

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

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

Heard: 3 February 2015

PANEL:

ANNE WARNER LA FOREST

Appeal Committee Member

APPEARANCES:

[REDACTED]
[REDACTED]

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On their own behalves, and on behalf of [REDACTED]
[REDACTED], and [REDACTED]
[REDACTED]

James Gibson

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)

Counsel for Canadian Investor
Protection Fund Staff

Sam Robinson

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Independent Legal Counsel for the Appeal
Committee of the Canadian Investor Protection
Fund

DECISION AND REASONS

Introduction and Overview

1. [REDACTED] and [REDACTED], [REDACTED], [REDACTED], and [REDACTED] (the “Appellants”) were clients of First Leaside Securities Inc. (“FLSI”), an investment dealer through which over 1200 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 it was suspended by IIROC on February 24, 2012, the same date FLSI was declared to be insolvent and 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 dated October 27, 2014.¹

2. The following investments were made by the Appellants:
- i [REDACTED] made investments in a number of First Leaside products between late December 2008 and early May 2010 in the amount of \$160,022 and received distributions in the amount of \$10,645.96 from the insolvency proceedings for a net claim of \$149,376.04;
 - ii [REDACTED] and his wife, [REDACTED], purchased 1,003 units of First Leaside Properties Fund on March 27, 2008 for a total investment cost claim of \$1,003;
 - iii [REDACTED] purchased 20,022 units in First Leaside Properties Fund (Class B) on March 27, 2009 for a total investment cost claim of \$20,022;

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

- iv [REDACTED], [REDACTED]'s brother purchased 500,000 units in First Leaside Progressive Limited Partnership on December 24, 2009. His total investment cost was \$500,000 and he received a distribution of \$51,104.13 for a net claim of \$448,895.87; and
- v [REDACTED]. made investments in two First Leaside products in late December 2009 and sold some units in one of the investments in September of 2010. His total investment cost was \$280,000 and he received a distribution of \$9,414 for a net claim of \$270,586.

3. 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 insolvency. CIPF Staff made a decision denying compensation to the Appellants on the basis that the Appellants' 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.

4. On February 3, 2015, an Appeal Committee Member of CIPF's Board heard the Appellants' appeals. The main issue in each appeal was whether to depart from the decision of CIPF Staff that denied compensation for losses suffered by the Appellants. The appeals were heard together at Neeson Arbitration Chambers in Toronto, Ontario and the hearing was open to the public. [REDACTED] and [REDACTED], on behalf of themselves and the other Appellants, were in attendance.

Chronology of Events Relevant to the Appellants' Claims

(i) [REDACTED]'s Investments and Claim

5. [REDACTED] became an investor with FLSI in 2008 and is a retiree in his early [REDACTED]. He invested with FLSI to augment his pension. His sole advisor was David Phillips who was found by both the OSC and IROC to have engaged in fraudulent and deceitful conduct. [REDACTED]'s investments are listed, in summary, as follows:

- i. 150,000 units of First Leaside Investors Limited Partnership purchased December 23, 2008. On March 4, 2009, 80,000 of these units were sold leaving a total of 70,000 units. The 80,000 units had been purchased through a \$60,000 loan to [REDACTED] and a \$20,000 loan to [REDACTED]

██████████. ██████████ stated in his testimony that he did not feel comfortable with the loan and this was the reason for the sale of units and repayment of the loans;

ii. 5,022 units of First Leaside Properties Fund (Class B) purchased on March 27, 2009 and held in ██████████'s TFSA account;

iii. 30,000 units of First Leaside Properties Fund (Class B) purchased March 27, 2009 (15,000 units) and May 1, 2010 (15,000 units) and held in ██████████'s RRSP account; and

iv. 55,000 units of First Leaside Universal Limited Partnership purchased on May 3, 2010.

6. The total value of ██████████'s investments was \$160,022. He recovered an amount of \$10,645.96 from the insolvency proceedings with respect to the First Leaside Universal Partnership leaving a net claim of \$149,376.04. His investments in First Leaside Investors Limited Partnership and First Leaside Universal Limited Partnership were held off book and were delivered out to ██████████ on December 24, 2008 and May 4, 2010 respectively. His investments in First Leaside Properties Fund were held on book and transferred to Fidelity in December of 2012 following FLSI's insolvency.

