superintendent of Securities
- Nunavut – Office of the Superintendent of Securities
- Yukon – Office of the Superintendent of Securities

All 13 provincial/territorial securities regulators are members of the **Canadian Securities Administrators, a national organization formed to streamline the** application process as governed by securities legislation and work towards the harmonization of securities legislation in Canada.

The following table set out the current governing securities legislation (the "Securities Acts") across Canada:

Province	Statute
Alberta	*Securities Act*, RSA 2000, c. S-4
British Columbia	*Securities Act*, RSBC 1996, c. 418
Manitoba	*The Securities Act*, CCSM, c. S50
Newfoundland and Labrador	*Securities Act*, RSNL 1990, c. S-13
New Brunswick	*Securities Act*, SNB 2004, c. S-5.5
Northwest Territories and Nunavut	*Securities Act*, SNWT 2008, c. 10
Nova Scotia	*Securities Act*, RSNS 1989, c. 418
Nunavut	*Securities Act*, SNu 2008, c. 12
Ontario	*Securities Act*, RSO 1990, c. S.5
Prince Edward Island	*Securities Act*, RSPEI **1998**, c. S-3.1
Quebec	*Securities Act*, CQLR, c. V-1.1
Saskatchewan	*The Securities Act*, SS 1988-89, c. S-42.2
Yukon	*Securities Act*, SY 2007, c. 16

As they pertain to "financial advisors", the Securities Acts contain provisions regarding the registration of persons acting as "advisors". By virtue of their membership in the *Canadian Securities Administrators*, all provinces are provided with "*National Instruments*", which represent an attempt to ensure similarity across all Canadian securities legislation. In accordance with the National Instruments and by agreement amongst the provinces, all Securities Acts provide that an "*advisor*" must be registered with the provincial securities regulator.

The standard wording located in many of the *Securities Acts* provides: [1]

Persons who must be registered

A person must not

(a) trade in a security;

(b) <u>act as an adviser;</u>

(c) <u>act as an investment fund manager; or</u>

(d) act as an underwriter;

unless the person is registered... [with provincial securities regulator]

In Ontario, the *Securities Act* provides:

25(3) Unless a person or company is exempt under Ontario securities law from the requirement to comply with this subsection, the person or company shall not engage in the business of, or hold himself, herself or itself out as engaging in the business of, advising anyone with respect to investing in, buying or selling securities unless the person or company,

(a) is registered in accordance with Ontario securities law as an adviser;

(b) is a representative registered in accordance with Ontario securities law as an advising representative of a registered adviser and is acting on behalf of the registered adviser.[2]

The Ontario *Securities Act* further provides the categories of "advisors" which may be registered:

Adviser registration categories

(6) A person or company making an application under subsection (1) with respect to registration as an adviser shall indicate for which of the following categories of adviser registration he, she or it is applying and shall provide such information as the Director may require to verify that the activities of the person or company will be within the permitted activities for that category of adviser registration:

1. *Portfolio manager, authorized to provide advice to a client with respect to investing in, buying or selling any type of security, with or*

[1] *The Securities Act*, CCSM, c. S50, s.6; *Securities Act*, SNWT 2008, c.10, s. 86; *Securities Act,* RSNS1989, c. 418, s. 31; *Securities Act,* RSPEI **2008**, Cap. S-3.1, s. 86; *Securities Act*, CQLR, c. V-1.1, s. 148.

[2] *Securities Act,* RSO 1990, c.S.5, s. 25(3).

without discretionary authority granted by the client to manage the client's portfolio.

2. *Restricted portfolio manager, limited to the advising activities authorized under section 27 for the person's or company's registration.*
3. *Such other category of adviser as may be prescribed by the regulations. 2009, c. 18, Sched. 26, s. 4.*

A preliminary issues arises – who is an "advisor" for the purposes of the Securities Acts? "Advisor" is generally defined in the Securities Acts as:

> "*adviser" means a person or company engaging in or holding himself or itself out as engaging in the business of advising others as to the investing in or the buying or selling of securities."*[3]

It should be noted that the Yukon *Securities Act* does not reference any registration requirement for "advisors", but instead requires:

> ***3*** *No person or company shall directly or indirectly act as a broker, security issuer, or salesperson unless the person or company holds a certificate of registration therefor under this Act which is in full force and effect.*[4]

Where the investments traded are commodities, specific legislation may apply. For example, in Ontario, commodity trading is governed by the *Commodity Futures Act*, RSO 1990, c. C-20. Section 28 of the Regulations under the *Commodity Futures Act* provides:

> ***28.*** *(1) Each registrant that is a dealer, commodity trading counsel or commodity trading manager shall, before accepting the account of a customer, make enquiries that,*
>
> *(a) will enable the registrant to establish the identity of the customer and, where appropriate,*

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[3] *Securities Act,* RSNS 1989, c. 418, definitions. Similar provisions are located in the Ontario and BC Securities Acts.
[4] SY 2007, c.158, s.3.

> *(i) the credit worthiness of the customer, in accordance with guidelines established by the registrant, and*
>
> *(ii) the reputation of the customer, if information known to the registrant causes doubt whether the customer is of good reputation;* […].

III. ADMINISTRATIVE FRAMEWORK FOR REGULATING FINANCIAL ADVISORS:

Beyond the limited statutory regime governing financial advisors, there exist a variety of administrative and regulatory sources which discuss rules, regulations, and procedures to be followed by financial advisors, and in particular, steps to be taken when recommending a particular investment or financial plan. As is seen later in this paper, liability for financial advisors often arises from a failure on the part of the advisor to adequately assess the client's suitability for a particular investment. The following administrative rules and guidelines provide guidance to financial advisors (and to the Courts) as to the requirements for "knowing your client" and "knowing your product".

As noted below, many of the "rules" are the creation of industry groups, and indeed the scope of the "rule" depends greatly on whether one is a "financial advisor", "stock-broker", or an "investment fund manager". What is key to remember in terms of civil liability for financial advisors is that Courts have concluded, as discussed below, that the "rules" mandate the minimum expectations for financial advisors.

A. IIROC

The Investment Industry Regulatory Organization of Canada ("IIROC") was created through the merger of the Investment Deals Association of Canada ("IDA") and Market Regulations Services Inc. in 2008. IIROC describes itself as the national self-regulatory organization which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. IIROC further indicates that it carries out its regulatory responsibilities through setting and enforcing rules regarding the proficiency, business and financial conduct of dealer firms and their registered employees and through setting and enforcing market integrity rules regarding trading activity on Canadian equity marketplaces. As the national self-regulatory organization for the Canadian investment industry, IIROC is responsible for enforcing rules and regulations regarding sales, business and financial practices and trading activities of individuals and firms under IIROC's jurisdiction.

IIROC publishes and maintains the "Dealer Member Rules", a lengthy compendium of rules which deal with issues such as account management and disclosure. The Dealer Member Rules are a continuation of the IDA Dealer Member Rules which existed as of June 1, 2008, with subsequent amendments. Changes to the Rules require the approval of the IIROC Board of Directors, as well as the approval of the various securities regulators across the country (as represented by the Canadian Securities Association). Also published and maintained by IIROC is a 350-page publication, the "Uniform Market Integrity Rules", specifically governing the trading of securities.

Rule 1300 of the Dealer Member Rules governs the "Supervision of Accounts". It provides rules regarding the process and standards for confirming the identity and creditworthiness of a client, as well as Rules regarding the discretionary management of portfolios. In short, Rule 1300 enacts the "Know Your Client" Rule, discussed in the caselaw in this paper. Rule 1300 provides in part:

> 1300.1.
>
> ***Identity and Creditworthiness***
>
> (a) <u>*Each Dealer Member shall use due diligence to learn and remain informed of the essential facts relative to every customer and to every order or account accepted.*</u>
>
> (b) *When opening an initial account for a corporation or similar entity, the Dealer Member shall:*
>
> (i) *ascertain the identity of any individual who is the beneficial owner of, or exercises direct or indirect control or direction over, more than 10% of the corporation or similar*

entity, including the name, address, citizenship, occupation and employer of each such beneficial owner, and whether any such beneficial owner is an insider or controlling shareholder of a publicly traded corporation or similar entity; and

(ii) as soon as is practicable after opening the account, and in any case no later than six months after the opening of the account, verify the identity of each individual identified in (i) using such methods as enable the Dealer Member to form a reasonable belief that it knows the true identity of each individual and that are in compliance with any applicable legislation and regulations of the Government of Canada or any province.

***

(g) If a Dealer Member, on inquiry, is unable to obtain the information required under subsections (b)(i) …, the Dealer Member shall not open the account.

(h) If a Dealer Member is unable to verify the identities of individuals as required under subsections (b)(ii) and (e)(ii) within six months of opening the account, the Dealer Member shall restrict the account to liquidating trades and transfers, payments or deliveries out of funds or securities only until such time as the verification is completed.

(i) No Dealer Member shall open or maintain an account for a shell bank.

***

(n) Dealer Members must maintain records of all information obtained and verification procedures conducted under this Rule 1300.1 in a form accessible to the Corporation for a period of five years after the closing of the account to which they relate.

Business Conduct

(o) <u>Each Dealer Member shall use due diligence to ensure that the acceptance of any order for any account is within the bounds of good business practice</u>.

Suitability Generally

(p) <u>Subject to Rule 1300.1(r) and 1300.1(s), each Dealer Member shall use due diligence to ensure that the acceptance of any order from a customer is suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance.</u>

Suitability Determination Required When Recommendation Provided

(q) <u>Each Dealer Member, when recommending to a customer the purchase, sale, exchange or holding of any security, shall use due diligence to ensure that the recommendation is suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance.</u>

Suitability Determination Not Required

(r) Each Dealer Member that has applied for and received approval from the Corporation pursuant to Rule 1300.1(t), is not required to comply with Rule 1300.1(p), when accepting orders from a customer where no recommendation is provided, to make a determination that the order is suitable for such customer.

B. CANADIAN SECURITIES INSTITUTE

Often, financial advisors may also be registered and certified through the Canadian Securities Institute to trade in securities. The Institute produces a Practice Handbook which sets out minimum standards for account documentation. In *Brian Gale v. ScotiaMcLeod Financial Services Inc.*,[5] the Court reviewed the Practice Handbook and noted that:

> *[62] …The significance of the portions of the New Client Application Form ("NCAF") that relate to the customer's investment knowledge and objectives is that they relate to the fundamental duty imposed upon all registered representatives to "know their clients". According to the Conduct and Practices Handbook, the purpose of the NCAF is summarized as follows:*
>
> *(i) to determine the client's investment objectives and risk tolerance;*
>
> *(ii) to judge the creditworthiness of the client; and*
>
> *(iii) to identify any industry regulations which will apply to this client of this account.*
>
> *[63] The "Know Your Client" obligation is a prominent feature of the Code of Ethics and Conduct found in the Canadian Securities Institute Conduct and Practices Handbook:*
>
> > *In addition to completing an NCAF for all new clients, registrants should update a client's NCAF periodically. The form should be updated whenever there is a major change in a client's circumstances such as:*
> >
> > - *change of account name (i.e. from "Marie Roy" to "Marie and Robert Roy")*
> > - *address change which would take client out of RR's jurisdiction*
> > - *new marital or employment status*
> > - *another person who takes a financial interest in or who gains control over the account*
> > - *new trading authorization*

[5] 2008 NLTD 152

- *a major change in financial circumstances*
- *new investment objectives or risk factors*
- *any amendment to items in the regulatory section (i.e., insider status)*

Any major change in circumstances could affect the client's investment objectives, creditworthiness or risk tolerance.

The Practice Handbook further provides guidance for brokers:

Standard A -- Duty of Care

While duty of care encompasses a wide number of obligations towards parties, the obligation to know the client is of paramount importance in order to ensure the priority of clients' interests. Including this, the three major components of duty of care are:

<u>Know Your Client</u>: The Know Your Client (KYC) rule is paramount for the industry. All registrants must make a diligent and business-like effort to learn the essential financial and personal circumstances and the investment objectives of each client. Client account documentation should reflect all the curial information about the client's current status, and it should be updated to reflect any material changes to the client's status in order to ensure suitability of investment recommendations.

<u>Due Diligence</u>: Registrants must make all recommendations based on a careful analysis of information about the client and information related to the particular transaction.

<u>Unsolicited Orders</u>: Registrants who give advice to clients must provide appropriate cautionary advice with respect to unsolicited orders that appear unsuitable based on client information. The registrant must be aware of the objectives and strategies behind each order accepted on behalf of his or her clients, whether it is solicited or not. Registrants should take appropriate safeguarding measures when clients insist on proceeding with unsolicited, unsuitable orders.

