

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

RE: [REDACTED], [REDACTED]

and [REDACTED]

Heard: August 18, 2015

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

Maureen Doherty

)
)

Counsel for Canadian Investor
Protection Fund Staff

[REDACTED]
[REDACTED]
[REDACTED]

)
)
)

On their own behalves

DECISION AND REASONS

Introduction and Overview

1. [REDACTED], [REDACTED] (“[REDACTED]”) and [REDACTED] (“[REDACTED]”) (collectively, 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 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. 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.

3. On August 18, 2015, an Appeal Committee Member of CIPF’s Board heard an appeal to determine whether to depart from the decision of CIPF Staff. The appeal hearing was held at Neeson Arbitration Chambers in Toronto, Ontario. The Appellants were in attendance. [REDACTED] made submissions on behalf of all of the Appellants.

Chronology of Events Relevant to the Appellants’ Claim

(i) The Appellants’ Investments and Claim

4. The claim arises from the Appellants’ purchases of various First Leaside Group products for a total net claim by [REDACTED] of \$758,423; by [REDACTED] of \$146,246 and by [REDACTED] of \$62,718. These claims include claims for undocumented purchases of \$439,043² by [REDACTED] and \$2,457 by [REDACTED].

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

² 139,720 units of First Leaside Capital (B Class); 7 units of First Leaside Capital (C Class); 60 units of First Leaside Acquisitions; 160,000 units of First Leaside Wealth Management Preferred; and 116,500 units of Wimberly Apartments LP.

5. The majority of the securities representing the Appellants' purchases were transferred to accounts in the names of the Appellants at Fidelity Clearing Canada ULC ("Fidelity"), or were delivered into the possession of the Appellants. The exception is various undocumented securities for which no information is available, however, the claims have been acknowledged by the insolvency trustee. [REDACTED] advises that these securities were never issued or delivered to him.

(ii) The Appellants' Application for Compensation

6. The Appellants applied to CIPF for compensation for their losses in investments made through FLSI. By separate letters dated March 2, 2015 to [REDACTED] and [REDACTED], and February 18, 2015 to [REDACTED], the Appellants were advised that CIPF Staff were unable to recommend payment of their claims. The relevant parts of the letters read as follows:

...losses caused by dealer misconduct, compliance failures or breach of securities regulatory requirements in respect of the distribution 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.

Analysis

7. Following the hearing, [REDACTED] forwarded an email to CIPF to emphasize points made at the hearing relating to the undocumented securities and claims for himself and [REDACTED] for investments made in September, 2011.

8. Although there are five undocumented securities, [REDACTED] has focused his attention on the securities which appear to have been purchased in 1990 and 1992³. Claims for these

³ 139,720 shares of First Leaside Capital B Class; 7 shares of First Leaside Capital C Class; and 116,500 units of Wimberly Apartments Limited Partnership.

undocumented securities (to be referred to as “the Undocumented Securities”) for which no information is available, have been acknowledged by the insolvency trustee. FLSI became a member of IIROC and CIPF in 2004; records prior to that date are unavailable.

9. [REDACTED] submissions with respect to the Undocumented Securities do not make reference to the other two securities having a claimed value of \$220,000, which were purchased in 1999 and 2002, for which information is also not available, but which claim has also been acknowledged by Grant Thornton. In any event, my comments would be equally applicable to those securities as well.

10. The CIPF Coverage Policy as of September 30, 2010 obliges CIPF to return securities to the customer, subject to certain provisions. Further, it states as follows: “The Directors may rely on the trustee in bankruptcy or the receiver under applicable law in determining the amount and validity of claims of a customer and for the purpose of calculating financial loss.” This is particularly applicable for the First Leaside Group entities since values for these securities were only available from the First Leaside Group itself rather than from an independent outside source such as an exchange.

11. The various First Leaside Group entities acted as their own transfer agents for the purpose of issuing securities to investors. Whether or not securities were ever issued for the undocumented securities is not known. In any event, the insolvency trustee now stands in the shoes of the entity which issued the security and acted as the transfer agent. The insolvency trustee has accepted [REDACTED] and [REDACTED]’s claims for the undocumented securities. The insolvency trustee is in a position to provide the Appellants with the certificates representing the undocumented securities.

12. When securities being claimed are securities traded on an exchange, it is relatively straight forward for CIPF to fulfill its obligations to return securities to the customer. When the securities are privately issued and the entity has acted as its own transfer agent, it is the insolvency trustee’s obligation to provide the certificates. It appears that the trustee did not do so, relying instead upon

its Acknowledgement of Claim form to show that it had recognized the Appellants' ownership of the securities. At such time as a distribution is made, the insolvency trustee is in a position to consider the Appellants' claims and determine what payment, if any, would be forthcoming.

