

SECURITIES LITIGATION SUPPORT

Litigation arising from trading losses by investors against their brokers is occurring with increasing frequency, exacerbated by the current decline in stock market prices relative to those in the mid 1990s. The typical scenario is that an individual invests \$200,000 in 1990 and by the end of 2001 the stocks remaining have a market value of only \$12,000. Is the loss really \$188,000. And whose fault is it?

Superficially, such claims appear to be straightforward. The calculation seems to be obvious, and the regulations administered by the British Columbia Securities Commission and the Investment Dealers' Association of Canada ("the IDA") are specific. Serious problems may arise, however, from the documentary underpinnings of the claim.

When presenting their cases, investors invariably forget the extent to which they withdrew or deposited cash and securities during the claim period. A typical case involves a married couple whose investments are in registered retirement saving accounts and non-registered margin or cash accounts segregated between Canadian and US funds; it is not unusual for such a couple to maintain six separate accounts with a single broker and for numerous transfers to occur between the accounts. If there has been extensive trading in options, the loss attributable to that activity should usually be analysed separately.

The consequence of the foregoing complexity to claimants and their counsel is that the magnitude of the claimable loss, if any, is an unknown until a serious amount of analytical work has been done at a significant cost. CSA's experience has been that about 30% of potential claims are, upon analysis, reduced to an amount that does not justify full Supreme Court proceedings. After we analysed two cases, the purported loss actually turned into a profit!

CSA has been retained in a sufficient number of such matters that it has been feasible to develop a methodology and identify the resources that enable us to provide preliminary assessments and deliver final reports in a cost effective and timely manner.

Our approach is as follows:

1. Performing detailed analysis of trading experience, reconciling cash and security positions to calculate the primary trading loss.

The first, critical step in the analysis is to reconcile the trading experience of the investor so that a summary can be reconciled to the monthly statements provided to the investor by the brokerage house. The summary contains the following elements:

- Cash deposited
- Securities transferred in at market value
- Dividends and interest received
- (Interest on margin trading)
- (Brokerage commissions)
- Trading profit or (loss)
- US exchange gain or (loss)
- (Cash or market value of securities removed)
- (Cash and market value of securities remaining at the end of the claim period)

The results of the foregoing analysis, converted into Canadian funds, must equal zero.

This analysis, or reconciliation, can be time-consuming. CSA's fee for this exacting task is \$110 per hour.

2 Determining the type of portfolio suitable to the needs and objectives of the plaintiff investor;

There are two dimensions to this aspect of securities claims. First, the trading experience must be reviewed in order to learn whether the broker followed the investor's instructions as set out on the New Client Application Form. ("NCAF") The second is to determine whether those instructions were suitable to the needs and goals of the investor.

CSA addresses these issues as follows:

The securities held in the investor's account are analysed at appropriate intervals to determine whether the holdings correspond to the original NCAF instructions and if the NCAAF has been properly updated. In that review, we also examine whether an excessive concentration has occurred in any investment sector or in any specific security. In the current market, an excessive concentration in high-tech stocks, particularly Nortel, is a common complaint.

If the instructions in NCAF have been carried out, it is necessary to determine whether the broker, given the fiduciary responsibility recognized by the IDA, should have accepted those instructions. In this respect, CSA, through its Vice-President, Stirling Shultz, will report on an asset mix that would have been suitable for that investor. Stirling's opinion is based on his financial planning qualification and his practical experience in giving such advice to actual clients.

An important part of this review is to assess the supervisory responsibility of the branch office and the head office of the investment dealer. This task is accomplished by analysing the monthly commissions paid by the investor and reported in item 1 above; the IDA sets parameters for mandatory review by branch managers and head office, based on monthly commission levels.

3 Reporting on the investment results that would have obtained over the specific period in any combination of stocks, bonds, and treasury bills.

When computing the loss from alleged deficiencies in the manner in which brokers' have discharged their responsibilities, it is necessary to consider not only the trading loss discussed above, but also the gain or loss that would have occurred if the funds entrusted to the broker had been invested in a manner suitable to the goals and needs of the investor. The principle, if not the methodology, has been established in [Laflamme v. Prudential-Bache Commodities Canada Ltd.](#), [2000] 1 S.C.R. 638.

The calculation of this alternate, or suitable, investment return is complex. The gain or loss on cash and investments entrusted to the broker's care must be measured from the date of investment and must be adjusted by withdrawals or disinvestments. As well, since no perfect asset mix can be defined, it is important for the parties and the court to be able to compare the results of varying asset mixes.

CSA has developed a computer model by which the alternative investment results can be accurately measured under varying assumptions. After the dates and amounts invested have been posted, alternate returns may be instantly determined under varying assumptions. The model is based on the TSX 300, long-term Canada bonds and Canada treasury bills. It factors in the broker's commissions, dividends compounded quarterly, interest compounded semi-annually, and capital gains on both stocks and bonds.

A sample of this aspect of our reporting is to be found at alternative investment return.

4 Determining the extent to which the defendant investment advisor and his or her employer are in compliance with the standards required by British Columbia regulators

Determination of the "ultimate question", that is the liability of the defendants and the quantum of the award, rests with the tribunal, not an expert retained by a party. CSA, through its President, Clayton Shultz, will report on the extent that the recommendations and actions of the defendant investment advisor and his or her employer are in compliance with the letter and spirit of the securities regulatory environment in British Columbia. Such reporting and testimony is designed to acquaint the tribunal with the standards and practice appropriate to participants in the securities industry.

Potential claimants whose estimated losses are \$50,000 or less should carefully consider the many advantages of the Securities Dispute Resolution Programme

<http://www.bcicac.com/cfm/index.cfm?L=105&P=191> sponsored by the IDA and administered by The British Columbia International Commercial Arbitration Centre in Vancouver. Provided that claimants commence arbitration proceedings before initiating a Supreme Court action, the broker is bound to participate in the arbitration process. A worthwhile second alternative to a fully litigated dispute is the Summary trial procedure, rules of which are to be found at http://www.ag.gov.bc.ca/courts/scrules/rule_18a.htm.

As a final, but important, note, CSA strongly recommends that parties to disputes in the securities area be represented by lawyers who are members of the Law Society of British Columbia. In our extensive experience, have found that self-representation has proven to be detrimental to claimants' interests.