C. MUTUAL FUNDS DEALERS ASSOCIATION OF CANADA

The Mutual Funds Dealers Association of Canada maintains and provides to its members an Annotated Rulebook, which provides regulations for its members. Amongst the Rules is a "Know Your Client" rules which provides:

> ***2.2 CLIENT ACCOUNTS***
>
> *2.2.1* ***"Know-Your-Client".*** *Each Member and Approved Person shall use due diligence:*
>
> *(a) to learn the essential facts relative to each client and to each order or account accepted;*
>
> *(b) to ensure that the acceptance of any order for any account is within the bounds of good business practice; and*
>
> *(c) to ensure that each order accepted or recommendation made for any account of a client is suitable for the client and in keeping with the client's investment objectives; and*
>
> *(d) to ensure that, notwithstanding the provisions of paragraph (c), where a transaction proposed by a client is not suitable for the client and in keeping with the client's investment objectives, the Member has so advised the client before execution thereof.*

D. ROLE OF THE REGULATIONS

In *Young v. RBC Dominion Securities,*[6] the Court was informed by a variety of materials, including the ones mentioned above in assessing the duty owed by a financial advisor to his client. In analyzing the liability of a financial advisor, however, the Court noted that the IDA regulations (now the IIROC regulations) and the Canadian Securities Institute Conduct and Practices Handbook established minimum standards. The Court noted that a breach of the standards is actionable where damages result (*Varcoe v.*

[6] [2008] OJ No. 5418.

Sterling;[7] *Davidson v. Norman Capital Management Inc.;*[8] and *Blackburn v. Midland Walwyn Capital.*[9])

In *Young*, the Court made note that there is a substantial difference between financial planners and investment advisors. The Court noted that "*Investment advisors are very different from financial planners. Financial planners assume the client's overall financial planning. The role of an investment advisor is much more limited*."[10] In other words, and as seen later in this paper, the role that the various regulations and rules play can differ substantially on the nature of the role played by the "advisor" in a particular circumstance. The extent to which the advisor engages in advising on the sale of "securities" or acts as an "investment fund manager" informs the extent to which the above 'rules' will apply.

In *Hunt v. TD Securities Inc.,*[11] the Court noted at paragraph 62 that "*the existence of professional rules or codes of conduct will influence the standards set by the Court for acceptable conduct in the profession*".

As noted above, the Canadian Securities Association, to which all provincial securities regulators belong, provides "National Instruments" to facilitate the harmonization of particular securities regulations across Canada. All provinces and territories in Canada have now adopted National Instrument 31-103, which provides nationalized rules as it pertains to the registration of investment managers, dealers, and advisors.

You should note that there is a close relationship between the Canadian Securities Association and IIROC. In fact, NI 31-103 goes so far as to provide that where a member has an IIROC membership suspended or revoked (as an investment dealer or

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[7] (1992), 7 OR (3d) 204.
[8] (2005), CarswellOnt 7243 (Sup. Ct.).
[9] (2003), CarswellOnt 684 (Sup. Ct.).
[10] *Young*, *supra*, note 6 at para 189.
[11] 66 OR (3d) 481.

mutual fund dealer), that members' registration with the provincial securities regulator is also suspended.[12] Additionally, NI 31-103 provides that:

> "*the adviser registration requirement does not apply to a registered dealer, or a dealing representative acting on behalf of the dealer that acts as an adviser in respect of a client's managed account if the registered dealer is a member of IIROC and the advising activities are conducted in accordance with the rules of IIROC.*"

One area of the regulatory regime criticized by judges is the complaints procedure/protocol. As noted above, the close relationship between IIROC and the Canadian Securities Association has essentially meant that if a member's IIROC membership is suspended, his or her registration with the relevant provincial regulator will also be suspended. For those advisors not subject to IIROC, enforcement of the regulations may not be as stern. For example, the Financial Advisors Association of Canada is an industry based advocacy group, operating under the name "Advocis" which lobbies on behalf of members as well as providing training and certification programs. Advocis maintains a Code of Professional Conduct which provides as follows:

> *As a condition of membership in Advocis, all members agree to abide by the Advocis/CLU Institute Code of Professional Conduct (CPC).**

1. *An Advocis Member shall act with integrity.*
2. *An Advocis Member shall act competently.*
3. *An Advocis Member shall act diligently.*
4. *An Advocis Member shall not disclose any confidential information without expressed consent.*
5. *An Advocis Member shall act in a client's best interests.*

[12] 6.2 and 6.3 – NI 31-103.

6. *An Advocis Member shall disclose any conflict of interest in providing products and services.*

7. *An Advocis Member shall act in a manner that reflects positively upon all other Advocis Members.*

8. *An Advocis Member shall respect and protect the privacy of others.*

9. *An Advocis Member shall act in accordance with the spirit and the letter of the law.*

In *Dyer v. Cunningham (Cunningham & Associates Financial Services),*[13] the defendant financial planner, following a complaint to the Financial Advisors Association of Canada, agreed that she breached the code of professional conduct. The Court in Dyer expressed its displeasure with the "*complaints procedure and the apparent lack of transparency and accountability in that procedure*".[14] It can be inferred that the Court was not impressed that no action was taken against the defendant by the Association in spite of the admission of a breach of professional conduct.

IV. DUTIES OWED BY FINANCIAL ADVISORS TO THEIR CLIENTS:

A. CAN A CLIENT SEEK DAMAGES FROM A FINANCIAL ADVISOR WHERE THOSE DAMAGES ARE "PURE ECONOMIC LOSS"?

Where a client suffers a substantial reduction in portfolio value as the result of actions taken or not taken by a financial advisor, the loss is said to be "pure economic loss", in that there is no physical damage to person or property. The "rule" preventing recovery for "pure economic loss" in its broadest form would be said to exclude all claims in negligence for loss in the absence of property loss or personal injury loss, to the client in

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[13] 2007 SKQB 395.
[14] *Ibid*. at para 67.

question. This "rule" does not get applied with such strictness as to truly qualify as a "rule". Rather, the Supreme Court of Canada has recognized exceptions to "rule".[15]

The Supreme Court of Canada has indicated that recovery for pure economic loss is prima facie permitted where, "*in addition to negligence and foreseeable loss, there is sufficient proximity between the negligent act and the loss. Proximity is the controlling concept which avoids the spectre of unlimited liability.*"[16]

One well recognized exception arises from the negligent performance of a professional service. Insofar as it pertains to financial advisors, there is no spectre of "unlimited liability" as the proximity relates directly to the advisor and the client. As such, it is without question that a client is not precluded from pursuing damages or recovery from a financial advisor even though those losses are said to be "pure economic loss".

B. DUTIES OWED IN CONTRACT

1. General statement of duties owed in contract

An investment advisor's relationship with the client is that of agent and principal. The agent takes instructions from the principal and carries them out with care, skill and diligence. Therefore, the advisor has a contractual duty to abide by the terms of the investment agreement, and to ensure that the client is "*fully informed as to all material matters relevant to his/her investment portfolio.*"[17] Non-disclosure is a breach of this duty. The failure to disclose information about a risk can result in liability if the failure to disclose denied the client the opportunity to avoid losses.

[15] *Canadian National Railway Co. v. Norsk Pacific Steamship Co.*, [1992] 1 SCR 1021.
[16] *Ibid.*, at para 258.
[17] *Davidson, supra*, note 8 at para 53.

Contractual duties were found to exist in the case of *Davidson v. Noram Capital Management Inc.*[18] The client opened a discretionary investment account with the financial adviser. The investment agreement specified very conservative investment objectives, and emphasized the safety of his capital by requiring investment in diversified, good quality fixed income securities.

The Court found that the financial advisor had a contractual duty to invest the client's capital pursuant to the terms of the investment agreement. The financial adviser had a further duty to explain the use of specific investment strategies he employed, such as margin, and to discuss the associate risks of these strategies. The Court found that for clients with conservative investment objectives and modest assets, particular care was required in explaining the risks. While there is freedom to contract and investors have to ultimately make up their own minds as to the nature of their investment portfolio, the financial adviser has a duty to carefully and fully explain all possible ramifications of investment strategies.

The defendant failed to explain the investment strategies and the associated risks, thereby breaching the contractual duties.

(b) What types of activity will give rise to a breach of contract?

A breach of contract will occur where the financial advisor acts contrary to the terms of the account agreement. For example, a significant term of the account agreement is the provision of discretion. Discretion allows investment advisors to make investment decisions without the approval by the client. A breach of contract may occur where the financial adviser engages in discretionary activity, within a non-discretion account.

Consider the case of *Hunt v. TD Securities Inc.*[19] Melville and Marion Hunt opened a non-discretionary investment account with TD Securities. Under the terms of the

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[18] *Ibid.*
[19] *Hunt*, *supra* at note 11.

account, the financial adviser could trade in securities on behalf of the Hunts only with their authorization.

The Hunts transferred their entire holdings from their previous investment account to their new TD Securities account, which included an amount of BCE shares that the Hunts referred to as their "nest egg". The financial advisor sold a significant amount of the BCE shares, claiming that Melville had authorized the transaction, and that it was in accordance with the overall investment strategy they had discussed. The Hunts alleged that the sale was unauthorized. The value of the sold BCE share rose, and the Hunts commenced litigation.

The Court found that the transaction was a breach of contract. The sale was unauthorized, and the investor-client relationship was purely contractual; not fiduciary. Therefore, the defendant was strictly bound by the terms of the contract, and was not authorized to make any transaction without the express authorization of the Hunts.

2. When does the role of the investment advisor evolve from mere 'order-taker' to portfolio manager?

The precise legal or equitable duties the law will enforce in any given relationship are tailored to the role the advisor plays in that relationship. If the financial advisor is found to be simply a conduit of information and an order taker, the duties owed are that of a contractual nature, breach of which give rise to damages for breach of contract.

If the advisor plays a substantive role in the investment decisions – providing professional advice, making transactions without the client's approval, and 'steering the ship', the duties created are fiduciary in nature, breach of which gives rise to equitable relief.

It should be noted, however, that the distinction between "order taker" and "portfolio manager" is not always clear. As stated by one Alberta judge:

> *[O]ne should consider the broker-client relationship to be a spectrum ... At one end is a relationship where the broker is merely an "order-taker" for the client, the client does not rely on any advice from the broker, and the broker had no discretion ... Relationships at this end of the spectrum lack the elements of a fiduciary relationship ... At the other end is a relationship of full trust and advice. The broker effectively makes all the decisions because of the great reliance and trust reposed in him or her by the client…. This is exacerbated where the account is discretionary, such that the broker has the authority to make trades without the client's consent or even knowledge … Obviously, there is a fiduciary relationship at this end of the spectrum… Most cases fall somewhere in the middle.*[20]

The division between order-taker and portfolio manager is based on a meticulous examination of the facts. An order-taker makes sales and purchases on the instructions of clients. The advisor may, if asked, agree to give opinions on purchases or sales, and may make it apparent to the client, if not already well understood between them, that these constitute no more than personal opinions, and are not in the nature of considered investment advice.

A portfolio manager employs the elements of trust and confidence and reliance on skill and knowledge and advice. Here, the relationship is fiduciary and the obligations that attach are fiduciary. The circumstances can cover the whole spectrum from total reliance to total independence. In such circumstances a financial advisor's duties are akin to that of any other professional advisor – doctor, accountant, engineer, lawyer – in the sense of being obliged to take reasonable steps to ensure that clients are aware of the available options, and of the main potential benefits and risks associated with them.

Stockbrokers who carry on business in this way accept responsibilities beyond those involved in bringing together buyers and sellers. They undertake the duty of providing careful, competent, considered professional advice of a sort in which clients, especially

[20] *Kent v. May* (2001), 298 AR 71 (QB), at paras. 51-53, aff'd (2002), 317 AR 381 (CA).

those who have no experience of their own to guide them, may well place their complete reliance.

In the case of *Secord et al. v. Global Securities Corporation et al.*,[21] the Court found that the defendant was neither an order-taker nor a portfolio manager, but operated at an intermediate point on the spectrum, although more toward the portfolio manager end of the spectrum.

The client opened a non-discretionary investment account with the advisor. The advisor made recommendations, performed analyses, performed the leg work on any decisions that had to be made, and passed the information to the client who made the final decision on any investment. Eventually, he persuaded the client to try options trading; an investment strategy she had no prior experience with. The accounts suffered significant loss, prompting the client to commence litigation.

The Court found elements of a fiduciary relationship were present – trust, confidentiality, and the complexity and importance of the subject matter, such that it was reasonable for the client to expect that the financial advisor was in fact exercising special skills in the client's best interests. The advisor undertook:

> "*the duty of providing careful, competent, considered professional advice of a sort in which clients, especially those who have no experience of their own to guide them, may well place their complete reliance*", [and thus the obligation arose to] "*take reasonable steps to ensure that customers or clients are aware of the available options, and of the main potential benefits and risks associated with them.*"[22]

The advisor knew that the client was relying on them to provide such advice and to take such steps.

The client relied heavily on the financial advisor for investment advice, particularly with respect to the options trading, and the defendant was well aware of the client's

[21] 2000 BCSC 1544.
[22] *Ibid*. at para. 152.

almost total reliance. The advisor took on the responsibility of giving careful, competent, considered professional advice. The advice was provided in the context of knowing that they were given a significant amount of the client's assets and they knew that she intended to live on those assets for the rest of her life.

