

**IN THE MATTER OF AN APPEAL TO THE APPEAL COMMITTEE
OF THE CANADIAN INVESTOR PROTECTION FUND**

RE: [REDACTED] **AND** [REDACTED]

Submitted: October 2015

PANEL:

PATRICK J. LESAGE) Appeal Committee Member

APPEARANCES:

In writing) Appellants, [REDACTED] and
) [REDACTED]

In writing) Counsel for Canadian Investor Protection
) Fund Staff, James D.G. Douglas

DECISION AND REASONS

1. [REDACTED] and [REDACTED] (“the Appellants”), were clients of First Leaside Securities Inc. (“FLSI”), an investment dealer through which over 1,200 customers made investments in various affiliated companies, trusts and limited partnerships (collectively the “First Leaside Group”). FLSI was registered with the Ontario Securities Commission (“OSC”) and was a member of the Investment Industry Regulatory Organization of Canada (“IIROC”). It was also a member of the Canadian Investor Protection Fund (“CIPF” or the “Fund”) until its suspension by IIROC on February 24, 2012, being the same date that FLSI was declared to be insolvent and the day after FLSI sought protection under the *Companies’ Creditors Arrangement Act*. The relevant history leading up to these events and the role of CIPF with respect to claims to the Fund are set out

in detail in the Appeal Committee's decision in relation to an appeal heard on October 27, 2014, released on December 17, 2014.¹

2. This appeal is an 'in writing' appeal.

3. ██████████ commenced investing in First Leaside Group entities, through FLSI in October 2005 and continued periodic investments until May 2010. ██████████ commenced investing in First Leaside Group entities, through FLSI in March 2009 through to May 2010. He invested a total of \$182,354.81. The amount claimed by ██████████, \$191,879.00, includes a value placed on the stock dividends which he received in the amount of \$16,178.00 and \$5,495.00 for additional units for which no traceable record can be located and a deduction of \$12,148.81. ██████████'s claim is for the amount she invested of \$85,180.00.

4. The Appellants sought recovery from CIPF on the basis that FLSI was a member of CIPF and as such the Appellants were entitled to protection through the Fund, which was established to provide coverage in the event of a loss arising from insolvency. By letters dated 19 December, 2014 and 3 June, 2014, Staff of CIPF denied compensation to the Appellants on the basis that their losses did not arise as a result of the insolvency of FLSI and thus was not covered under the CIPF Coverage Policy dated September 30, 2010.

5. The Appellants request I consider their written material, any relevant background information that has been presented at earlier appeal hearings, as well as the arguments raised by Representative Counsel for investors of FLSI referred to in earlier hearings.

6. The Appellants written submissions include in part the following which are to be found at pages 78, 79 and 150, 151 of Volume 1 of the Appeal Record.

- i. FLSI was, and had consistently marketed itself to customers such as myself (ourselves) as being a CIPF member since 2004. In fact, they consistently remarked how my (our) investment is insured through CIPF from the beginning of my (our) investment through to 2012.

¹ This decision is available on the CIPF website and will be referenced throughout as the "October 27, 2014 decision".

- ii. I (we) deposited money with FLSI on January 1, 2009 to February 23, 2012. By the time of the Member's insolvency, [REDACTED] had deposited approximately \$191,879.00 and [REDACTED] had deposited approximately \$85,180.00 (the "Claimed Funds") in account(s) held with FLSI through its carrying broker, Penson Financial Services Canada Inc., which funds were to have been invested in proprietary First Leaside products on the understanding that such funds would be invested in those products for the primary purpose of funding the acquisition and/or development of various real estate projects.
- iii. I (we) have since learned that the Claimed Funds, all of which were deposited between January 1, 2009 through to February 23, 2012, were not used for my (our) intended investment purpose, but rather were unlawfully converted by First Leaside for its own use. In this regard, and unbeknownst to me (us), First Leaside was also the subject of an ongoing Ontario Securities Commission ("OSC") investigation from 2009 through 2011. The significant internal and regulatory concerns which lay at the heart of that investigation ultimately led to the retention of a consultant, Grant Thornton Limited ("Grant Thornton"), to review and prepare a report on First Leaside's operations and financial viability. Upon completing that review, Grant Thornton, in a report provided to First Leaside on August 19, 2011, concluded that without the infusion of new capital, First Leaside would be unable to continue to operate:
- The future viability of [First Leaside] is contingent on their ability to raise new capital...If [First Leaside] was restricted from raising new capital, it would likely be unable to continue its operations in the ordinary course as it would have insufficient revenue to support its infrastructure, staffing costs, distributions, and to meet their funding requirements for existing projects.
- iv. Despite the concerns which had been identified by early 2009, and the release of Grant Thornton's report in August 2011, it was not until three months later, in November 2011, that I was (we were) first advised that the OSC had been investigating First Leaside and had told the company that it was "*not appropriate to use money raised*

