



## RED FLAGS

Look for warning signs and protect yourself before your client complains. By **Ellen J. Bessner**

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

**You may** think that credibility in court does not affect you, as you don't ever expect to be a witness in court! But beware. With the increased number of claims and complaints made by clients, some say it is not a question of *if* but *when* an advisor will be sued or called onto the IDA carpet.

Practice management skills can improve your credibility in court, as well as serve to strengthen your relationship with clients and get you into good habits of complying with your regulatory and legal obligations.

Let's look at an example. Mr. H was an engineer in his 50s when he met his broker, Mr. B. Mr. H had previously invested heavily in stocks and options, however, he did not have very much money and had not taken a high degree of risk with his investments in the past.

Mr. B was an experienced advisor, with the chartered accountant designation. He had a particular expertise in option investments and developed a special strategy for index options. On Mr. B's advice, Mr. H's account consisted mostly of uncovered options—speculative and highly leveraged. Mr. H began to suffer losses and had to sell stock to

cover a margin call. He decided to sell his entire account as he could not afford to lose any more money and instructed Mr. B accordingly. Mr. B encouraged Mr. H to hold. Mr. H held and suffered further losses.

The firm where Mr. B worked sued Mr. H for over \$250,000—the amount owing in his account after it was closed out. Mr. H counter-claimed against the firm asserting failure to supervise, and against Mr. B, asserting that he breached his duty by investing in unsuitable investments and for refusing to follow Mr. H's instructions to sell.

Mr. B and Mr. H each gave their testimony. The judge described Mr. B as “carrying an air of knowledge, competence and assurance.” He also described Mr. H as a “sincere, soft-spoken person, not aggressive or combative,” adding that “while he appeared knowledgeable about the stock market, he also appeared somewhat naively optimistic.”

The judge described Mr. B and Mr. H's relationship as teacher and student. “Mr. B was the guru in this very specialized field and...[the client] placed his trust and reliance in him almost totally.”

It's easy to guess the judge ruled in favour of the client because the judge concluded that the “naively optimistic” client reposed his trust

in his advisor.

But there is more to this matter than meets the eye. There were several red flags that, if the advisor had properly responded, could have changed the outcome of this case. There was little evidence that the advisor listened and followed the client's instructions. The advisor didn't send any letters to the client or even take any notes during telephone calls. In short, the advisor's evidence was his word against the client's with no documentary evidence to support his position that he followed the client's instructions.

No doubt the advisor lost the client, suffered bad publicity, as did his firm. Employing better practice management skills, including listening to the client and documenting meetings which confirm that the client understood and accepted the risks, may have led to an out-of-court settlement of the case. A better paper trail may lead a judge to prefer the advisor's version of events to that of the client.

In my next column, I'll take a look at an advisor whose version of events was believed in court, and why. **AE**

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