(d) The existence of concurrent duties in tort and contract

The financial advisor may be subject to concurrent duties in tort and contract. Concurrent duties arise where an financial advisor professes special skills, and failure to exercise those skills will give rise to liability in both tort and contract. The duties in tort are informed by the statutory and regulatory framework which governs the profession. Duties in contract are informed by the contractual relationship between financial advisor and client.

Concurrent duties in tort and contract were found to exist in the case of *Blackburn v. Midland Walwyn Capital Inc.*[23] The client retained the advisor to handle their investment needs. The mismanagement of their account led to significant losses, which prompted the litigation.

The Court found that duties in tort were established by the existence of regulatory obligations. The obligations required the advisor to complete and update the client's account application forms that contained important information about the client's risk tolerance and investment objectives. There was also a requirement to maintain the ethical standards to provide advice which was appropriate with the client's objectives, and to ensure that all activities were within the bounds of good business practice.

The Court also found the existence of a duty in contract. There was an obvious contractual relationship between the parties; a fee-for-service arrangement. The clients paid commission and margin interest to the firm, and received investment advice as well as processed trades.

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[23] 2003 CanLII 41421 (ONSC).

C. DUTY OF CARE AND NEGLIGENCE

1. What is the content of that duty?

The content of the duty of care owed by a financial advisor was concisely stated in *Young v. RBC Dominion Securities*.[24] Following a review of the Ontario Securities Commission Regulations, the Investment Dealers Association and the Canadian Securities Institute policies, the Code of Ethics and Conduct, and the Conduct and Practices Handbook, as well as the case law, the Court gleaned the following principles:

> a) *Primarily, a broker's relationship with the client is that of agent and principal. The agent takes instructions from the principal and carries them out with care, skill and diligence. Failure to do so may give rise to an action in breach of contract or negligence.*
>
> b) *The liability of a broker in contract and the tort of negligence is concurrent.*
>
> c) *So long as a broker applies the skill and knowledge relied upon and advises fully, honestly and in good faith, the broker has discharged his obligation and is not responsible if the transaction proves unfavourable.*
>
> d) *The extent of the duty of care owed beyond the duty of executing instructions and acting honestly, will depend on the circumstances of each individual case and is a question of fact in each case.*
>
> e) *The standard of care which applies to an inexperienced investor is considerably higher than the standard that exists between a broker and a seasoned investor.*
>
> f) *The duty on behalf of a broker will vary from that of an order taker to that of a fiduciary depending on the specifics of the relationship. This is what has been referred to as the "continuum" or the "spectrum".*
>
> g) *The nature and extent of the broker's duty to his client will depend on the nature of the advice given during their business relationship.*
>
> h) *If the client wants to make an investment that is not suitable for the client, then the extent of the duty to warn depends on the level of sophistication of the client.*

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[24] *Young*, *supra* note 6.

i) *An Investment Advisor must explain the risks of a margin account. Because leveraging can magnify losses, it is critical that an Investment Advisor ensures that the client understands the risks of borrowing to invest, in particular the risks of using collateral, including investments made with monies borrowed, as security for loans.*

j) *The IDA regulations and the Conduct and Practices Handbook establish minimum standards. Breach of the standards is actionable where damages result.*

k) *In addition to proving a breach of industry standards, a plaintiff must also demonstrate causation. There must be a nexus between the breach and the loss suffered. Non-compliance with the standards or regulations do not, in and of themselves, give rise to damages.*

l) *A breach of internal guidelines, even if the guidelines were part of the contract, or indicated a standard of care for negligence, cannot give rise to any liability to the client unless the breach resulted in the damages sustained by the client.*

m) *The cardinal rule of the brokerage business is the "know your client rule". A broker who opens an account for a client is required to obtain from the client an "account application form" (in this case, referred to as the KYC form). The form is to contain detailed information about the client including age, employment, income, net worth, trading experience and trading objectives, as well as personal and family responsibilities. The broker has an obligation to the client to keep up-to-date on the client's circumstances and be informed of any significant changes in those circumstances.*

n) *The "know your client" rule is designed to ensure that portfolios are suitable for the client. Suitability is the cornerstone of the investment industry.*

o) *The concept of suitability involves a consideration of five factors relating to the investor: his age; his income and net worth; his investment knowledge; his investment objectives; and his risk tolerance. "On a best efforts basis", the broker will ascertain all relevant information from the client, such as his awareness of risk and return; the time horizon for his investments, and his net worth.*

p) *The "know your client" rule is related to another fundamental duty owed by the financial advisor to his client, which is to ensure that all investments made for the client are suitable for the client and in keeping with the client's investment objectives and risk tolerances. An investment portfolio created by an advisor for his client must be suitable for the client. The advisor must also monitor the* *ongoing suitability of investments to ensure they continue to remain suitable when there are material changes in the client's personal or financial circumstances, investment objectives or risk tolerances.*

q) *The "know your client" rule and the suitability obligation are interwoven obligations.*

r) *The Investment Advisor's duties with respect to suitability analysis cannot be dodged or somehow left to the client.*

s) *An Investment Advisor is not a guarantor of financial success but owes an obligation to apply an appropriate degree of skill and knowledge and advise fully.*

t) *An Investment Advisor has a duty to make a balanced presentation to a client and to ensure that the client is aware of all positive and negative factors in a transaction, prior to executing a trade.*

u) *A market downturn is not an independent intervening act but rather a foreseeable event that an Investment Advisor should anticipate and so advise.*

v) *There is no law that prevents competent adults from making their own foolish investments.*

The duty of care requires that the financial advisor "Know Your Client". Advisors must make their investment suggestions in the context of an understanding and careful analysis of information about their clients. The client's particular information will inform the standard of care owed by the financial advisor to the client. This duty does not arise simply through the existence of a relationship between client and broker, but from particular circumstances of that relationship.

Take, for example, the distinction between the standard of care for a client who is interested only in speculating and that of a client who relies upon the financial advisor for advice on a long-term investment. The obvious differences in the needs of these clients require different standards of care. Thus:

> *"[t]he standard of care owed by an investment advisor to a particular client is concordant with the services that he advised or undertook to provide to the client,*

> *that is, whether the client was to be provided advice as opposed to mere information or whether the advisor was given discretion to trade on behalf of the client."*[25]

The question then arises as to how far does the duty of the broker extend?

Although a duty to warn the client may exist, this does not extend to the responsibility to see that the client stops what the broker or advisor may assess as imprudent trading. In one particular case the Court stated:

> *"In certain circumstances I can see that at that point there might be an obligation on the CFM [Commodities Futures Merchant] to advise the customer affirmatively that in the view of the CFM trading should stop. Prudence might well require that such a recommendation should not only be explicit but in writing. With the wisdom of hindsight it would have been prudent for Merit to have done so in this case, although in my view it would not have influenced the course of events."*[26]

The Courts have also acknowledged that assessing the facts of a particular case in hindsight will be wrong: *"In reaching a decision in such a case a Judge should be alert to avoid imposing an unrealistic and impractical standard, importing legal niceties to which a layman would be a stranger, and being influenced by the wisdom of hindsight…"*[27] The duty needs to be understood in the context of what the circumstances entail and what can reasonably be expected from the people involved.

As an adjunct to the "Know Your Client" rule, there is a responsibility of the broker that the trades be suitable for the client:

> *[a] fundamental duty owed by the financial advisor to the client [is] to ensure that all investments made for the client are suitable for the client and in keeping with the client's investment objectives and risk tolerances. An investment portfolio created by an advisor for his client must be suitable for the client. The advisor must also monitor the ongoing suitability of investments to ensure they continue*

[25] *Carom v. Bre-X Minerals Ltd*. (1999), 44 OR (3d) 173, 35 CPC (4th) 43 (S.C.J.), at p. 234.
[26] *Merit Investment Corp. v. Mogil* [1989] OJ No. 429 at p. 16.
[27] *Ibid*. at p. 26.

> *to remain suitable when there are material changes to the client's personal or financial circumstances, investment objectives or tolerances …*
>
> *[T]he Know Your Client rule is designed to ensure portfolios are suitable for the client. Suitability of the portfolio is the cornerstone of the investment industry. An advisor must ensure the information being received from the client is consistent and makes sense, that orders being received are in the client's best interests and are suitable for the client. If a client wants to make an investment that is not suitable for the client then the extent of the duty to warn on that point depends on the level of sophistication of the client.*
>
> *For an unsophisticated client, the advisor should warn the client that the investment is unsuitable and if the client does not understand the risks and the harm that could follow the advisor should refuse to execute the instructions even if the client wants the investment. For a sophisticated investor there is still a responsibility to advise the client that the order may not be suitable for them. If the client insists on proceeding notwithstanding the advice, the order can be executed but the advisor should then have the client sign a waiver that they have been advised that the investment is not suitable, but have instructed the advisor to proceed notwithstanding the advice.*[28]

When a new client opens an investment account, they are required to complete a new account form. The information on the form serves as a starting point for determining the investment landscape of the client. The significance of the information on the form is that it relates to the "*fundamental duty imposed upon all registered representatives to know their client. The "Know Your Client" obligation is a prominent feature of the Code of Ethics and Conduct found in the Canadian Securities Institute's Conduct and Practices Handbook….*"[29]

If the advisor's role is more than mere order-taker, failing to stringently follow the new client forms is not demonstrative of a breach of duty, and determinative of liability. In one case it was determined that:

> *"the futures account application form signed by David when he commenced trading contained a section headed "Account Restrictions Imposed," intended for completion by a designated individual at Merit, to indicate the number of*

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28 *Robinson v. Fundex Investments Inc.*, [2006] OJ No. 2976, at para. 114.
29 *Transpacific Sales Ltd. v. Sprott Securities Ltd.*, [2001] OJ No. 597, at para. 29.

> *contracts the applicant would be permitted to trade. This space was completed by insertion of the words "Limit Open." There was much energy expended at trial on the propriety of this insertion and as to its meaning and effect. I mention this only to indicate that it has not been overlooked. In my view, it was intended for internal use only, had no effect on the critical sequence of events, and is not material to the disposition of the issues*."[30]

Thus, there is a limit to the use that should be made of these forms when the advisor is more than an order-taker. They may assist in guiding the investment advice that is provided, but they do not outline strict requirements that comprehensively define boundaries for that advice. In one case the Court noted:

> "*Whether Mr. Abrams' investment expertise is properly described as 'good' or 'sophisticated' is a question of degree and, to some extent, depends on the meaning that different people might ascribe to those terms. I note that in various 'Know Your Client' documents that were prepared in relation to his investment accounts at some of the 10 firms, Mr. Abrams' investment expertise was variously indicated as 'excellent', 'sophisticated' and 'good'*."[31]

The content of forms may not impact the events that follow. There may be much more that influences the investment decisions made, not the least of which is the determinations made by the investor and his or her actual knowledge and understanding.

These documents should be relied on with care. There will be flexibility in how they can be interpreted. This suggests that they do not provide a precise prescription for what the client requires. The care with which the content of the forms should be viewed was summarized in one case as follows:

> "*The experts agree that in September 2000 there was no universal format for a K.Y.C. form. The said K.Y.C. form can be subject to interpretation and to a difference of opinion as to what one financial advisor considers to be a low risk, medium risk or high risk investment as opposed to another financial advisor and that it is not always black and white. There can also be categories or a range of categories within the categories themselves. Not every investor fits neatly into*

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[30] *Merit Investment Corp. v. Mogil, supra* note 26 at page 12 of 30.
[31] *Transpacific Sales Ltd., supra* note 29 at para. 20.

the boxes that are outlined in the Know Your Client form and an advisor, in order to properly assess the risk, has to look at the investor's objectives and profiles."[32]

It may be that, over time, the "Investment Objectives" or the "Approximate Amount of Capital Available for Investment" or the "Approximate Risk Tolerance" will change. The cases recognize that the obligation to "Know Your Client" is a continuing one:

> "*If the advisor becomes aware of a significant or material change in the investor's personal or financial circumstances such as investment objectives or risk tolerances, the industry standard is to update the K.Y.C. form*."[33]

In light of the above, consider the case of *Parent v. Leach.*[34] The client had been actively investing, through the defendant, for approximately eight years. The client alleged that through those eight years, he did nothing other than rely on the advice of the defendant. Accordingly, he alleged, he did not understand the investing he undertook and was unprepared for the losses he suffered.

The financial advisor's failure to make investments that were suitable for the client and that complied with the Know Your Client information on the account forms, constituted a failure of the advisor to "Know Your Client". The failure to update the forms to correspond to material changes to the investment objectives of the client confirmed and compounded the mistake. The advisor failed to comply with the duty owed to the client and formed a basis for the liability of the defendants.

