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Rogue Brokers: The Damages They Cause

Where a plaintiff alleges that their stock broker has caused them financial loss, the plaintiff must prove their damages.

If the broker is negligent, some of the common ways in which a broker causes a financial loss to their client include:

- advising the client to purchase and hold unsuitable investments;
- churning the account to generate commissions and/or mutual fund fees, for the broker, with the corresponding cost to the client;
- discretionary trading; and/or
- failing to execute client instructions.

Alternatively, the broker may have misappropriated their client's funds.

In a recent case, the judge described the conduct of the broker, George Georgiou, as follows:

“The negligent conduct of George Georgiou is obvious. Documents were incorrectly prepared and not explained to or reviewed with the clients. He persuaded clients into taking positions in the market without consideration of their goals and objectives. He selected stocks which were highly speculative without justification. He traded in the Blackburn's account without their authorization or with authorization improperly obtained. He was dishonest, representing stock was in inventory and guaranteeing a transaction profit when the stock had already sold for a loss.”

“A review of the Blackburn accounts at Midland and Levesque also indicates the substantial commission revenue results from a high transaction volume which can only be described as "churning".” Ontario Superior Court of Justice, D. Gordon J. [2003] O.J. No. 621

In cases of negligence, the objective of the damage quantification is to determine the amount of money required to put the plaintiff in the financial position that they would have been in, but for the breach or wrong. The forensic accountant often achieves this by preparing an Expected Result, the financial position that the client would have been in but for the breach or wrong. The Expected Result is compared with the Actual Result, with the difference being the plaintiff’s damages.

The preparation of the Expected Result may require the forensic accountant to address issues such as: which investments were unsuitable, what investments would have been suitable, what were the commissions in the Expected Result, what transactions would have occurred in the Expected Result if the broker had executed the client’s instructions, income tax implications for registered plans, and how and when the portfolio would have been rebalanced. The forensic accountant often relies upon the liability expert for certain key assumptions underlying the calculations.

The resulting calculations of Expected Results, and the tracking of the Actual Results are often very detailed analyses, which cover a number of years.

The approach to determining the Expected Results can have a large dollar impact on the quantum of the financial loss. In several recent cases, if the plaintiff’s capital loss was \$500,000, then the plaintiff’s loss relative to investing in suitable investments would have been around \$1,000,000. A capital loss calculation assumes that the plaintiff receives their money back; a dollar invested in unsuitable investments should be compensated by returning the dollar. However, during the recent bull market, a dollar invested in

unsuitable investments meant that the dollar was not invested in suitable investments, many of which doubled in value in the late 1990s.

The calculations may become even more complicated if the investments include private placements, and/or tax shelters.

In the case where the broker has misappropriated their client's funds, the forensic accountant's task is to identify the funds misappropriated, often tracing through a number of accounts, across a number of years.

The calculations become even more complicated when there has been both negligence and misappropriation.

In summary, the role of the forensic accountant in determining the financial loss caused by a rogue broker often includes complex calculations, and reliance upon the liability expert for certain key assumptions underlying the calculations.

November 2003

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