

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

RE: [REDACTED]

Heard: February 9, 2016

HEARD BEFORE:

ANNE W. LA FOREST

Appeal Committee Member

APPEARANCES:

Nicolas Businger

)

Counsel for Canadian Investor

)

Protection Fund Staff

[REDACTED]

)

On his own behalf

DECISION AND REASONS

Introduction and Overview

1. [REDACTED] (the “Appellant”) was a client 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 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, 2014.¹

2. FLSI was declared to be insolvent on February 24, 2012. The Appellant sought recovery from CIPF on the basis that FLSI was a Member of CIPF and as such the Appellant was entitled to protection through the Fund which was established to provide coverage in the event of insolvency. CIPF Staff made a decision denying compensation to the Appellant on the basis that the Appellant's losses did not arise as a result of the insolvency of FLSI and thus were not covered under the CIPF Coverage Policy dated September 30, 2010.

3. On February 9, 2016, an Appeal Committee Member of CIPF's Board heard an appeal to determine whether to depart from the decision of CIPF Staff. The appeal took place at Neeson Arbitration Chambers in Toronto, Ontario. The Appellant was in attendance and made submissions on his own behalf.

Chronology of Events Relevant to the Appellant's Claim

(i) The Appellant's Investments and Claim

4. The Appellant invested in three different First Leaside Group products between September 8, 2010 and September 30, 2011. The total value of his purchases was \$220,000. The Appellant then made a deduction from his claims in the amount of \$20,432.05 representing a combination of return of capital and distributions received in the insolvency proceedings. The total claim was in the amount of \$199,567.95. On January 6, 2016, the Appellant advised CIPF and this Appeal Committee that he would only be pursuing an appeal before me with respect to his purchase on September 30, 2011 of \$50,000 in relation to 50,000 units in the Special Notes Limited Partnership. He restated this intention at the hearing on February 9, 2016.

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

5. A certificate representing the Appellant's purchase of the Special Notes Limited Partnership units was delivered to his possession on October 20, 2011. The materials filed before me establish this and statements made by the Appellant during the hearing confirm these matters.

(ii) The Appellant's Application for Compensation

6. The Appellant applied to CIPF for compensation for his losses in investments made through FLSI. By letter dated February 26, 2015, the Appellant was advised that CIPF Staff were unable to recommend payment of his claims. The relevant parts of the letter to the Appellant read as follows:

Regarding your claim for unlawful conversion, it does not appear to us that any property held by FLSI for you was converted or otherwise misappropriated. The securities that you purchased were subject to the disclosure of an offering memorandum or other offering documentation which, among other things, disclosed the risks relevant to the purchase and the investment. These investments, like any securities, were subject to market forces and, unfortunately, the loss appears to have been a loss caused by a change in the market value of the investments and not a loss resulting from the insolvency of FLSI or the conversion of your property. Losses caused by dealer misconduct, compliance failures or breaches of securities regulatory requirements in respect of the distribution of securities are not covered by CIPF.

In addition, at the date of insolvency, the securities [which were held off book and one of which was the Special Notes Limited Partnership] were not held by, or in the control of, FLSI. Therefore, the loss is not one that is eligible for CIPF coverage, as indicated above.

Analysis

7. The Appellant provided submissions in writing at the hearing and also made oral submissions. As noted above, the Appellant has abandoned his appeal in relation to his original claim with the exception of his investment in the Special Notes Limited Partnership. His reasons for adopting this approach relate to his belief that any appeal in relation to his other two investments or the investments made by his wife would fail for the reasons that were set out in the October 27, 2014 decision and subsequent decisions of the Appeal Committee.

8. The Appellant, however, submitted that the situation in respect of the Special Notes Limited Partnership differed from that arising in other decisions in several respects.

9. First, the Appellant noted that unlike the other investments at issue in the FLSI appeals, the Special Notes Limited Partnership was not a real estate investment. Rather, the investment was intended to be a short-term bridge-financing vehicle by FLSI where return of the invested capital was to be returned within a short period of time; i.e. within six months. The Appellant submitted that but for the insolvency, the Special Notes Limited Partnership would have returned full capital to the investors and in this regard provided an attachment indicating that FLSI had sufficient cash on the date of insolvency to pay out these kinds of loans. The Appellant also referred to Essex Capital Management Limited (“Essex”) in support of his argument as in that case, the investments at issue were interest-bearing deposits and thus comparable to the Special Notes Limited Partnership.