However, the Court found that the advisor did not employ any discretion in respect of the various accounts and trading for the client. Everything was done based on the decisions of the client. The Court found that the client

> *"had been involved in every trade made on his behalf, had lost money, had been warned of the risks in the investments he was undertaking, had been directed to managed investments, had had his margins called and had been required to extend*

[32] *Robinson v. Fundex, supra* note 28 at para. 54.
[33] *Ibid.* at para. 55.
[34] 2008 CanLII 26688 (ONSC).

> *his cross-guarantees to meet the demands of his positions. It is not reasonable to suggest that he was not aware of the risks."*[35]

Therefore, even though the investments may not have been suitable, in that the defendant failed to "Know Your Client", the client approved the transactions. Thus, on the allegation that the investments made were not suitable given the client's investment objectives and risk tolerances, the Court stated

> *"What is the purpose of knowing your client if that knowledge is not acted on by having the resulting investments reflect that understanding? ... Suitability is not to be understood as having a single or absolute meaning. Its application will depend on the client and the circumstances. It cannot be measured looking backwards ... The duty owed by the broker does not act independent and separate from the actions and decisions of the client."*[36]

The financial advisor's understanding developed from an appreciation of the tolerance for risk consistently demonstrated by the trades made by the client. They were part of a pattern that developed over the course of the years, continued despite the warnings of the brokerage. The evidence demonstrated that the client received at least one letter from the advisor advising him of the risks of the trading he was involved in.

Ultimately the Court held that, insofar as the obligation to update the forms is concerned, the broker did not comply with the duty placed on them by the "Know Your Client" rule. However, the Court did not find that this was in any way a cause of the losses suffered by the client. The fact that he failed to heed the warnings, and continued to trade in options when he cannot have helped but known that he was putting the very funds he sought to protect at risk, is not something that the client can blame on others, even if they did not keep their records up-to-date.

When called on to account the advisor is not, of course, answerable as "guarantor", "custodian" or "insurer" … but only to show that he or she reasonably applied the skill and care appropriate to the task undertaken and to the circumstances of the case."

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[35] *Ibid.* at para 128.
[36] *Parent v. Leach*, supra, at para 141.

In *Rhoads v. Prudential-Bache Securities Canada Ltd.*,[37] the financial advisor's duty arose when they advised the client to invest their retirement savings in three mutual funds and in "retractable" preferred shares of two corporations. The advisor company held themselves out as possessing special skills – by offering guidance to would-be investors on "*growing and managing retirement wealth*" and "*keeping investments safe*", and their ability to serve in "ways that no one else can" through the advice of "*two financial advisors with 22 years of combined investment and taxation experience*".

At that point, the advisor was more than an order-taker, and they should have expected that their advice may be relied on as that of skilled, independent professional advisors. Therefore, the advisor was required to demonstrate that they reasonably exercised the skill and care to be expected of professional advisor in their field.

The Court found that having learned that the investment objectives of these unsophisticated new customers was "100 per-cent income" with "minimal risk", the advisor cannot be said to have acted reasonably in then advising them to put two-thirds of their money into growth-orientated mutual funds, without first telling them of the sort of after-tax return they might receive from "income-based" mutual funds and "growth-oriented" mutual funds, as compared with their previous after-tax return from bank interest income, and of the risks associated with each.

Having represented themselves as professional advisors in the way that they did, they were required to provide careful and objective advice having in mind the goals described by their customers, and all the options open.

The Court found that the clients were not prepared to risk their capital in order to seek capital appreciation, but wanted the capital maintained at minimal risk and to continue to live off the income produced by it, and that they so informed the defendant.

[37] 1992 CanLII 658 (BCCA)

In *Brandt v. Moldovan,*[38] the Court underscored the importance of vigilantly adhering to the "Know Your Client" rule, particularly in the context of high risk investments. In that case, the client sustained significant losses in the fall of 2008 as a result of his participation in an option trading program. His investment advisors had failed to conduct a sufficient investigation to determine whether the risky option program was suitable for him.

The Court noted that the information-gathering process behind the "Know Your Client" rule requires more than merely accepting at face value information on account opening forms. Rather an investment advisor must use due diligence to learn the essential facts of a client's financial circumstances, and, in some instances, "put his nose into his client's business". Only then can the advisor make an informed assessment of whether an investment strategy is suitable.

The Court determined that the client was obviously not a suitable candidate for the option trading program – he was 80 years old, retired, and lacked the significant capital resources (or margin) required to "stay in the game" given the unlimited risk associated with option trading. The Court held that if the advisors had undertaken an assessment of the client's suitability for participation in the option program they would have concluded it was not an appropriate investment strategy. Accordingly, the advisors were found liable for breaching their duty to "Know Your Client" since this breach led to the losses incurred.

2. Can you certify a class action against a financial planner?

In *French and Karas et al v. Smith and Stephenson et al.*,[39] the Ontario Superior Court of Justice certified a class action brought by clients of Money Concepts (Barrie) ("MCB") who sustained substantial losses through a complex "leveraging scheme"

[38] 2013 BCSC 1218.
[39] 2012 ONSC 1150.

masterminded by two advisors as a “one size-fits all” investment strategy. This leveraging scheme was based on layering levels of debt for each client. Essentially, clients borrowed as much as possible to buy mutual funds, increasing the clients’ assets under management (AUM). This permitted the advisors to use their clients’ AUM as collateral to have them borrow more money from lenders who advanced loans on the collateral security of mutual funds acquired for each client. The scheme effectively used borrowed money to borrow more money. This financial “house of cards” came crashing down during the 2008 recession.

The proposed class members alleged that the advisors recommended the leveraging scheme “systemically” and that MCB arranged the loans for clients. The plaintiffs alleged they had invested money they did not have, which increased the AUM managed by Investia Financial Services Inc. (the parent company of MCB and a registered mutual fund dealer). This, in turn, increased the fees for the advisors and Investia.

In support of the plaintiffs’ claim was an affidavit of a prominent University of Toronto business professor, and director of the Investment Industry Regulatory Organization of Canada (IIROC). Professor Kirzner opined that adopting a common investment approach for all clients (the allegation made respecting the leveraging scheme) would be a “direct violation of suitability and inconsistent with industry standards”. Furthermore, in any instance where leveraging is considered by an advisor, the first step is to review the “Know Your Client” forms to determine the suitability of this investment strategy. Whether borrowing money to invest is suitable for an investor is dependent on their personal circumstances and a detailed analysis of their portfolio.

Ultimately, the Court found that the plaintiffs had met the required test set out in the Ontario *Class Proceeding Act* and the proposed class action was certified.

The class action settled shortly after certification following lengthy negotiations. The settlement totalled $10 million, including $2.9 million in legal fees for class counsel.

Not surprisingly, particularly given the substantial legal fees which can be recovered by class counsel once a class action is certified, there have been increasingly more class actions involving financial advisors in recent years.

In *Ivany et al. v. Financiere Telco Inc., et al.*,[40] the Ontario Superior Court of Justice certified a class action after 600 investors sustained losses of more than $17 million following an investment scheme masterminded by their advisor Verbeek.

The claim alleges that Verbeek, while a registered representative with Fortune Financial Corp. and Buckingham Securities Corp. told clients they could access their RRSPs on a tax-free basis. Specifically, Verbeek advised clients to access their RRSP funds by using them to purchase the shares of certain Canadian controlled private corporations (CCPC). Clients were advised these shares were investments for locked-in RRSPs. The clients then received loans that were backed by the CPCC shares. Those shares later turned out to be worthless and the clients sustained substantial losses of their retirement savings.

What is particularly noteworthy about the Court's certification reasons is the manner in which the Court dealt with the issue of whether each plaintiff's individual claim shared a "common issue" as required by the Ontario *Class Proceeding Act*. The defendants argued the plaintiffs' allegations of breach of contract, negligence and breach of fiduciary duty would require the Court to assess the suitability of the individual investments proposed by Verbeek to each client. This would effectively render those claims as being incapable of being common issues. The Court rejected this "degree of hyper-commonality" demanded by the defence and concluded the causes of action did disclose common issue. Lauwers, J. accepted the plaintiffs' position that "the

[40] 2013 ONSC 6347.

investment scheme was a scam and entirely inappropriate for any investor", which he found to be a plausible assertion based on the available evidence.

This class action presently remains before the Court.

The Supreme Court of Canada has also recently weighed in on the suitability of class actions as providing a mechanism for access to justice in these types of claims. In *AIC Limited v. Fischer,*[41] the contentious issue at the Supreme Court was whether a class action was the "preferable procedure for the resolution of the common issues". The investors had brought a class action in the lower court against a group of investors who had allegedly engaged in "market timing" causing them to suffer losses in the value of their investments. The mutual fund managers were the subject of an investigation conducted by the Ontario Securities Commission (OSC) and they ultimately entered into agreements with the OSC that paid the aggrieved investors millions. These settlement agreements did not preclude the possibility of future civil proceedings against the mutual fund manager and the investors subsequently applied to certify a class action relating to the same "marking timing" conduct.

The Supreme Court of Canada ultimately sided with the investors, concluding that a class action was the preferable procedure since there was arguably some basis to believe that procedural and substantive "access to justice concerns" still remained following the OSC settlements since the investors had not been compensated for some $335 million in losses.

This Supreme Court decision is also notable because it confirms that a settlement payment in regulatory proceedings does not preclude certification of a class action on behalf of the same investors who received compensation through the regulatory process.

The *AIC Limited* class action presently remains before the Court.

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[41] 2013 SCC 69.

3. Factors for the investment advisor to consider when advising the client

In the case of *Young*, *supra*, the Court outlined the following factors to consider when advising a client:

a) the nature of the future expenditure(s) the investment plan is intended to fund;
b) the client's current level of wealth available for contribution to the investment plan;
c) the actions the client is able to take during the course of the plan to assist in achieving his investment goal;
d) the ability to take compensatory action if the plan is not going well;
e) the client's tolerance for deviations from the plan;
f) planning horizons;
g) the client's personal income tax situation.

D. WHEN IS A FINANCIAL ADVISOR A FIDUCIARY?

1. When is a fiduciary duty owed?

The Courts have identified five interrelated factors that are to be considered when determining whether financial advisors stand in a fiduciary relationship to their clients:

a) *Vulnerability – the degree of vulnerability of the client that exists due to such things as age or lack of language skills, investment knowledge, education or experience in the stock market.*

b) *Trust – the degree of trust and confidence that a client reposes in the advisor and the extent to which the advisor accepts that trust.*

c) *Reliance – whether there is a long history of relying on the advisor's judgment and advice and whether the advisor holds him or herself out as having special skills and knowledge upon which the client can rely.*

d) *Discretion – the extent to which the advisor has power or discretion over the client's account.*

e) *Professional Rules or Codes of Conduct – help to establish the duties of the advisor and the standards to which the advisor will be held.*

These factors should be applied within framework mentioned earlier – along a spectrum where at one end is a relationship of full trust and advice, and at the other end is a relationship where the broker is merely an "order-taker" for the client.

Recall the case of *Hunt, supra*. The Court analyzed the facts against the factors listed above to find that the relationship between the financial advisor and the client was not fiduciary. The client was not vulnerable. He held an executive position during the last period of his career, he had bought and sold shares over the course of his adult lifetime, regularly monitored his accounts, and made his own investment decisions. There was no finding of trust because the client had opened a non-discretionary account. There was no finding of reliance because the client made his own investment decisions, and authorized all of the investments. Lastly, there was no discretion conferred to the defendant. Ultimately, the Court found that the relationship was purely contractual; not fiduciary.

The case of *Secord, supra* is an example of the Court engaging the spectrum analysis to determine that fiduciary duties were owed. The Court used the five factors listed above in determining that the defendants were at an intermediate point of the spectrum, between order-taker and portfolio manager, but one toward the portfolio manager end of the spectrum.

The Court found that, although there was no discretion conferred on the account, the advisor took on the responsibility of giving careful, competent, considered professional advice to the client. The defendant was given a substantial amount of the client's assets and knew that the client intended to live on her assets for the rest of her life. Their advice was given in that context. Moreover, the advisor took on the responsibility of being the client's "teacher". He knew that she was not a sophisticated investor in general and that she was wholly inexperienced with options in particular. He agreed to advise her in the investing of her funds using his expertise and experience, and persuaded her to try options trading. The advisor knew that she was reliant upon him for advice and for education in the workings of the market.

Ultimately, the Court found a fiduciary relationship, and the advisor had obligations consistent with that role. There were elements such as trust, confidentiality, and the complexity and importance of the subject matter, such that it was reasonable for the client to expect that the defendant was in fact exercising their special skills in the client's best interests.

Additionally, as professional advisors, the advisor undertook

> "*the duty of providing careful, competent, considered professional advice of a sort in which clients, especially those who have no experience of their own to guide them, may well place their complete reliance*" [and the obligation] "*to take reasonable steps to ensure that customers or clients are aware of the available options, and of the main potential benefits and risks associated with them*".

In the case of *Brian Gale v. ScotiaMcLeod Financial Services Inc.*,[42] the Court used the five factors to determine that there was no fiduciary duty.