7. With the exception of the investments on May 1 and May 3, 2010 all the investments made by ██████████ occurred before the date when the OSC had begun to investigate FLSI. The investments in May 2010 were made before the OSC sought an independent evaluation of FLSI. In his testimony, ██████████ stated that CIPF coverage was critical to his investments being made in a private securities firm and that he discussed this matter with David Phillips.

(ii) ██████████'s and ██████████'s Investments and Claim

8. As noted above, ██████████ and ██████████ purchased 1,003 units in First Leaside Properties Fund (Class B) in March 2009. This investment was made before the OSC investigation commenced in the fall of 2009. It was held on book in a registered account and was transferred to Fidelity in December 2012 following FLSI's insolvency.

(iii) ██████████'s Investments and Claim

9. As noted above, ██████████ purchased 20,022 units in First Leaside Properties Fund (Class B) in March 2009. 5,002 of these units were held in her TFSA account and the remaining 15,000 units were held in a registered account. These units were purchased before the OSC investigation commenced in the fall of 2009 and were held on book until transferred to Fidelity in December 2012 following FLSI's insolvency.

(iv) ██████████'s Investments and Claim

10. ██████████ is in his late ██████████ and has had to restart a private business due his losses from investments in FLSI. His sole advisor was also David Phillips. ██████████ purchased 500,000 units in First Leaside Progressive Limited Partnership in late December of 2009 which was just after the OSC investigation into FLSI began. As noted, he recovered an amount of \$51,104.13 from the insolvency proceedings with respect to his investment and subtracted this amount from the purchase price of \$500,000, leaving a net claim of \$448,895.87. The units were held off book and were delivered out to ██████████ on December 29, 2009.

(v) ██████████'s Investments and Claim

11. As noted, ██████████ made two investments as follows:

- i 250,000 units of First Leaside Series II Preferred Shares purchased December 24, 2009; and
- ii 80,000 units of Development Notes Limited Partnership purchased December 24, 2009. On September 1, 2010, 50,000 of these units were sold, leaving a total of 30,000 units.

12. The total value of these investments was \$280,000.00. ██████████ received distributions of \$9,414 through the insolvency proceedings in relation to his investments in the Development Notes Limited Partnership. His net claim is \$270,586. His investments in the First Leaside Series II Preferred Shares and the Development Notes Limited Partnership were held off book and were delivered out to on December 29, 2009.

13. The investments made by [REDACTED] were made after the OSC began its investigation of FLSI.

14. None of [REDACTED], [REDACTED], [REDACTED] or [REDACTED] were aware of the problems with FLSI until November of 2011.

The Appellants' Application for Compensation

15. The Appellants applied to CIPF for compensation for their losses in investments made through FLSI prior to the October 12, 2013 deadline for submitting claims that was set by the CIPF Board of Directors. The Appellants [REDACTED] and [REDACTED] also provided additional information regarding the claim attached as the "Claim Rationale" in Attachment D, email correspondence dated April 25, 2013 and August 6, 2013, and written correspondence dated May 4, 2012 and January 10 2014. The Appellants [REDACTED] and [REDACTED] submitted a document entitled "Investor [REDACTED] and [REDACTED] Circumstances" dated May 30, 2012 and correspondence dated January 11, 2014 in response to CIPF Staff's request for a claim confirmation on November 15, 2013.

16. By letters dated March 14, 2014 [REDACTED], [REDACTED] and [REDACTED], [REDACTED], [REDACTED], [REDACTED], the Appellants were advised that CIPF Staff was unable to recommend payment of their claims. The relevant parts of the letters read as follows:

[REDACTED]: Regarding your claim for unlawful conversion, it does not appear to us that any property held by FLSI for you was converted or otherwise appropriated. In addition, while you have not provided evidence of the truth of all of the assertions in support of your claim, losses caused by dealer misconduct, compliance failures or breaches of securities are not covered by CIPF. 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, your loss appears to have been a loss caused by a change in the market value of your investments and not a loss resulting from the insolvency of FLSI.

With respect to the securities that you purchased [in First Leaside Properties Fund], they were properly recorded in the books and records of FLSI at the date of the

truth of all of the assertions in support of your claim, losses caused by dealer misconduct, compliance failures or breaches of securities are not covered by CIPF. 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, your loss appears to have been a loss caused by a change in the market value of your investments and not a loss resulting from the insolvency of FLSI.