10. Second, the Appellant argued that he did not receive an offering memorandum in relation to the Special Notes Limited Partnership and that the offering memorandum dated October 22, 2008² provided by CIPF has no relevance to this investment made in September 2011. The Appellant expressed the view that in the absence of such an offering memorandum, the certificate he received is no more than a receipt and does not reflect possession or control of the investment.

² Appeal Record, Volume 2, Tab 3.

11. Finally, the Appellant argued that the Special Notes Limited Partnership were launched after the Grant Thornton Report was released in August of 2011 and that as a result, the Special Notes Limited Partnership offering should never have happened. In this regard, the Appellant stated that FLSI's ability to raise capital arose because the OSC did not compel release of the report and that collectively, the organizations created to protect investors failed those individuals who invested in the Special Notes Limited Partnership. In support of this position, the Appellant noted that a group of FLSI investors have launched a lawsuit against the OSC on the basis that the OSC should have released or compelled the release of the Grant Thornton Report. In addition to these arguments, the Appellant also raised the argument that I could exercise my discretion in relation to the Special Notes Limited Partnership as the amounts at issue would not be significant.

12. In terms of the Appellant's argument that the nature of the investment was a loan, the difficulty is that in fact, the transaction is structured as an investment and thus, as in the case of other investments made by FLSI customers, the property at issue is the investment rather than the underlying cash itself. An account statement dated October 31, 2011 makes clear that a certificate representing the investment in the Special Notes Limited Partnership was delivered out on October 20, 2011 and the certificate was in the possession of the Appellant as at the date of the insolvency. The certificate received by the Appellant represents the property itself and demonstrates the possession and control of the investment. The Coverage Policy provides coverage in situations where the Member has failed to return property including a failure to return property as a result of unlawful conversion. There is no such failure here because the property, the Special Notes Limited Partnership, was in the possession of the Appellant. Stated otherwise, the Appellant had no proprietary interest in the cash held by FLSI on the date of insolvency as his property was the investment he had made.

13. In respect of Essex, I will simply state that in that case, coverage was provided not because the investments were interest-bearing deposits but rather because the Member in that case misappropriated funds from clients' accounts without authorization on a number of occasions and thus engaged in unlawful conversion of their property. Here the purchase of the Special Notes

Limited Partnership was authorized by the Appellant and he received a certificate representing that investment that was in his possession at the date of insolvency.

14. In terms of the Appellant's argument with respect to the absence of an offering memorandum in relation to the Special Notes Limited Partnership, counsel for CIPF Staff noted that the offering documentation was referred to in these cases largely to make the point that the issuers involved in the First Leaside Group were separate entities from FLSI and that the Coverage Policy addresses insolvency of the Member and not the issuers. In this case, the materials make it very clear that the Appellant purchased units in the issuer Special Notes Limited Partnership and received a certificate representing that interest and had possession of that investment in an issuer at the date of insolvency of FLSI.

15. With respect to the Appellant's argument that CIPF is collectively responsible with other organizations such as the OSC for the Appellant's loss, I would make three comments. First, as noted in the October 27, 2014 decision, the Appeal Committee is not in a position to act as a trier of fact and in particular, it is not able to prejudge the outcome of an action against the OSC. Second, and more importantly, the CIPF does not act as a regulator; it is the OSC and IIROC who have the capacity to regulate the First Leaside Group and FLSI respectively. Finally, it is important to note that in the October 27, 2014 decision, the investor in that case made some of his investments in the period following the Grant Thornton Report and there is nothing to distinguish this case from that one.

16. Finally, I cannot accept the Appellant's argument with respect to discretion. As was stated in the October 27, 2014, the word "discretion" in the Coverage Policy cannot be interpreted to create a new head of coverage; the Appeal Committee is bound to exercise its discretion within the limits of CIPF's mandate. It is not the amount of money that would be payable that limits the discretion. Rather it is the custodial nature of protection under the Coverage Policy.

17. I have considerable sympathy for the losses suffered by the Appellant but unfortunately, I cannot use discretion in a manner that is inconsistent with the purpose and intent of CIPF coverage

and I am otherwise unable to find that his losses fall within the Coverage Policy. The Appellant's losses did not arise from a failure by FLSI to return or account for the Appellant's property. I wish to note that I appreciated the measured and thoughtful way in which the Appellant presented his case and his broader focus on the longer term in suggesting that given the losses suffered in this case, CIPF revisit its coverage mandate.

Disposition

18. The appeal is dismissed. The decision of CIPF Staff is upheld.

Dated at Toronto, this 18th day of March, 2016

Anne Warner La Forest