The clients opened an investing account with the defendant. The original 'Know Your Client' form stated that the clients had an "average" trading experience. It stipulated that their investment objectives were "100% Capital Appreciation" and that the risk factors which they were prepared to accept were "100% medium".

The clients eventually opened a margin account and an options account with the defendant. The defendant, properly, reassessed the investment experience as average, the objectives as being 80% capital appreciation and 20% speculative trading, and the risk factors as being 80% medium and 20% high. The issue before the Court was whether the trading which took place was made in accordance with the investment objectives and acceptable risk factors conveyed to the advisor by the client.

The Court did not find the existence of a fiduciary relationship. The client was not vulnerable. He had a sufficient amount of experience in trading options to give him a

[42] 2008 NLTD 152.

clear understanding of the risks, he was aware of the warnings contained in the Options Trading Agreement that he signed, the risks were discussed with the defendant, and he was advised that options trading was risky.

The level of trust was not sufficient to establish a fiduciary relationship. The client had a degree of comfort with the advice provided by the advisor, particularly as the strategies engaged in up to that time had been highly successful. However, it was not a position of absolute trust. The client did not always accept the advice of the advisor, he had rejected a number of recommendations made by him, thus he did not absolutely trust and rely upon every recommendation made by the advisor. The client's independent research of various stocks indicated a personal initiative with respect to investing, not consistent with a position of blind trust of the recommendations.

There was not a high degree of reliance placed upon the financial advisor. The early recommendations and advice from the advisor proved fruitful, thus "*whetted Mr. Gale's appetite for more and more profits and it lead him to accepting more and more risks*." However, the client did not follow the advice of the advisor with respect to the purchasing of certain shares.

The advisor did not exercise any discretion in the acquisition of stock and options on behalf of the client. While the investment in technology stocks were largely the recommendations of the advisor, the extent of those investments was as a result of the client's unreasonable appetite for more and larger profits and that it was he who decided upon the extent of the larger investments made. The Court found that the advisor regularly advised the client to take out his profit and deal with it more conservatively thereafter. However, "*[the client's] greed got the better of him in this regard*".

Lastly, the Court relied on expert opinion to find that the amendments made to the 'Know Your Client' forms complied with the Professional Rules or Codes of Conduct. Based on this analysis, no fiduciary duty existed between the client and the advisor.

Where the client accepts the risks inherent in their investments, the Court may forego the determination of whether a fiduciary relationship exists.

In *Mills v. Merrill Lynch Canada Inc.*,[43] the clients commenced an action against the advisor, alleging negligence, breach of contract and breach of fiduciary duty. The chief complaint against the advisor was that, in breach of the advisor's duty to competently advise her, he did not warn her of the risks associated with her extremely concentrated position in SDL shares and the need to diversify her holdings.

The Court found it unnecessary to resolve the question of whether a fiduciary relationship existed, based on the client's acceptance of the inherent risk in her investments. The client fully understood the essential risk that she faced by remaining concentrated so completely in SDL stock. The client was warned of this by the defendant, but more importantly, the Court found that it was self evident to the client. She was employed by SDL. She knew that she was concentrated and she knew that she risked a decline in the stock value. She had watched the stock closely since her employment started; it was a topic of much conversation among her fellow employees at SDL. She witnessed the stock's startling volatility. At one point, she was watching the stock on the Nasdaq Exchange weekly and at times, daily.

The Court found that the client well understood the course of the declining value of her SDL shares. Her monthly statements from the advisor contained a summary cover page which clearly indicated the declining values of her portfolio. The client and the defendant discussed the pros and cons of selling SDL stock.

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[43] 2005 BCSC 151.

Thus, the client was carefully monitoring her own financial position; she was alive to her concentration in SDL stock and the risk associated with that stock. The client fully understood the danger of her concentrated position in SDL, but she was confident of its prospects and held on to the shares with "*her eyes open to the risk of a declining share price*".

The client understood the inherently high risk of staying concentrated in SDL. The client was on the ground floor closely following a very volatile stock over a lengthy period. The client did not lack the knowledge or experience to evaluate such risks. Ultimately, the Court did not find a breach of the duty of care by the advisor.

2. What is the content of the fiduciary duty?

The content of the fiduciary duty requires the investment advisor to take reasonable steps to ensure that the client is aware of the options, and of the main potential benefits and risks associated with them.

For example, in the case of *Secord*, *supra*, the advisor did not act in the client's best interests when they persuaded her into active and complex options trading. The advisor's advice, upon which they knew the client relied, was not given with sufficient care, and they were thereby in breach of their duty of care. They failed to provide her with advice and education as she built a long-term equity portfolio and they were thereby in breach of the contract.

The fiduciary duty also requires the investment advisor to warn of the risks inherent in any investment.

In *Turcotte v. Global Securities et al.*,[44] the client transferred her investment portfolio of approximately $330,000 to the financial advisor. Previously, her investments had

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[44] 2000 BCSC 1232.

allowed her to withdraw at least $2,471 income per month. She alleged that the defendant stated that it "would be easy" to obtain $3,000 per month.

The client had made it clear to the advisor of her need to preserve her capital but to generate some growth in that capital that would give rise to her required monthly return. She also made it clear that, while her portfolio was placed with her previous broker, she had been receiving $2,471 per month with little or no encroachment on the capital of her investment.

The Court found no evidence that the advisor clearly advised or warned the client of the impact of her monthly withdrawals upon the capital of her portfolio, even though they were aware of her experience with her previous broker. It was reasonably foreseeable that the client would think that, as she had been doing before moving her portfolio, she could continue to withdraw $2,471, if not $3,000, per month without encroaching on the capital of her investment.

The failure of the advisors to warn the client of the consequences of her actions constituted a breach of the duty of care that they owed to the client.

The case of *National Bank Financial Ltd. v. Potter*,[45] illustrates a particularly egregious breach of fiduciary duty. This judgment represents the final chapter in the protracted "Knowledge House" litigation which arose after Knowledge House Inc. (KHI), a Nova Scoria-based, publicly-traded technology company, collapsed in August 2001. KHI had previously risen from penny stock to "tech darling" before collapsing and costing investors millions. Unbeknownst to KHI investors, the company never had real income, a viable business plan or secure financing. Instead the company was kept afloat by manipulative and artificial trading in KHI shares. A "rogue" stockbroker was the main actor in the manipulative trading in KHI shares. The stockbroker's employer National Bank Financial Ltd (NBFL) had failed to supervise the stockbroker properly,

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[45] 2013 NSSC 248.

allowing him to continue trading in a manner than was contrary to statutory and industry regulations, and to the NBFL's own rules.

In assessing whether a fiduciary relationship existed between the stockbroker and the various investors, the Court referred to the five factors listed in *Hunt, supra.* with approval and also noted that an investment advisor (and his/her firm) has a continuing obligation to identify and mitigate any existing or potential conflict of interest.[46]

The Court had no hesitation in concluding that the stockbroker was a fiduciary to his client, and that his conduct had breached his fiduciary duty. The client was a vulnerable, naive and unsophisticated investor who placed his trust and confidence in the stockbroker and relied upon him. The stockbroker understood that the client wanted a diversified portfolio but instead diverted him into margin account and continued to hold KHI shares as security for debt. The Court concluded that the stockbroker had sufficient insight into the risks associated with a client holding KHI shares, particularly when this risky stock was almost his only stock. Accordingly, by failing to diversify the account (and sell KHI shares), he breached his fiduciary duty to the client. The stockbroker did not give full disclosure of what he knew about KHI, including his own very significant investments on behalf of KHI insiders. The stockbroker did not disclose that he had a conflict of interest both in respect of his own holdings and his dealings on behalf of other KHI insiders.

The Court determined that punitive damages were warranted due to the stockbroker's serious breach of his fiduciary duty and NBFL's own "aggressive, no-holds-barred" approach to defending the Dunham case well after NBFL was fully aware of the extent of the stockbroker's fraudulent activities. The Court awarded the client punitive damages of $200,000, stating:

[46] National Instrument 31-103, Registration Requirements and Exemptions (NI 31-103).

> *The public securities market involves enough risks without the risk that an investor's broker or investment advisor cannot be trusted to act honestly and in good faith, especially in those circumstances where the relationship is more than a simple order-taker and rises to a fiduciary-like relationship. Investment advisors are generally looked on as professionals. They have an obligation to act prudently and to protect their client's interests. Their duty is infused by this obligation. Clarke had been on the receiving end of securities industry discipline before his employment by NBFL. His dishonesty toward Dunham is inexcusable. NBFL's duty is infused by this with an obligation to have systems in place to inspect for, monitor, and enforce statutory, exchange, industry, and their own rules. They should not be forced by civil litigation proceeding to carry out their duty.*
>
> *The failure by NBFL to properly monitor him was more than a minor glitch or aberration. It appears in this case to have been a major failing.*
>
> *The aggressive, no-holds-barred, prolonged pursuit of litigation against Dunham, with respect to liability more than quantum, in light of what NBFL knew when it commenced the Main Action about Clarke's misconduct, and which it defended in motions before Justice Scanlan in 2005, is not justifiable. It was, in hindsight, outrageous.*[47]

3. Why does being a fiduciary lead to differing conclusions than mere liability in contract or negligence?

If money is given by a beneficiary to a person in a fiduciary position, the monies are held by the fiduciary as trust funds. The fiduciary owes an equitable duty to account to the beneficiary for the funds. The test for determining whether or not the funds are held in trust by the fiduciary is whether the money was paid over by, or for the account of, the principal.

A fiduciary holding property for the benefit of another must account for that property. The equitable duty to account is well established in law. The fiduciary duty to account extends beyond trust claims to such matters as agents who hold property for their principals. The basis for duty to account is the fiduciary relationship.

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[47] *Ibid.* at paras. 890-892.

The measure of damages for breach of trust involving a failure to account for trust property is that the trustee must make the trust whole. To the extent that monies have been paid over to the trustee or fiduciary which cannot be accounted for, the trustee or fiduciary must make up the difference.

A trustee has the burden of establishing that he has both accounted for and discharged his duty prudently.

The proper approach to damages for breach of fiduciary duty is restitutionary. The clients are entitled to be put in as good a position as they would have been in had the breach not occurred. This includes a substantial expectation loss, flowing from the fact that the client's securities would have increased in value.

A constructive trust is imposed in circumstances where "good conscience" requires it, and to hold fiduciaries and people in positions of trust to the high standards of trust and honesty. Constructive trusts may also be imposed to do justice between the parties, and to maintain the integrity of institutions dependent on trust-like relationships. There are two categories in which a constructive trust may be imposed. The first is where property has been obtained by the wrongful act of the defendant, such as breach of fiduciary duty or a duty of loyalty, and secondly, where although the advisor has not acted wrongfully in obtaining the property, he would be unjustly enriched to the client's detriment if he was allowed to keep the property.

The above principles were reviewed in the case of *Schwarzkopf v. McLaughlin.*[48] The client retained the advisor to invest an amount of nearly $17 million. During the relationship, the advisor liquidated the client's securities and converted them, in large part, to a speculative venture in raw land, and took, for himself and his company, shares in companies which controlled the assets paid for with the client's securities.

The clients' claim was framed in breach of fiduciary duty, and a demand for accounting.

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[48] 2008 BCSC 730.

The Court found that the client was entitled to be restored to the position he was in before the transactions. This included a substantial expectation loss, flowing from the fact that the client's securities would have increased in value. The client had taken steps to mitigate the losses, thereby reducing the monetary claim being advanced.

The defendant's breach of his fiduciary duty and duty of loyalty were sufficient to engage the conscience of the Court and support a finding of constructive trust.

The advisor was under a fiduciary duty in relation to the property at issue. He failed to pass on information to the clients, and allowed his own interest to conflict with those of his client. He acquired property for himself as a direct result of his breach of his duties to the client. The advisor was enriched by the wrongful acquisition of the property.

Finally, the Court found that a constructive trust was required to ensure that the defendant remained faithful to their fiduciary duties and duty of loyalty.

4. Is a downturn in the market "reasonably foreseeable"?

The question of whether a downturn in the market is "reasonably foreseeable" was examined by the British Columbia Court of Appeal.

In *Rhoads v. Prudential-Bache Securities Canada Ltd.*,[49] the clients brought an action in negligence, breach of fiduciary duty and breach of contract against the defendant branch manager, account representative and investment firm for the loss of $132,787.81 suffered by the clients when they liquidated their portfolio soon after the October 19, 1987 stock market collapse known as "Black Monday".

Before the clients retained Prudential-Bache as their financial advisors, the clients had recently retired after selling their business and invested their savings comprising about $600,000 with the defendants. The clients were conservative investors and wished to preserve their capital at minimal risk. Following the account representative's advice,

[49] 1992 CanLII 658 (BCCA).

the clients authorized Prudential-Bache to put $400,000 into "growth-oriented" mutual funds and the balance of $200,000 in retractable preference shares of two large companies.