13. ██████████ repeated the arguments that were presented by representative counsel in the October 27, 2014 appeal. Those arguments focused on an interpretation of the phrase "property unlawfully converted", which can be found in the CIPF Coverage Policy. Those arguments, and ██████████'s written claim, referenced investments which were made after the time that the OSC began its investigation in the fall of 2009 with respect to the First Leaside Group. It must be noted that approximately 80% of ██████████'s investments took place before 2009, as well as half of ██████████'s investments. In contrast, all of ██████████'s investments were made in 2009 and following. Having consideration for the timing of the Appellants' investments, any submissions relating to the allegation of "property unlawfully converted" would not be applicable to the majority of the amounts claimed by ██████████.

14. ██████████ has specifically noted certain investments made by himself and ██████████ ██████████ in September, 2011, after the Grant Thornton report was available to the First Leaside Group. He suggests, but offers no proof, that the majority of the funds raised after the Grant Thornton report was available, were still in cash deposits when Grant Thornton assumed its insolvency role, and were used by Grant Thornton to fund the insolvency process. As such, he submitted, the funds were "unlawfully converted". He submitted that these funds should have been set aside by the partnership in which they were invested so that they could have been returned to investors once the issues of the Grant Thornton report had been resolved.

15. This is an argument to be presented to the insolvency trustee. The books and records of FLSI show that the funds were received and were invested in the Special Notes Limited Partnership as was instructed by the Appellants.

16. Further, it is worth examining the Offering Memorandum⁴ with respect to the Special Notes Limited Partnership. It specifically provided, under the heading “Business of the Partnership”, that it would deal in First Leaside Wealth Management Notes and other securities of the First Leaside Group, including being engaged in “(vi) repaying any indebtedness or satisfying any obligation, including any indebtedness or obligation to any member of the First Leaside Group”. The Special Notes Limited Partnership was not created to invest in real estate, but to deal in securities of the various entities of the First Leaside Group.

17. CIPF’s mandate and Coverage Policy is limited to its member, FLSI and not the various entities in the First Leaside Group. From CIPF’s perspective, the Appellants’ funds were applied as instructed to FLSI and were not unlawfully converted. To adopt these arguments relating to “property unlawfully converted” suggests that the Appellants’ claims are really of fraud, material non-disclosure and/or misrepresentation which does not fall within the meaning of the phrase "including property unlawfully converted" as was discussed fully in the October 27, 2014 decision. Such an interpretation would in effect create a new head of coverage. In fact, ██████████’s arguments did not address issues of fraud on the part of the First Leaside Group.

18. ██████████ also submitted that the First Leaside Group entities were improperly interfered with by the OSC and IIROC, which resulted in the various insolvencies. He noted that the OSC investigation process was lengthy. He speculated that had there been communication and not the precipitous action by the regulators, it might have been possible for more of the entities to continue in business, thereby resulting in less dislocation to the investors. He blamed all involved parties, the regulators, representative counsel, Grant Thornton and CIPF as participants in the process.

19. ██████████ emphasized the component aspects of the CIPF name. He offered the view that investors indirectly pay for CIPF fees when they deal with a CIPF member firm. He suggested

⁴ See Appeal Record, Vol 2, Tab 12, page 126 (of Vol 2).

that the “protection” in the CIPF name referred to a protection of the fund, rather than that of investors’ interests. It is unfortunate, but understandable, why [REDACTED] feels this way.

20. [REDACTED] also observed that investors had not been permitted to form a group to present their claims. It should be pointed out that the normal claim to CIPF would involve missing property, which has not been the case in FLSI. Other than in the extremely rare case where certificates cannot be located, all property held by FLSI has been accounted for. In those rare cases where property is missing and no records are available to CIPF, it appears that the insolvency trustee has acknowledged the claim in any event. In the claims being made by [REDACTED] and other FLSI Appellants, the issues being dealt with are not that of missing property, but personal to the particular Appellants. In such a case, a group action would not be appropriate.

21. The Appellants suggest that their claims should be successful and their investment funds returned to them, at the last value shown prior to the values being shown as N/A. It must be pointed out that if this were the case, then all payments received by the Appellants over all of the years of the investments would also have to be accounted for. The hearing did not discuss that possible outcome. It would be surprising, and contrary to information otherwise received, to be advised that the Appellants had received no returns on their investments for a period lasting over 20 years. It seems highly unlikely that they would have continued to invest with the First Leaside Group if that were the case.

22. CIPF’s mandate and its coverage is custodial in nature; in other words, to ensure that the clients of an insolvent member have received their property. This custodial coverage is set out in CIPF’s mandate, which is approved by the OSC and other provincial securities regulators. The mandate is restricted to this coverage, and does not extend to coverage for fraud, material non-disclosure and/or misrepresentation. The nature and extent of the coverage is discussed in full in the October 27, 2014 decision.

23. [REDACTED] made lengthy submissions which provided his perspective on the events surrounding the insolvency of FLSI and the First Leaside Group. His observations and submissions

were appreciated, and I have sympathy with respect to losses experienced by the Appellants, however, I conclude that the submissions in this appeal are not persuasive and do not give rise to a successful claim for compensation from CIPF.

Disposition

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

Dated at Toronto, this 27th day of August, 2015.

Brigitte Geisler