



CREDIBILITY VICTORY

It is possible for an advisor to be favoured over his or her client in court. *By Ellen J. Bessner*

THIS IS THE THIRD OF A
THREE-PART SERIES
ON CREDIBILITY IN COURT.

You've likely heard many stories of advisors who failed to know their client and suffered in court. Do judges and arbitrators ever believe advisors?

They do. In 2002, the IDA, Alberta District Council, heard a complaint by "Mr. G" against his advisor, Gregory Pepper Shanks. Mr. G claimed that Shanks failed to learn the essential facts relative to his client, that his recommendations were unsuitable, that accounts were churned and that he engaged in discretionary trading.

The client, Mr. G, had a net worth of about \$1.25 million and opened a margin account with Shanks. Shanks completed his firm's new client application form, but there were no specific requirements that he attribute the percentage breakdown to either the risk factors or investment objectives.

In court, Mr. G asserted that he didn't understand how a margin account operated nor had he ever expressed any desire to speculate. He also testified that Shanks must have engaged in discretionary trading, as he had not given Shanks any instructions.

Shanks testified that he recalled

several discussions with his client and that Mr. G understood margin accounts. To prove this, he produced a spreadsheet Mr. G had prepared.

On cross-examination, Mr. G admitted he had previously engaged in speculative investments. He also admitted that he remembered some of the conversations Shanks had described in his testimony.

KYC

Though the new client application form was limiting, the District Council concluded Shanks did not violate his obligation to learn the essential facts relative to his client. The District Council relied on a British Columbia Court decision¹ for this conclusion:

"These forms constituted the beginnings of the . . . Know Your Client rule. They do not constitute everything embraced in this term. There is the knowledge which the broker gains as he becomes familiar with his customer and the latter's dealings in the market."

Suitability

Though the investments in the margin account were speculative, the suitability of the investments was dependent on Mr. G's sophistication.

Although the client asserted he was unsophisticated, the advisor was believed! Shanks was able to recall

details of conversations. Furthermore, Mr. G's other speculative "unsolicited" investments rendered his evidence less believable. The District Council determined that the investments were suitable.

Churning

The District Council concluded that to prove churning, three elements must be present²: excessive trading, the advisor must exercise control over the trading and have an ulterior motive. Based on the evidence, those elements were not present.

Mr. G's inconsistencies and failure to recollect details led the District Council to favour the advisor's version of the events. As a result, the advisor maintained his reputation, his licence—and he returned his cheque book to his drawer. That is the happy ending to the credibility story! **AE**

Ellen J. Bessner is a lawyer at Gowling, Lafleur, Henderson. She practises in the area of brokers' liability and offers compliance training to brokerage firms. The above is intended for a general audience and should not be considered legal advice.

Footnotes

¹ Scotia McLeod Inc. v. Relova [1991] B.C.J. No. 854.

² Reich, Nancy "Use of Statistical Evidence in Proving Churning of Securities Accounts," 27 AJ PF 3d at p. 213, June 18, 2002.