The Court found the defendants liable, and determined that they failed to seek the facts they needed from the clients when they were initially retained by the clients. The investments selected for them were inappropriate having regard to their circumstances and investment objectives.

On appeal, one of the arguments raised by the advisors was that the loss suffered by the clients was the result of a market downturn for which they had no control. They alleged that the market collapse was unique and unpredictable, and that they therefore could not be held responsible for the clients' losses.

The British Court of Appeal, however, disagreed and found that a "downturn in the market" (and not only a market collapse) was a reasonably foreseeable circumstance. The Court stated as follows:

> *"The appellants say that the decision to sell was made by Mr. and Mrs. Rhoads on the basis of their own fears of a "market meltdown" and that the resulting loss cannot be regarded as a reasonably foreseeable consequence of any of the wrongful acts alleged. They say the October 19, 1987, "Black Monday" market collapse was "unique, unpredicted, and an unpredictable catastrophe", one which affected all stockmarket investments, including those properly described as "income-based", and against which they could not have been expected to warn.*
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> *But the possibility that shares in a growth-based equity mutual fund would decline in value in the event of a downturn in the stock market must have been foreseeable to those in the position of Mr. and Mrs. Yzenbrandt. They would know that there might, at almost any time, be a market downturn, and that should there be a market downturn it might prove to be of minor or major proportion. The contention advanced by counsel for the appellants that the loss incurred by Mr. and Mrs. Rhoads was not reasonably foreseeable, because no one could have predicted the extent of the market downturn which occurred, seems to equate the concept of foreseeability with that of predictability, and this cannot, in my view, be right. Damages may well be foreseeable without being predictable –*

accident injuries, for instance, are *<u>foreseeable</u>* *as a possible consequence of a venture on the highway without being* *<u>predictable</u>* *at the outset of any journey.*

Thus, the Court of Appeal did not interfere with the trial judge's finding that the defendants were liable for the losses suffered by the clients. This case is important in confirming that a "downturn in the market" will likely be considered a "reasonably foreseeable circumstance.

V. THE ROLE OF CONTRIBUTORY NEGLIGENCE OF THE CLIENT:

Contributory negligence is a legal principle which requires that a Court consider whether a client's actions can be said to be a contributing cause to the damage incurred. If the client shares some of the responsibility for his loss with the defendants, then the client will be found contributorily negligent and will not be able to recover 100 percent of his damages from the defendants.

In cases where client clients bring claims against their financial advisors for negligence or breaches of their fiduciary duties, clients are not immune to findings of negligence against them. In certain circumstances, the Courts will make a finding that the client clients bear some of the responsibility for their investment losses, notwithstanding the negligence or breaches of fiduciary duty by their financial advisors.

Whether a client may be contributorily negligent must be decided on a case-by-case basis. However, the discussion below provides examples of situations where the Courts have found the client responsible, in part, for losses suffered as a result of the negligence of their financial advisors.

The question of whether a client can be held contributorily negligent was examined by the British Columbia Court of Appeal in *Hawkenson v. Rogers.*[50] In that case, the clients

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[50] 2006 BCCA 177.

held investment margin accounts at the defendant investment firm. The clients brought an action alleging breach of contract, negligence and breach of fiduciary duty against the firm and their financial advisor employed by the firm. One of the clients' margin accounts had plummeted from a high of $147,100 over total client contributions in May 1996 to $426,840 under total client contributions when the account was closed in November 1997. The account was based on highly speculative investments which were fraught with risk.

The Court determined that the financial advisors had a professional duty to advise the clients to curtail losses and that they were negligent in failing to properly supervise the account during the May 1996 to September 1997 period when the account value declined dramatically. The Court went on to calculate the clients' damages and based his calculation, in part, on the hypothetical assumption that the advisors reviewed their account in May 1996, as they ought to have, and received competent investment advice from the advisors.

Given that the Court applied a hypothetical scenario to determine damages, the Court declined to find the clients contributorily negligent. The Court's position represented the traditional view that there could be no contributory negligence on the part of clients when their brokers were negligent or in breach of their fiduciary duties.

On appeal, the Court of Appeal noted that the application of the apportionment provision in the *Negligence Act* is a two-step process:[51] first, the Court must determine whether the client failed to take reasonable care for his own interests and second, the Court must determine the proportion of the loss attributable to the client's own negligence. The Court found that possible contributory negligence by the client must be a consideration and therefore disagreed with the Court on this issue. The Court

[51] *Negligence* Act, RSBC 1996, c. 333, s. 1.

therefore concluded that a client could bear some liability in contributory negligence if its actions or omissions contributed to the loss.

In the circumstances of this case, however, the Court determined that there was no basis to apportion any of the loss to the client since the loss was wholly as a result of the negligence and breaches of fiduciary duty on the part of the defendants.

In certain instances, a client's failure to make inquiries about the nature of his investments can amount to contributory negligence. This was the case in the Ontario Supreme Court decision of *875121 Ontario Ltd. v. Nesbitt Burns Inc.*[52] In that case, the client corporation claimed damages for the alleged negligence of the defendant financial advisor which resulted in a substantial loss from a mutual fund investment tied to foreign currencies. The loss was occasioned by the currency devaluation of the Mexican peso which occurred on or about December 20, 1994.

The client corporation had purchased the mutual funds with the goal of ensuring that its capital would be preserved, although it was prepared to accept some small risk. The devaluation of the Mexican peso was an unexpected event and the Court accepted that the client did not appreciate that there was any risk that could be termed real or substantial associated with the capital of the investment.

The Court found the advisor liable in negligence for failing to properly disclose the degree of risk in the investment. However, the Court also found the client contributorily negligent for failing to make specific inquiries which would have alerted it to the degree of risk in its investments. The Court noted the following:

> *…I conclude on the evidence that while the plaintiff relied on Lynch, Shipper did not make any inquiry in the context of knowing that there was some greater risk*

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[52] [1999] OJ No. 3825 (ONSC).

> *than the previous investments, whether the risk could possibly impair capital as opposed to reducing by a small percentage the return on the investment.*
>
> *As a result of Shipper's failing to make the specific inquiry, Lynch may well have been lulled into believing not only that Shipper understood but accepted the increased risk. I therefore find that Shipper's failure to inquire contributed to the incomplete disclosure.*[53]

Thus the Court determined that the client was responsible, in part, for its own loss by failing to make reasonable inquiries about its investments. In the circumstances, the Court deemed the client and the advisor equally at fault.

Another example of contributory negligence is when a client fails to limit his own losses when he is in a position to do so. In *59698 Ontario Inc. v. Midland Walwyn Capital Inc.,*[54] the client was an experienced speculator trading in futures options. The defendant Midland Walwyn Capital Inc. ("Midland Walwyn") was his broker, and the defendant, Dennis Ho, was an employee of Midland Walwyn.

In July 1994, the client lost $105,900 when Ho failed to properly execute certain orders relating to trades. The client again lost money later in August 1994 due to Ho's failure to close all outstanding index positions when the Toronto Stock Exchange reached a certain index value. The above omissions by Ho were contrary to the client's instructions.

On August 11 and August 22, 1994, Ho called the client to advise that he had not executed the client's order. The client did not provide Ho with further instructions. The client arranged for Ho to attend at his home and had Ho sign a letter acknowledging full responsibility for the loss arising from Ho's failure to follow the client's order. On Ho's promise to absorb the loss above a certain limit, the client

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[53] *Ibid* at paras. 66 and 67.
[54] [1999] OJ No. 25.

agreed not to mention the matter to Midland Walwyn. When the client's order was finally executed, the loss was $683,000.

The Court found that the client's instructions to Ho were ambiguous and between August 11 and August 22 when the client became aware that Ho had failed to execute the client's order, the client adopted a "do nothing strategy". The Court also determined that in view of the non-liquidity of the contracts and options, and the client's failure to give Ho any further guidance during this period, there were not enough trading opportunities to allow Ho to restrict the client's loss to a lower figure than his actual loss.

The Court determined that a substantial part of the client's losses were attributable to his own conduct:

> *The evidence, in my view, demonstrates that a substantial part of Hu's losses can be accounted for by his own conduct. He had an exalted view of his trading expertise. Having made substantial profits in the first half of 1994, he decided to "go for broke". When he saw the market moving against him, he took off, leaving ambiguous instructions. Acting either alone or jointly with Ho, he made a decision between August 11 and August 22, 1994, to engage in a "do nothing" strategy. He then skillfully obtained an acknowledgment from Ho which he believed would legally blindside Midland Walwyn and then agreed with Ho to conceal the information from Midland Walwyn for as long as possible.*[55]

Although both Ho and Midland Walwyn were held liable to the client, the Court reduced the damages awarded to reflect the client's own negligence. The fact that the client failed to limit his losses during the August 11 to 22 period when he had an opportunity to do so was sufficient for the Court to find him contributorily negligent.

A similar conclusion was reached in *National Bank v. Potter, supra*. In that case, the Court had little difficulty in concluding that "but for" Clarke's fraudulent stock

[55] *Ibid.* at para. 45.

manipulation activities, the substantial losses incurred by the investors Weir and Dunham would not have occurred. The plaintiffs were not required to establish causation with "scientific exactitude". A common sense approach was sufficient. The Court concluded that Weir would have sold his KHI stock and Dunham would have diversified his portfolio were it not for Clarke's *"deliberate refusals to execute sell orders and the creation of an artificial price and volume in the KHI shares"*. The market manipulation deprived Dunham and Weir of the information they needed to make informed decisions with respect to their portfolios. Ultimately, the Court concluded that "but for" Clarke's failure to disclose his market manipulation and ongoing conspiracy, Dunham and Weir would have liquidated their entire position in KHI.

However, the Court arrived at a far different conclusion regarding the investor Wadden because Wadden had discovered the market manipulation and conspiracy. Wadden was *"faced with a choice of losing everything and then suing to recover his losses or participating in the scheme with the hope that he would be able to find a buyer to allow him to sell his shares and exit the conspiracy"*. Wadden chose the latter. The Court was far from sympathetic to Wadden's predicament, stating:

> *Wadden was certainly faced with a difficult choice, but it can hardly be said that "but for" the actions of Clarke, Wadden would not have suffered the losses he experienced. Wadden's losses occurred after he assumed the risk and responsibility of holding the second largest stake in the equity of KHI.*
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> *Wadden knew about the box account and that KHI was being manipulated by Clarke and others. He took a chance; it did not pay off. It was Clarke that pushed Wadden to the precipice, but it was Wadden who chose to remain there, and it is Wadden that must bear the responsibility for any damages that resulted from him falling off.*[56]

[56] *National Bank Financial Ltd., supra* note 45.

Another situation where a client may be found contributorily negligent is where the client has failed to read the mail received from his financial advisor. This was the situation in *Penner v. Yorkton Continental Securities Ltd*.[57]

In that case, Penner sued Yorkton and its employee Buskell for negligence and breach of fiduciary duty. Penner opened a commodities trading account through Buskell, a broker employed by Yorkton. Penner's account was opened in December 1989 and it was closed ten months later on September 30, 1990. Penner's loss was $468,922.99.

The Alberta Court of Queen's Bench found that Yorkton and Buskell were both liable to Penner for gross negligence. The Court found that Buskell was guilty of making numerous improper and complicated transactions using Penner's funds without Penner's knowledge or permission. Buskell also failed to advise Penner of the significant losses which Penner was suffering, and attempted to conceal these losses by making further transactions with Penner's funds.

The Court also found Yorkton liable in gross negligence on the basis that its systems were "sloppy" and it failed to carry out the most basic steps to supervise Penner's account given the excessive losses and transfers which were occurring in his account.

On the contributory negligence issue, the Court also determined that Penner was 25% contributorily negligent. Yorkton had mailed account statements regularly to Penner throughout their ten month relationship. However, Penner stopped opening his mail after only a few weeks as he became bored and disinterested; he was content to rely on information he received from Buskell during their telephone conversations. The Court concluded that if Penner had opened his Yorkton mail, at some point in time he would have discovered that his accounts were being mismanaged and suffering significant losses. Further damage could therefore have been avoided. The fact that Penner did not review his mail gave rise to the finding that he was contributory negligent.

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[57] (1996), 10 CCLS 248 (ABQB).

The cases described above highlight the fact that client clients may bear some of the liability for their losses if the Court determines that they failed to act reasonably in all the circumstances, and their negligent conduct caused or contributed to their losses.

VI. "RATIFICATION" AS A DEFENCE:

Even where a financial advisor is negligent or breaches a fiduciary duty owed to a client, in certain circumstances the advisor may rely on the *doctrine of ratification* to defend any allegations of a breach of duty of care or fiduciary duty. The doctrine applies where a client ignores or "turns a blind eye" to a wrongful act (such as unauthorized trading) committed by its financial advisor or broker. The client's conduct in ignoring the wrongful act amounts to a *ratification* of the wrongful act, and the client is treated at law as approving of the wrongful act.

