

## Update

# Financial planners liability insurance: Exclusion for gross fault declared inoperative

The Quebec Court of Appeal recently rendered a judgment<sup>1</sup> written by Marie-France Bich, J.C.A., with respect to the professional liability of a financial planner<sup>2</sup>.

The financial planner was sued by his former clients Denis Guillemette, France Mercier and Alimentation Denis et Mario Guillemette Inc. (hereinafter the "Guillemettes"). From 1996 to 2005, the Guillemettes had retained financial planner Yves Tardif to develop an investment strategy for them. They wanted to ensure that they would have sufficient income for their retirement through safe and low risk investments that would be more profitable than a deposit or term savings product. Contrary to the Guillemettes' instructions, however, Mr Tardif decided to concentrate their investment portfolio in high risk products, and ultimately his clients lost all their investments.

The lawsuit was also brought against the companies iForum Financial Services Inc. and iForum Securities Inc., for which Mr Tardif worked respectively as a mutual fund dealer

and a representative of a full service securities broker, as well as against their professional liability insurers, Underwriters at Lloyd's (hereinafter "Lloyd's").

At trial, François Huot J., found that Mr Tardif had breached his duty to inform and his duty of prudence and diligence by failing to abide by his clients' instructions, failing to adequately diversify their investment portfolio, and investing in securities of dubious quality. Moreover, Mr Tardif had invested part of his clients' money in products in which he was not authorized to trade. The judge also ruled that iForum Financial Services Inc. and iForum Securities Inc. had to assume liability for the fault of their representative, Mr Tardif. Further, he concluded that the firms had committed distinct faults in their oversight of Mr Tardif and that consequently, they were also liable.

<sup>1</sup> *Souscripteurs du Lloyd's v. Alimentation Denis & Mario Guillemette Inc.*, 2012 QCCA 1376.

<sup>2</sup> Over the years, Mr Tardif held various certificates pursuant to the *Act Respecting the Distribution of Financial Products and Services*, R.S.Q., c. D-9.2, i.e. financial planner, representative in financial planning, mutual fund dealer, independent representative in group insurance of persons, independent representative in financial planning, mutual fund dealer and representative of full service securities broker.

Huot J. found that coverage had been triggered under the liability insurance policies issued by Lloyd's, dismissing Lloyd's argument based on the application of six exclusions, including gross fault.

Lloyd's appealed the judgment on the following grounds.

Did the trial judge err: 1) in failing to consider the Guillemettes' contributory negligence; 2) in concluding that Mr Tardif had committed a fault in the course of his professional activities covered by the two insurance policies and in the performance of his duties; and 3) in concluding that the exclusion for gross fault was inapplicable?

Firstly, considering both their limited knowledge (the Guillemettes were laypersons with respect to stock market investments and other financial products) and Mr Tardif's reassurance when they expressed concern about their investments, the Court of Appeal dismissed Lloyd's argument that the Guillemettes had contributed to their damages.

The Court of Appeal then turned to the issue of whether the fault committed by Mr Tardif had been committed in the scope of his professional activities and in the course of his duties within the meaning of the two insurance policies issued by Lloyd's.

In the two Lloyd's policies, the term "professional activities" was defined as [TRANSLATION] "services that fall within the activities of a representative [...] to the extent that these services are rendered in accordance with the applicable provisions of the *Act Respecting the Distribution of Financial Products and Services* [...]". Lloyd's position was that Mr Tardif's activities were instead governed by the *Securities Act*, R.S.Q., c. V-1.1.

Lloyd's also argued that Mr Tardif had not acted in the scope of his duties within the meaning of the policy issued to iForum Financial Services Inc. when he invested the Guillemettes' money in financial products in which he was not authorized to trade.

The Court of Appeal determined that as the securities that Mr Tardif was not authorized to trade are governed by the *Securities Act*: 1) Mr Tardif had first and foremost acted as the Guillemettes' financial planner; 2) it was in this context that the initial fault was committed by Mr Tardif; and 3) financial planning is an activity governed by the *Act Respecting the Distribution of Financial Products and Services*. The Court then concluded that financial planning met the definition of a professional activity within the meaning of the two insurance policies.

The Court of Appeal also determined that had it found that Mr Tardif had committed two faults: firstly, having rendered inappropriate financial planning services (within the scope of his "professional activities"), and secondly, having traded in certain securities for which he was not authorized (outside of his "professional activities"), this would not change anything. Even if the two faults were to be considered concurrent causes, one being covered and the other excluded, insurance coverage would nevertheless be triggered. In this regard, the Court of Appeal reiterated that under Quebec civil law, the common law rule that when loss results from concurrent causes, one of which is excluded, the excluded cause will prevail, does not apply.

Finally, the Court of Appeal addressed the exclusion for gross fault. Lloyd's alleged that Mr Tardif's gross fault lay in the reckless, careless and grossly negligent manner in which he handled the Guillemettes' investments, as well as in his falsification of certain statements in order to hide transactions. With respect to iForum Financial Services Inc., Lloyd's alleged that it had committed a gross fault in its serious breach of its duty to oversee its representatives and ensure that they respected the scope of their professional certifications.

The Court of Appeal held that the exclusion for gross fault in the insurance policy covering Mr Tardif should be declared inoperative as it contravened the provisions of the *Act Respecting the Distribution of Financial Products and Services* and its regulations, which set out the insurance requirements for representatives such as Mr Tardif and the firm.

The Court of Appeal pointed out that the provisions setting out the insurance requirements make no distinction between the types of faults that should be covered and that therefore they require the inclusion of gross fault. Given that the insurance policy contained a clause providing that any of its terms which conflicted with the legislation of the province in which it had been issued were amended to take such legislation into account, the Court of Appeal held that the Lloyd's policy was consequently amended so as to no longer exclude gross fault.

As to iForum Financial Services Inc., the Court of Appeal found that it had not committed a gross fault in the scope of its oversight measures. It added that even if it had decided otherwise, with respect to the liability of iForum Financial Services Inc. for the faults of its representatives, articles 2414 and 2464 of the *Civil Code of Quebec* prevent an insurer from denying coverage in the case of gross fault committed by the insured firm's representatives. The Court held that in any event, the exclusion for gross fault should be declared inoperative according to the reasoning set out above.

In summary, this case reiterates the importance of conducting a thorough analysis of not only the policy wording, but also the applicable legislative framework in assessing the coverage afforded by an insurance policy.

Exclusions for gross fault should be examined closely to determine whether they would be declared inoperative according to the reasoning of the Court of Appeal in this case. In this regard, it is important to remember that not only financial

planners, but also representatives in insurance of persons, group insurance representatives, damage insurance agents, damage insurance brokers, and claims adjusters are governed by the *Act Respecting the Distribution of Financial Products and Services* and its regulations. Further, the professions governed by the Professional Code, R.S.Q. c. C-26, are also subject to insurance requirements that must be analyzed bearing in mind this jurisprudential development.

### Further information

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