Furthermore, at the date of insolvency, the securities [in First Leaside Series II Preferred Shares and Development Notes Limited Partnership] was not held by, or in the control of, FLSI. Therefore, the loss is not one that is eligible for CIPF coverage, as indicated above.

17. The Appellants [REDACTED] and [REDACTED] provided a written response to the decision of CIPF Staff on April 30, 2014 and further correspondence dated December 12, 2014. The Appellants [REDACTED] and [REDACTED] provided a written response to the decision of CIPF Staff on May 19, 2014.

Analysis

18. The Appellants made arguments in their correspondence mentioned above. Many of the arguments raised by the Appellants are similar to those that were addressed in the October 27, 2014 decision and in this regard, we rely upon our analysis in that decision at paragraphs 27 through 49. The Appellants in this case provided a well organized and thorough presentation that sought to restate and develop these arguments while using the specifics of their own situation to argue that they fit within the parameters of the Coverage Policy.

19. In their executive summary, the Appellants focused on three arguments connected to the terminology of the Coverage Policy. First, they argued that their losses were due solely to the insolvency. Second, that there was a failure of FLSI to return their property due to the insolvency and that failure included the fact that there had been an unlawful conversion of their property. Third, the Appellants argued that CIPF allowed itself to be marketed by FLSI in a manner that led to their losses.

20. In arguing that their losses were solely due to FLSI's insolvency, the Appellants submitted that the word "insolvency" in the Coverage Policy should not be assessed on the basis of the date of February 24, 2012 as relied upon in other decisions of the Appeal Committee. In their view, since the Coverage Policy does not itself define the "type" of insolvency that is intended, the appropriate approach is to focus upon "accounting insolvency" or the date upon which total liabilities exceeded total assets. While the Appellants did not then identify a specific date upon which FLSI was accounting insolvent, they alleged that FLSI was accounting insolvent at least as early as 2008 and that this continued through 2011 and the cessation of FLSI in February of 2012. Such a conclusion would mean that all of the Appellant's investment occurred during this period. The Appellants then argued that their losses were in effect caused by the insolvency because FLSI would not during this period have been in the position to return any of their investments. In short, their argument is that their losses were not so much as a result of loss of market value, unsuitable investments, or the default of an issuer as stated by CIPF Staff in their decision, but rather that FLSI was accounting insolvent at the date of their investments and could not return their investments.

21. While counsel for CIPF Staff made two responses to this set of arguments around insolvency, I accept their first point and there is no need to discuss the second. Their argument was that the Coverage Policy is concerned only with the insolvency of the member - here FLSI - and not the issuers in whose investment vehicles the investors have placed their monies. In this regard, CIPF Staff referred to the Coverage Policy itself which states:

The date at which the financial loss of a customer is determined shall be fixed by the Directors as the date of bankruptcy of the Member, if applicable, or the date on which, in the opinion of the Directions, the Member became insolvent.

In this case, CCAA proceedings were commenced on February 23, 2012 and the following day, FLSI was suspended by IIROC.

22. The date of FLSI's insolvency is not an issue to be debated as part of proceedings before the Appeal Committee. Insolvency refers to CIPF Members, and in this case the relevant date is February 24, 2012, which was the date of FLSI's suspension from IIROC. The insolvency date is set as part of the claims procedure.

23. The second argument presented by the Appellants was that FLSI had failed to return or properly account for their investments due to the accounting insolvency. In short, the Appellants argued that the reported value of their investments was never there and thus could never be returned from the day that their funds were invested. In particular, the Appellants argued that their investments were reported at a valuation of \$1/unit throughout the relevant period in circumstances where FLSI knew otherwise. Furthermore, the Appellants suggested that the form of reporting was constantly changing from the time of their investments to the date of insolvency. In terms of unlawful conversion, the Appellants stated that their understanding was that the funds they invested would be invested in products for the primary purpose of funding the acquisition and/or development of various real estate products. They argued that their investments were not used for the intended investment purpose, but rather were unlawfully converted by the First Leaside Group for its own uses during a period when there was an OSC investigation and a review by Grant Thornton Limited. Finally, the Appellants argued that even if these arguments were not accepted, I should revisit the conclusion in the October 27, 2014 decision to the effect that fraud, non-disclosure, and misrepresentation is not included in the Coverage Policy as in their view, that conclusion was unreasonable.