The doctrine was explained by the Ontario Court of Appeal in the case of *Hunt, supra*, where the Court provided the following definition of "ratification":[58]

> [T]*he adoption and confirmation by one person with knowledge of all material facts, of an act or contract performed or entered into in his behalf by another who at the time assumed without authority to act as his agent. Essence of "ratification" by the principal of act of agent is manifestation of mental determination by principal to affirm the act, and this may be manifested by written word or by spoken word or by conduct, or may be inferred from known circumstances and principal's acts in relation thereto.*

For the doctrine of ratification to apply, the Court confirmed that ratification by the client must be based on knowledge of all the material facts and may be express or implied.

[58] 2003 CanLII 3649 (ONCA), at para. 65.

In *Davis v. Orion Securities Inc.*,[59] the Ontario Superior Court of Justice neatly explained the doctrine:

> *The client cannot simply turn a blind eye to wrongful acts which he alleges that his broker has done, such as unauthorized trading. Upon discovery of the fact, the client may elect to either repudiate or ratify any wrongful act of his broker, no matter how serious and no matter what its nature. Ratification may be established by express assent or by implication from acquiescence or failure to repudiate within a reasonable time after being informed by the broker of what he has done. If not repudiated by the client, the transaction is treated as having been ratified and is binding on the client as if authorized in the first instance. …*

An example of the doctrine being applied is *Hunt*, *supra*. The Court of Appeal found that the Hunts had knowledge of the sale of the BCE shares within ten days of the completion of the transaction. Clearly, the Hunts never *expressly* ratified the sale. The Court of Appeal then looked at whether the Hunts ratified the sale of the BCE shares by *implication* (through their conduct).

The broker argued that ratification can be implied from the Hunts' conduct in that they continued to process sale transactions through Schram for a lengthy period after becoming aware of the unauthorized sale of the BCE shares. They argued that the Hunts were obligated to take positive steps to repudiate the sale within a reasonable period after becoming aware of the unauthorized sale.

The Court of Appeal found, however, that Melville Hunt did not sit by and do nothing. He complained about the unauthorized transaction as soon as he received the transaction slips in the mail and he continued to complain about the unauthorized transactions thereafter. The Court therefore distinguished the facts in this case from the facts in earlier cases, where the Courts found that there was implied ratification as a

[59] 2006 CanLII 26966 (ONSC), at para. 57.

result of the clients remaining silent about the unauthorized transactions while they continued to process other transactions through their broker.

The Court determined that the Hunts repudiated the unauthorized transaction, and therefore did not ratify the transaction:

> *In my view, the Hunts' complaints amount to express repudiation of the unauthorized sale. While continued dealings may be evidence of ratification, it is not determinative. In my view, ratification cannot be implied in the face of continuing repudiation even when the investor continues to use the broker for other transactions.*
>
> *The Hunts were faced with shares that had been sold and a choice of what to do with the proceeds. They chose to use the sale proceeds to make other investments. In light of their continued express repudiation of the sale, the fact that they did not choose to repurchase BCE shares does not amount to ratification by implication nor does their continued course of dealing with Schram.*[60]

Given the Court's findings that there was no ratification by the clients, the defendants could not rely on the doctrine of ratification as a defence, and were therefore liable for the clients' losses.

Another recent example of a case in which a Court applied the doctrine of ratification is *Davis v. Orion Securities,*[61] which involved a negligence claim against the client's investment broker and the securities firm, Yorkton, which employed the broker. The claim for damages in the action related to the period from September 27, 2000 to September 30, 2001 (the "Claim Period") during which time the client had a securities margin account with Yorkton, and traded through the defendant broker.

All buy and sell transactions carried out by Yorkton for the client's margin account during the Claim Period were documented and reported to the client in accordance with the accepted practices of the securities industry. In accordance with the applicable

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[60] *Ibid* at paras. 75 and 76.
[61] 2006 CanLII 26966 (ONSC).

margin account agreement dated May 18, 2001, each monthly statement of account delivered by Yorkton to the client included a statement that "Failure to object to incorrect or unauthorized trades within 30 days to the Director of Compliance at our Head Office address constitutes ratification by you of these trades". The client's account was a non-discretionary account.

During the Claim Period, the estimated market value of the securities in the client's margin account fluctuated from a high of $393,591.37 to a low of $140,000. However, at the end of September 2001, the estimated market and equity values were reduced to $709.18 as a result of a margin call by Yorkton. The client alleged that the Claim Period comprised a series of "disastrous trades" in "inappropriate stocks". The client alleged that the defendant broker purchased on his behalf a total of 5,000 shares of Entrust Tech Inc. in two trades on May 25, 2001, which trades he claims were unauthorized and in violation of his non-discretionary account.

Looking at the facts, the Court determined noted that the client was aware of the Entrust trades, brought them to the broker's attention and made no complaint at the time. The Court observed:

> *In this case, Davis alleges that the purchase of 5,000 shares of Entrust on May 25, 2001, during the Claim Period was unauthorized. His evidence is equivocal. He did discuss these transactions with Meliambro and he did not repudiate them. He did not testify as to any other unauthorized trading by Meliambro in the Davis account. The cases cited by the plaintiff's counsel … involved "rogue" brokers who were regularly engaging in unauthorized trading, churning and other wrongful acts, and deliberately concealing them from their clients. Evidence of such conduct is absent in this case.*[62]

Since there was a failure by the client to repudiate within a reasonable time after he became aware of the Entrust trades, there was ratification of the trades by the client, and the client's action was dismissed.

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[62] *Ibid.* at para. 59.

Ratification was also discussed in the recent case of *National Bank Financial Ltd. v. Potter*, *supra*. The defendant NBFL argued that various investors had acquiesced and therefore ratified the impugned transactions undertaken by the "rogue" stockbroker Clarke since they had failed to complain about the transactions in their respective accounts.

The Court concluded that none of the clients, except for an investor named Wadden (who learned of and then later became a member of the stock manipulation scheme), were aware of Clarke's market manipulation scheme in KHI and his fraudulent behaviour. The Court concluded that Clarke's market manipulation was a "material circumstance" and the clients could only be found to have ratified the transactions through their acquiescence *if* they were aware of Clarke's fraudulent behaviour. Accordingly, the defence of ratification was defeated with all investors, except for Wadden, and the Court accepted the investors' argument that they "could not ratify that of which they were unaware".

VII. DUTY OF THE CLIENT TO MITIGATE LOSS:

A. IS THE DUTY TO MITIGATE THE SAME WHETHER THE CLAIM IS IN CONTRACT OR BREACH OF FIDUCIARY DUTY?

As with tort law, any damages for breach of contract will be disallowed to the extent that a client has failed to mitigate (i.e. taken steps to minimize or avoid) his or her losses. The question then arises whether there is also a duty to mitigate for breach of fiduciary duty.

As discussed earlier in this paper, in *Secord*, the BC Supreme Court found a fiduciary relationship between the client and the defendants whereas in *Hunt*, the Ontario Court of Appeal overturned the trial judge's finding of a fiduciary relationship and found that there was no fiduciary relationship in that case. However, in assessing damages, the Court in *Secord* declined to "*discuss the special considerations arising from breach of fiduciary* *obligations*" for no equitable relief had been sought,[63] whereas the Court in *Hunt* decided to consider whether the duty to mitigate would have arisen had the unauthorized sale amounted to a breach of a fiduciary obligation.

The Court first looked to the case of *Canson Enterprises Ltd. v. Boughton & Co.*,[64] wherein LaForest J. stated the following in dealing with principles of law and equity: "*…barring different policy considerations underlying one action or the other, I see no reason why the same basic claim, whether framed in terms of a common law action or an equitable remedy, should give rise to different levels of redress*."[65]

In a concurring judgment in *Canson*, McLaughlin J. (as she then was) distinguished between the different policy considerations underlying tort and contract from breach of fiduciary duty. In tort and contract, a party is expected to pursue their own best interest. Once the tort or breach of contract has been committed, this expectation continues in that they will mitigate any loss. However, in a breach of fiduciary duty, the fiduciary has assumed responsibility to act in that party's best interest. It would be somewhat inconsistent to require a party who ceded control to the fiduciary to remain eternally vigilant of their own self interest. While at some stage the party may be expected to reassume the primary function of safeguarding their own interest, McLachlin J. indicates that this point will only arise when a party, "*after due notice and opportunity, fails to take the most obvious steps to alleviate his or her losses*," at which time it may be concluded that the party is now "*the author of his [or her] own misfortune*."[66]

Then Court then returned to LaForest J.'s above statement on law and equity which he revisited in *Hodgkinson v. Simms*.[67] In *Hodgkinson*, the client invested in a real estate development on the advice of his accountant, a specialist in the area. After the

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[63] *Secord*, *supra* note 21 at para. 196.
[64] (1991), 85 DLR (4th) 129 (SCC).
[65] *Ibid*. *Hunt*, *supra* note 11 at para. 108.
[66] *Canson*, *ibid*.; *Hunt*, *supra* note 11 at paras. 109-110.
[67] (1994), 117 DLR (4th) 161 (SCC).

development fell through, the client learned that his accountant was also acting for the developers. The client argued that had he been aware of that fact, he would not have invested in the development. LaForest J. then connected the client's right to equitable remedy in those circumstances to a duty to react and mitigate loss once the client learned of the breach or within a reasonable time thereafter.[68]

On the duty to mitigate for breach of fiduciary duty, the Court in *Hunt* concluded:

> *The majority judgment in Hodgkinson, together with the judgment in Canson, indicate that where a breach of fiduciary does not raise policy concerns that militate against imposing a duty to mitigate, and the rationale behind the common law duty to mitigate is applicable, then equity will impose the same obligation to mitigate in order to avoid unnecessary loss*.[69]
>
> [Emphasis added]

Applying the above law to the facts in *Hunt*, the Court found that no matter whether the wrongful sale of shares was a breach of contract or a breach of fiduciary duty (which it already found to be the former), there were no policy concerns to weigh against imposing a duty to mitigate. Mr. and Mrs. Hunt were required to mitigate and purchase replacement shares shortly after discovering the breach.[70]

B. WHAT IS REQUIRED TO MITIGATE AND HOW QUICKLY DOES THE CLIENT NEED TO ACT TO MINIMIZE LOSS?

In discussing what is required to mitigate, a more detailed discussion of mitigation is warranted. Mitigation of damages is the principle that a client may not recover losses which could have been avoided by taking reasonable action once they learned of the wrong. What this action entails will depend upon the circumstance of the case. For example, where a broker fails to complete a sale of shares or real estate in a rising

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[68] *Hunt, supra* note 11 at paras. 111-113.
[69] *Hunt, supra* note 11 at para. 114.
[70] *Hunt, supra* note 11 at paras. 115-116.

market, the client would normally be expected to purchase replacement shares or real estate within a reasonable time to mitigate their loss.[71]

In *Secord*, the client relied on inadequate advice with regards to options trading thereby exposing her to higher risk than she intended. Approximately 6 months after she transferred her portfolio to another firm. The advisor argued that the client ought to have acted sooner to mitigate her losses. The BC Court of Appeal upheld the trial judge's finding that in this instance six months was a reasonable time frame to mitigate her losses. Upon review of the case law, the Court found:

> *… in deciding on the extent of the duty to mitigate and the appropriate measure of damages, a Court must have regard to the particular factual circumstances of the particular case to arrive at a just result. Due regard must be paid to the nature of the portfolio or the transaction in question and as well as the experience and sophistication of the client. A not entirely irrelevant factor is a consideration of whether the relationship between the client and broker has entirely broken down to the point where the broker has lost the confidence of the client. …*
>
> *In the instant case, the trial judge found, and in my view was entitled on the evidence to find, that the brokers were not acting appropriately in advising Mrs. Secord to embark on trading in options. Such a course was out of accord with her express intentions as to what she wanted to achieve in her portfolio. The course adopted led to significant losses as a result of the option trading. The client said that she had zero trust in her advisors after she examined what had happened… Although this client had some experience in trading securities,… it seems to me that she was not knowledgeable or well informed about this type of trading. I am of the view that she acted reasonably in taking a period of time to assess the situation herself and in proceeding to find a new advisor in whom she would have confidence.*[72]

In the above quote, the Court of Appeal focused more on the client's lack of sophistication and reliance on her brokers to provide appropriate advice in line with her stated intentions. The Court also made reference to "*the nature of the portfolio or transaction in question*." This aspect of consideration was explained by Smith J. in her

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[71] See *Secord*, *supra* note 21 at para. 178.