from new investors to fund the operating losses, rehabilitation costs and distributions of existing limited partnerships”. Indeed, it was only at this late date that First Leaside was prevented from raising further capital, through FLSI, from customers such as myself (ourselves). While this was discovered due to the investigation of FLSI, it was evident that FLSI was operating in this manner well before the investigation.

- v. In the result between January 2009 (by which time First Leaside was well aware of its untenable financial position and significant regulatory concerns regarding the inappropriate use of customer funds) through to November 2011, FLSI solicited, accepted and proceeded to use the Claimed Funds for its own purposes in a manner which was contrary to my (our) rights in and to that money – all while intentionally misleading me (us) as to why First Leaside actually required, and how it intended to use my (our) money. To date, none of the Claimed Funds have been returned to me (us). It is my (our) understanding that only a small fraction of the Claimed Funds will ultimately be returned to me (us) through the receivership process.
- vi. FLSI’s solicitation and use of the Claimed Funds represented an unlawful conversion of that money. In particular, in soliciting and accepting my (our) money while knowingly concealing from me (us) that First Leaside’s financial viability was entirely contingent on FLSI’s ability to obtain such further deposits, FLSI unlawfully induced me (us) to deposit the Claimed Funds. In such circumstances, any direct or implied consent which I (we) may have provided to withdraw the Claimed Funds from my (our) account(s) in order to purchase investment products offered by First Leaside was vitiated and of no force or effect.
- vii. There is no doubt that the insolvency (and related suspension of FLSI’s registration) was effected, in large part, so as to protect future investors from the systemic misuse of funds by FLSI. There is similarly no doubt that that same insolvency rendered FLSI unable to return the Claimed Funds. In such circumstances, it cannot have been intended that existing FLSI customers such as myself (ourselves) (who are victims of the same misconduct which the regulators eventually acted to prevent) should alone have to bear the burden of that policy decision – particularly given CIPF’s express

mandate to contribute to the security and confidence of customers of Canadian investment dealers by maintaining adequate resources to return assets to eligible customers in cases where a Member becomes insolvent.

- viii. In the result, I (we) hereby seek recovery under CIPF's coverage policy in the full amount of the Claimed Funds (less any amounts which I (we) have or may actually recover through future receivership processes) – being losses which I (we) incurred solely as a result of the insolvency of FLSI and its failure to return funds rightfully belonging to me (us) but wrongfully converted by FLSI.
- ix. In addition, this letter dated June 10, 2015, was received by CIPF Staff and included in the Appeal Record, Volume 1 at page 49:

Dear Sir:

It is indeed most disconcerting that we must continue to expound on our investment and claim against CIPF (First Leaside Securities Services Inc.) in regards to CIPF and IIROC.

My wife and I had been planning to retire some five years ago, travel and enjoy our grandchildren.

Unfortunately, First Leaside came along. We believed that our investments were covered by CIPF and IIROC. Not to mention that all of our correspondence, statements, etc, contain the CIPF and IIROC logos.

We had been assured that there were no problems with First Leaside except to the point that they were behind in the preparation of previous year's financial statements and not to worry because all documentation was being provided. Well, what a mistake

In addition, First Leaside was allocating investment funds to projects that were in a deficit position without advising the investor and noting that values were based on a "NOT AVAILABLE" – "N/A" position.

