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Court of Appeal Reiterates the Importance for Investors to Conduct Due Diligence

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The Court of Appeal of Quebec has rendered an important decision on the liability of securities dealers and investment advisors. In *Mazzarolo v. BMO Nesbitt Burns ltée*, 2013 QCCA 245, the Court of Appeal, in accordance with its precedents, reaffirmed the respective duties of investors, investment advisors and dealers, while reiterating the importance of differentiating the mandate of an investment advisor from that of a portfolio manager.

FACTS

Mr. Mazzarolo, a wealthy businessman, sued, on his own behalf and on behalf of his companies, his investment advisors Messrs. Lazarus and Albert, as well as the dealer BMO Nesbitt Burns, for over 4 million dollars. The case was dismissed at trial by the Honourable Joël A. Silcoff, J.S.C. Mr. Mazzarolo brought the matter before the Court of Appeal.

Mr. Mazzarolo claimed to have limited to a maximum of $250,000 the capital gains arising from the redemption of certain mutual funds in two of his accounts. Mr. Mazzarolo was also dissatisfied with the performance of one of his accounts, arguing that his investment advisors acted in fact as portfolio managers and that they had ventured beyond the investment proposal which Mr. Mazzarolo claimed to have accepted.

ISSUES

The Court of Appeal had to determine whether the trial judge had erred in his assessment of the evidence as to the existence of the $250,000 ceiling for capital gains that had allegedly been set for Mr. Mazzorolo's two accounts, as well as the evidence on the resulting damages. The Court also had to consider whether the trial judge erred in characterizing the mandate accepted by Mr. Mazzarolo's investment advisors.

COURT OF APPEAL DECISION

The Court of Appeal analyzed evidence presented at trial, having regard to the principle that it must exercise restraint with respect to findings of fact made by the trial judge. Further to its analysis, the Court of Appeal corroborated the findings of the trial judge.

The evidence revealed that Mr. Mazzarolo was a successful businessman, experienced in various types of investments and able to withstand a high level of risk. The Court of Appeal thus found no error in the decision of the trial judge to dismiss the allegations as to the existence of a ceiling of $250,000 for capital gains. The Court of Appeal did not overturn the trial judge's finding that it was the client's responsibility to calculate its capital gains.

As for the existence of a discretionary *de facto* portfolio management mandate, the Court of Appeal noted that this argument is based on a misconception of the mandate of investment advisors. A discretionary *de facto* portfolio management mandate is not created solely because multiple transactions were solicited or recommended by investment advisors, particularly if, as in this case, the client is not vulnerable. This is not a distinctive feature of discretionary portfolio management.

The Court of Appeal also considered the argument of the ratification of the disputed transactions. Mr. Mazzarolo had never disputed the transactions that were alleged to have been made without his consent. Furthermore, it was found that his assistant prepared monthly reports for him in which the disputed transactions were detailed.

The authorities cited by the Court of Appeal emphasize that the securities regulatory framework requires sending confirmations and account statements to clients. When a client fails to question or challenge the transactions within a reasonable time following the receipt of such confirmations or account statements, one may conclude in the ratification of the effected transactions.

The Court of Appeal noted that an investor cannot remain passive in such a context, much less when he holds a non-discretionary account with advice rather than a discretionary account. A judge is then entitled to make a rebuttable presumption of ratification by the investor. Recalling the principles established in *Immeubles Jacques Robitaille inc. v. Financière Banque Nationale*, 2011 QCCA 1952, the Court reiterated that investors are bound to a certain duty of due diligence in the management of their portfolio.

The Court of Appeal specified, however, that the analysis of whether a transaction had been ratified may be different when the disputed transaction does not match the client's investment objectives, which was not the case of Mr. Mazzarolo.

IMPACT OF THE DECISION

It should be noted that there are particular facts in this case. The Court of Appeal should not, in principle, intervene in the findings of fact made by the trial judge. The Court's ability to intervene is limited where the majority of matters under appeal concern the assessment of the evidence presented at trial.

Nevertheless, it is interesting to note that the Court of Appeal upheld the findings of its recent decisions, noting that investors, even neophytes, have obligations in the relationship with their advisor. The Court's analysis with respect to the ratification of the transactions is particularly interesting insofar as it condemns passivity and disinterest on the part of the investor.

In addition, after several years of ambiguity following the decision of the Supreme Court of Canada in *Laflamme v. Prudential-Bache Commodities Canada Ltd.*, [2000] 1 S.C.R. 638, we have witnessed over the last few years a better qualification of the respective obligations of investment advisors in relation to those of portfolio managers. Finally, we note an increase in the use by courts of IIROC rules to evaluate the conduct of advisors and dealers, making it possible to adapt the civil law rules on mandate to the particularities of the securities context.

Click here to read the Court of Appeal's decision (available in French only). Please do not hesitate to contact our Litigation - Securities team with any questions you may have.

Please note that BMO Nesbitt Burns and the two individual defendants were represented by Heenan Blaikie before the Superior Court and the Court of Appeal.

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