[72] 2003 BCCA 85 ("Secord Appeal") at paras. 40-41. See also *Laflamme Inc. v. Jules Roy and Prudential-Bache Commodities Canada Ltd.,* 2000 SCC 26, wherein the Court found it to be reasonable to allow the client a year to assess matters and move the account.

trial judgment noting that the period for mitigation of loss will generally be very brief when dealing with shares or other securities which are readily transferable as opposed to assets which have substantial physical bulk or lack an active market which will be afforded a longer mitigation period.[73]

In *Hunt,* the Court affirmed that the starting point in determining the mitigation period is that "*the obligation to purchase like shares arises on the date of breach or knowledge thereof in the injured party*".[74]

However, the Court emphasized that "*the process of determining the mitigation period is not a mechanical one; the period must be a reasonable one, in light of all of the circumstances*."[75] Upon review of the case law, the Court held that the following factors warrant consideration in determining what is reasonable:

1. Ease of purchase of replacement shares -- which involves considering the number of shares to be purchased, whether they are readily available in the market, and the time and risk involved in the purchase;
2. The degree of sophistication and experience of the investor;
3. The degree of trust reposed in the broker;
4. Whether the broker was obliged to follow the investor's instructions in making transactions; and
5. Whether the relationship between the investor and broker has broken down to the point that the client has lost confidence in the broker.[76]

In applying these factors to the facts of the case, the Court found:

1. The repurchase of BCE shares would have been relatively easy given that the

[73] *Secord*, *supra* note 21 at para. 188.
[74] *Hunt, supra* note 11 at para. 95.
[75] *Ibid*. at para 96.
[76] *Ibid*. at para 97.

shares were readily available in the requisite quantities on the market and they had the financial means to do so;

2. Melville Hunt had experience in purchasing BCE shares having done so for a lengthy period prior to the unauthorized sale;

3. The relationship between the Hunts and their broker was such that, in comparison to other cases such as *Secord*, there was a lesser degree of trust reposed in the broker;

4. The Hunts had a non-discretionary account and, save for the unauthorized sale, the broker had followed their instructions in every case; and

5. The relationship between the Hunts and their broker had not broken down and they had continued to use him for several months following the unauthorized sale.[77]

The Court held that in these circumstances a brief mitigation period was reasonable, for "*to impose a duty to mitigate on the Hunts at a date later than that would be to permit them to speculate at the broker's expense*."[78]

Given that the price of BCE shares dropped after the mitigation period expired, the Court found that the Hunts were only entitled to recover the costs associated with the unauthorized sale including taxes, transaction costs and commissions. Had they

[77] *Ibid*, at paras. 99-102.
[78] *Ibid*. at paras. 98 and 105.

purchased replacement shares, they would have been entitled to those transaction costs and commissions.[79]

Therefore, an investing party's duty to mitigate is not triggered until they learn of the broker's error or omission or within a reasonable time thereafter. What is reasonable will depend on the facts of the particular case. From the above case law, we see that the law will afford a more generous mitigation period to an unsophisticated client who has a fiduciary relationship with their broker as opposed to a client who has more knowledge and control over their investments. Assets with less transferability will also be afforded a longer mitigation period. In mitigating their losses, the party has two options: (1) buy or sell, as the case may be, and claim damages for any losses incurred thereby, or (2) stand still, in which case their losses will be deemed to have crystallized after the expiry of a reasonable mitigation period.

In *Andrews v. Keybase Financial Group Inc.*,[80] the Court considered the issue of mitigation in the context of the 2008 recession. Nine clients commenced separate actions against their former financial advisor and the mutual fund dealerships where he worked. The advisor had forged "Know Your Client" information by inflating the value of his clients' assets and the extent of their investment knowledge as part of a fraudulent leveraged investment strategy.

At issue was whether the clients had a duty to mitigate their losses by selling their investments and paying down their loans as far as possible, once aware of their predicament (before the recession in 2008). The defendants argued that by not "cutting their losses" within a reasonable mitigation period after learning of their true financial situation during the fall of 2007, the clients made a conscious choice to accept the market risks in keeping their investments going forward and any future losses beyond

[79] *Ibid*. at para. 106.
[80] 2014 NSSC 31.

the mitigation period were their own responsibility. The defendants relied on *Hunt, supra,* discussed above.

The court distinguished *Hunt* on the basis that it involved reasonably knowledgeable investors and had not been vulnerable or relied on the broker's advice. The relationship found to exist was only a contractual one. The Court concluded that here Keybase Financial Group clearly owed an ongoing fiduciary duty to the clients who were all unsophisticated investors having little to no investment knowledge. In rejecting the failure to mitigate argument, the Court stated:

> *So what were these plaintiffs to do, particularly in their state of mind at the time? They only had two choices: sell or stay the course. Some of the plaintiffs did not fully understand they had the option to sell (as earlier canvassed in this decision). Those who did understand the availability of that option did not have the financial resources to pay the early redemption fees and take the loss. They were, in the vernacular, between a rock and a hard place, trying to deal with what was for them a highly complex situation. Indeed, this is another situation where it is apt to adopt the language in Laflamme that"an average investor faced with similar circumstances would have been indecisive and hesitant when faced with the various options".*
>
> *Whether through indecisiveness, lack of resources or conscious choice, all of these plaintiffs stayed the course. In hindsight, it was not the right route to take. However, in my view, they cannot be faulted for that. It bears repeating that Keybase never actually recommended the selling option to anyone, notwithstanding the unsuitability of this type of investment. Rather, the plaintiffs were in some measure enticed to stay the course which was in the best interest of Keybase, not theirs.*[81]

The Court found that the defendants had failed to meet the burden of establishing a failure to mitigate. The Court further commented that a failure to mitigate will be more difficult to establish in the context of a fiduciary relationship. Ultimately, the Court chose the trial date as the valuation day to be used calculating the plaintiffs' financial losses.

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[81] *Ibid* at paras. 187-188.

VIII. MEASURE OF DAMAGES - DEMONSTRATING ALTERNATIVE INVESTMENTS:

It is incumbent upon a client to lead evidence as to what alternative appropriate investments were available and would have been made instead of the improper investments for which the client alleges to have suffered a loss.

In the case of *Young v. RBC Dominion Securities,*[82] the clients claimed that Mr. Houghton breached his duty of care to them by failing to know his clients; update their KYC forms; recommend investments consistent with their goals; re-adjust their investments to comply with these goals; and give them appropriate cautionary advice regarding their over-concentration in high tech stocks. In addition, the clients claimed that RBC had not adequately supervised Mr. Houghton.

The Court found that Mr. Houghton had not breached his duty of care to his clients and that he was more of an order-taker than a fiduciary. Moreover, by the time that they began to invest in high tech stocks, both clients were knowledgeable and well-informed investors and Mr. Houghton communicated with and advised them regularly — in particular, about the risks associated with overconcentration in Nortel and other high tech stocks. The Court rejected the clients' submission that Murray was as an unsophisticated investor dependent on Mr. Houghton. Since the Court found that there was no breach, it did not have to assess the amount of damages to which the clients would have been entitled. Nonetheless, the Court did state the following with regards to damages:

> *… I was given no damage brief, nor was expert evidence called by the Clients with respect to the issue of damages. I was simply provided with two spreadsheets (one for Mrs. Young and one for Murray Young) which purported to set out damage calculations. In my view this was not sufficient.*

[82] 2008 CanLII 70045 (ONSC).

> *Firstly, the Plaintiffs did not lead evidence with respect to what alternate appropriate investments would have been made instead of the alleged impugned concentration in technology stocks (see for example, Lockwood v. Nesbitt Burns Inc., [2000] O.J. No. 2857 and Blackburn v. Midland Walwyn capital Inc., [2005] O.J. No. 678 (C.A.)). Moreover, the damage assessment itself is fundamentally flawed in the circumstances of this case. Essentially the issue in this case was the over concentration of technology stocks in these portfolios. There is no doubt, on the evidence before me, that some holding of technology stock in these portfolios was appropriate. No expert evidence was led as to the appropriate amount. Any damage calculation would have to take into account an appropriate holding of technology stocks. The Plaintiffs' calculations have assumed that everything would or should have been sold.*

The evidence as to what alternative appropriate investments would have been made include a requirement on the part of the client to produce a "hypothetical" portfolio of their investments had the breach not occurred.

In *Hawkenson v. Rogers,*[83] the client sought damages for losses incurred in a company investment account managed by the investment advisor. Over the course of approximately six months, the account had accumulated a concentration of speculative investments in excess of the investment objectives indicated in the account application. The account had initially done well; however, as a result of the fall in value of some of the speculative investments, the client lost a significant sum of money. The Court's decision that the investment advisor was negligent in his duty to advise the Client to mitigate his losses and divest numerous speculative investments was not challenged on appeal.

The result was that the investment advisor was liable for the difference between the actual performance of the account and the performance of a hypothetical account which would have been in place had the Defendant not breached his duty of care. The Court

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[83] 2006 BCCA 177.

highlighted that in assessing damages, "[t]*o be effective, the judge's approach to assessment required an analysis of the market performance of the hypothetical portfolio.*"[84]

Therefore, it is important to bear in mind that when a client is claiming for damages, a Court will require that the client provide evidence in the form of a "hypothetical" portfolio as to what alternative appropriate investments would have been made instead of the erroneous investments that were recommended.

IX. DAMAGES - SUBTRACTING PROFITS EARNED DURING THE RELATIONSHIP:

This question was addressed by the Court in *Secord, supra*. In that case, the financial advisor argued that the client had suffered no loss and the Court had to determine whether the client was entitled to keep the profits she made on the shares purchased by the defendants or would that amount to double recovery and be unfair in the situation.

The Court found that to answer this question, it was necessary to look to the time at which damages should be assessed, the duty to mitigate, and the treatment of potential losses that do not materialize because they are avoided by the client. After so doing she concluded:

> *The essence of that analysis is that the mitigation period, at least in the context of sales of shares, is very brief. The actual loss is the loss at the date of the breach, and subsequent gains or losses in the share value are to the benefit or detriment of the plaintiff. This is so despite the fact that the plaintiff in Jamal would not have possessed the shares, and thus would not have been in a position to resell them, but for the defendant's breach.*
>
> *However, the rule that the loss to be ascertained is the loss at the date of the breach is not absolute. It permits of exceptions which are framed by two other principles: the duty to mitigate and its corollary, the necessity to account for avoided loss. In sum, where the circumstances are such that the plaintiff has a duty to mitigate his or her losses, he or she will be given a reasonable time to do so and if, during that period, the plaintiff takes steps in mitigation which in fact*

[84] *Ibid*. at para. 39.

> *avoid losses, the plaintiff is only permitted to recover for the losses he or she has actually experienced.*[85]

The Court's assessment of damages was upheld on appeal except for her awarding $20,000 relating to commission fees as this amounted to double recovery.[86]

In *Brandt v. Moldovan*, *supra*, the advisors were found liable on the basis that they had failed to exercise reasonable care in assessing whether participation in a risky option program was suitable for the client. The client sought damages of $311,291 based on the losses he incurred. The defendants argued that the client's earlier gains (incurred while he was a client at the defendants' previous brokerage) should be taken into account because the impugned transactions and trades were "linked" as part of a "systematic approach" to producing income through the action of selling combinations of options. The Court accepted this approach towards assessing damages based on the conclusion that "but for" the advisors' negligence, the client should and would have been excluded from the program at the outset. Accordingly, both his gains and losses had to be taken into account in order to put the client back into the position he would have enjoyed had the breach of duty not occurred. Damages were assessed at approximately $212,952 on this basis.

X. CONCLUSION:

As has been noted above, the liability exposure for financial advisors is very fact-specific. Courts are guided by a variety of sources to determine not only the existence of a duty, but the nature and scope of that duty which a financial advisor owes to a client.

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[85] Secord Trial, *supra* note 21 at paras. 176-177.
[86] Secord Appeal, *supra* note 21 at para. 42.

Provinces have done little to regulate financial advisors. Rather, the regulatory regime arises from a variety of industry based "rules" and principles which serve to guide financial advisors. The key regulatory "rules" are that a financial advisor must "know your client" – in other words, they must in a general sense know their client's tolerance for risk and investment goals.

This paper has addressed the manner in which Courts determine the duty of care and the standard of care owed by a financial advisor to a client. In essence, the duty depends greatly on the extent to which the client is relying on the advice of the financial advisor. An inexperienced client, with no knowledge of investments, may rely heavily on the advice of an advisor as to the manner in which to best invest and manage his or her funds. In such cases, the duties owed by the financial advisor are great, and in some circumstances, can extend to fiduciary duties with a heavy burden on the financial advisor. As is noted in this paper, the fundamental duty of a financial advisor is to ensure that all investments made for the client are suitable for the client and in keeping with the client's investment objectives and risk tolerances.

Finally, the paper has addressed issues that arise when a breach of duty has been found by the Court and the substantial damages, including awards of punitive damages, that may result from such breaches. Where a client shares some responsibility for the loss, a Court may find that they have been contributorily negligent in the circumstances. Where a client "turns a blind eye" to the wrongful conduct of a financial advisor, a Court may also find that the client has "ratified" the wrongful conduct and will be seen as having approved it. Finally, there remains a duty on the part of the client to mitigate his or her losses, with due regard being paid by the Court to the nature of the portfolio or the transaction in question and as well as the experience and sophistication of the client.