24. For its part, counsel for CIPF Staff noted that the Appellants' arguments focused on issuer failures rather than upon FLSI's failure to return or account for their property and upon FLSI's misconduct through fraud, non-disclosure and misrepresentation. Counsel submitted that the relevant question is what the Coverage Policy provides for, and that document focuses upon the Member's failure to return or account for property and does not provide for misconduct of the kind at issue in this case.

25. Ultimately, the Coverage Policy provides for custodial protection and the question for the Appeal Committee is whether Appellants' property was returned to them. In this case, the Appellants acknowledged that they were in possession of the certificates representing their off book investments and the Appellants' units in other investments had been transferred to another IIROC Member after the insolvency of FLSI. The difficulty with the Appellants' position in general is that it represents an attempt to characterize what is clearly a claim for fraud, material non-disclosure and/or misrepresentation as one of failing to return or account for property and unlawful conversion

in particular. The language that the Appellants used in their submissions, both written and oral, makes this very clear. While they assert that their property has been unlawfully converted, the foundation for that statement is concisely summarized in the following excerpt from an email dated August 6, 2013, authored by the Appellant [REDACTED]:

FLSI's solicitation and use of the Claimed Funds represented an unlawful conversion of that money. In particular, in soliciting and accepting my money while *knowingly concealing* from me that First Leaside's financial viability was entirely contingent on FLSI's ability to obtain such further deposits, FLSI *unlawfully induced* me to deposit the Claimed Funds.

26. Similarly, in their claims in relation to insolvency, the Appellants commented on the fact that the principals of FLSI misled investors in their reports to investors. There is no question that the decisions of both IIROC and the OSC determined that the principals of FLSI engaged in fraudulent actions. But neither the IIROC nor OSC decisions suggests that there was a misappropriation or conversion of property. The difficulty is that while the actions of FLSI's principals are egregious, they do not fall within CIPF's Coverage Policy. While the Appeal Committee certainly sympathizes with the Appellants' situation, our role is to interpret the Coverage Policy as drafted. To include claims in relation to fraud, non-disclosure, and misrepresentation would be to amend rather than interpret the document.

27. Thirdly, the Appellants' submissions focused upon CIPF's role in their losses. They argued that in effect, CIPF allowed itself to be used in FLSI's marketing endeavours. In this regard, they referred to investment documentation in relation to the First Leaside Group in which the CIPF logo was used to assure investors that their investments were covered. The Appellants also argued that CIPF should be aware of the fact that investors rely upon CIPF coverage when choosing to invest in a private investment firm and a review of the CIPF website and documentation could reasonably be interpreted by an investor as covering all investor losses following the insolvency of a member. Indeed, the Appellants suggested that those in the industry understood that CIPF coverage would apply to their situation. Furthermore, it was their view that the CIPF website does not express the limitations of the Coverage Policy clearly enough and that changes in the policy support that conclusion. Finally, it was their argument that CIPF had a duty to oversee how members use the logo on account statements and market themselves using CIPF's name.

28. As we indicated in the October 27, 2014 decision, any misrepresentations in relation to CIPF were made by FLSI itself or by members of the First Leaside Group. Furthermore, the CIPF brochure and website clearly state that there are defined limits on the return of cash and securities. Additionally, oversight of members is within the jurisdiction of IIROC, and not CIPF itself.

29. Finally, in their written submissions and at the hearing, the Appellants undertook considerable effort to identify and outline what they described as a systemic failure in terms of the oversight of FLSI. In this regard the Appellants discussed, among others, the OSC, IIROC, and CIPF itself. In particular, the Appellants stated that CIPF was part of the audit and review of FLSI in early 2009. Counsel for CIPF Staff was quite right to say that there was no evidence supporting this statement. The Appellants also expressed their disappointment that CIPF Staff seemed to be focused on looking for ways in which to avoid liability rather than upon ways to help investors. While the Appeal Committee appreciates the substantial effort of the Appellants in developing this discussion, its jurisdiction is limited to assessing whether or not the Coverage Policy is applicable to these facts. While, as noted, the Appeal Committee has considerable sympathy for the Appellants, unfortunately, their circumstances do not give rise to a successful claim for compensation from CIPF.

Disposition

30. The appeal is dismissed. The decision of the CIPF Staff is upheld.

Dated at Toronto, this 24th day of March, 2015.

Anne Warner La Forest