Investors have been duped not only by First Leaside but by their government. We do not take kindly to the CIPF Investment procedure and feel that our claim is valid.

Yours truly

A solid black rectangular box redacting the signature of the sender.

7. It is to be noted that both IIROC and the OSC found David Phillips and John Wilson guilty of egregious conduct that violated rules, regulations and statutes that governed their professional involvement with the First Leaside Group of companies.

8. I understand and appreciate the Appellants statements contained in the above letter. However, my task is to determine whether the CIPF coverage may apply to the Appellants. The Appellants like many of the investors in First Leaside product have indicated that they were seriously misled by FLSI as to the parameters of the CIPF coverage. However, the CIPF brochure makes clear that the diminution, loss of value of the entity in which the investment was made is not a matter that is covered by CIPF.

9. Counsel for CIPF Staff submit in their written materials that, CIPF, as explained in their brochure, makes clear that coverage applies only to losses suffered as a result of the insolvency of the broker, FLSI. It does not cover economic or other losses suffered by the entity in which the investment has, at the direction of the client, been made.

10. The amended, consolidated and related declarations of trust, the offering memoranda of the various First Leaside Funds in which [REDACTED] invested all provided authority for the specific fund to invest in or make loans to other First Leaside entities. We know from the materials now disclosed from the insolvency that many of the investments ended up with other entities other than the specific entity in which the investor may have invested.

11. The coverage policy of CIPF does not compensate for loss occasion by deceit, misrepresentation or fraudulent failure to disclose, or the manner in which the entity used the client's investment monies.

12. The letter from the Appellants is moving and heartfelt. Their loss, like the loss of so many others, has had an apparent devastating effect on them.

13. As counsel for CIPF Staff submit, the CIPF brochure makes clear, the coverage applies only to loss or losses suffered as a result of the insolvency of the broker FLSI. It does not cover economic or other losses of the entities in which investments are made.

14. The Appellants raise in their submissions the position that what occurred here was an ‘unlawful conversion’. Unlawful conversion at its simplest means the converting of another’s property that is in your possession, to or for a purpose beyond the terms that govern that possession. For example, [REDACTED] transferred money from themselves to FLSI so they could purchase units of First Leaside Fund (Series B), First Leaside Properties Fund (Class B), and First Leaside Properties Fund (Class C). That is what FLSI did. Further when FLSI received the documentation/certificates reflecting that investment, its responsibility was to either hold the certificates in trust for [REDACTED] or to transfer them at their direction. That is what FLSI did. Simply put, FLSI handled the monies provided by [REDACTED] as directed by [REDACTED] and [REDACTED] and handled those certificates, the indicia of the investment, as directed by [REDACTED] and [REDACTED]. There was no unlawful conversion by FLSI.

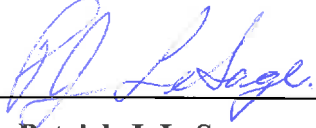
15. As stated in earlier decisions flowing from this FLSI insolvency, the coverage policy offers compensation for losses occurring from a member’s failure as a custodian of the customer’s property and for unlawful conversion. It is coverage for what should be in one’s account on the date of insolvency.

16. CIPF coverage is limited to custodial coverage. As was indicated in the October 27, 2014 decision, the CIPF brochure outlines this limitation on coverage. Any misrepresentations of the coverage that may have been made were not made by CIPF but by FLSI and/or the promoters of the First Leaside Group who were selling the product. Oversight of brokers is primarily the jurisdiction of IIROC with additional oversight by the Ontario Securities Commission.

17. Whilst I have sympathy for the Appellants position, it does not change the fundamental fact that this appeal does not meet the requirement of establishing a valid legal claim for coverage under the terms of the CIPF policy.

18. The appeal must therefore be dismissed. The decision of the CIPF Staff is upheld.

Dated at Toronto, this 18th day of December, 2015



Patrick J. LeSage