

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

RE: [REDACTED] and [REDACTED]

April 30, 2015

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

James Gibson

)
)

Counsel for Canadian Investor
Protection Fund Staff

[REDACTED]
[REDACTED]

)
)

On their own behalves

DECISION AND REASONS

Introduction and Overview

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 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 dated 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 April 30, 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 took place at Neeson Arbitration Chambers in Toronto, Ontario. The Appellants were in attendance.

Chronology of Events Relevant to the Appellants’ Claim

(i) The Appellant’s Investments and Claim

4. The claim arises from the Appellants’ purchases of various First Leaside Group products as follows:

██████████:

- i. 50,000 units of First Leaside Properties Fund Series B for a cost of \$50,000 purchased on February 5, 2009;
- ii. 4,929 units of First Leaside Properties Fund for a cost of \$4,929 on June 2, 2009;
- iii. 5,000 units of Wimberly Fund Series 8% Designation 2010 on March 25, 2010 for a cost of \$5,000 and a further 100,000 units on September 7, 2010 for a cost of \$100,000; and
- iv. 65,000 units of First Leaside Mortgage Fund on September 7, 2010 for a cost of \$65,000.

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

██████████:

- v. 50,000 units of First Leaside Properties Fund Series B for a cost of \$50,000 purchased on February 5, 2009;
- vi. 4,929 units of First Leaside Properties Fund for a cost of \$4,929 on June 2, 2009;
- vii. 5,000 units of Wimberly Fund Series 8% Designation 2010 on March 25, 2010 for a cost of \$5,000 and a further 100,000 units on September 7, 2010 for a cost of \$100,000; and
- viii. 65,000 units of First Leaside Mortgage Fund on September 7, 2010 for a cost of \$65,000.

██████████ or ██████████

- ix. 150,000 units of First Leaside Investors Limited Partnership for a cost of \$150,000 on December 22, 2008 and a further 48,269 units for a cost of \$48,269 on August 19, 2009.

5. The Appellants received distributions from the insolvency Trustee as follows: ██████████ - \$13,992.38 and ██████████ - \$13,992.38. All of the securities in the names of either ██████████ or ██████████ were transferred to accounts in the names of the Appellants at Fidelity Clearing Canada ULC (“Fidelity”), with the exception that the certificate representing the investment in First Leaside Investors Limited Partnership was delivered to the Appellants.

(ii) The Appellants’ Application for Compensation

6. The Appellants applied to CIPF on May 21, 2013 and October 6, 2013 for compensation for their losses in investments made through FLSI. By letters dated December 19, 2014, the Appellants were advised that CIPF Staff were unable to recommend payment of their claims. The relevant parts of the letters 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. In addition, as a basis for explaining your claim, you stated:

- “We would never have invested in any company that did not have CIPF insurance [...] Needless to say David Phillips from Leaside also emphasized the protection that this insurance provides the investor.”
- “All investments qualified for RRSP – further assurance these vehicles were safe and regulated and audited by governing body IROC [sic] and CIPF.”
- Leo DeBever was Chairman of the board, well recognized as an expert in the investment field, and an investor in the Leaside Group of Companies [...]
- [...] I wasn’t protected by OSC Grant Thornton or IROC [sic]”
- “There is no question in my mind, as a result of the courts [sic] decisions, that FLSI was not operating in a fully trustworthy manner [...]

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 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.

In addition, with respect to the securities that you purchased, they were properly recorded in the books and records of FLSI at the date of insolvency. Those securities were transferred to accounts in your name at another IIROC Dealer Member subsequent to February 24, 2012. Therefore the loss is not one that is eligible for CIPF coverage, as indicated above.

██████████ or ██████████: In addition, at the date of insolvency, the security described in the table below 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.

Analysis

7. The Appellants raised a number of arguments with respect to their appeal. The main position advanced was that funds given to FLSI to invest in securities of the First Leaside Group were unlawfully converted by FLSI and as such, the Fund should provide coverage. The Appellants noted that their account statements had shown a value of the investment equivalent to

² See paragraph 4 (ix) above for details of the investment.

the amount originally invested, but subsequent to the insolvency, that value was then shown as 'not available'. They submitted that any profits which might have been made had been diverted to trustees, lawyers and other creditors and thereby deprived investors. The Appellants also argued that they should have had returned to them the value of their investments at the time of the insolvency. CIPF Staff noted that the values on the account statements were not independently determined, as might be the case for a security traded on a public stock exchange, but were the valuations provided by the First Leaside Group.

8. The Appellants raised arguments similar to those advanced at the October 27, 2014 hearing. This included interpretation of the phrase "including property unlawfully converted" in the Coverage Policy. The Appellants argued that the funds they invested 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 products. They submitted that their funds had been diverted and expressed the concern that there was no value available when the properties which were held by funds were sold by the insolvency Trustee for what appeared to be profitable amounts. The Appeal Committee is of the view that the adoption of these arguments 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.

9. Another argument put forward by the Appellants related to the exercise of discretion by the Appeal Committee under the Coverage Policy. As was indicated in the October 27, 2014 decision, the Appeal Committee is bound to exercise its discretion within the limits of the CIPF mandate which is to provide custodial coverage to customers in the event of the insolvency of a Member. While the Coverage Policy provides a residual discretion, it is limited to cases where the application of the Policy might result in an outcome that frustrates or defeats the purpose of the compensation scheme. It is not intended to use discretion to create a new head of compensation such as misrepresentation or the default of an issuer. The Appeal Committee's discretion is limited to the Coverage Policy which, in general terms, provides for the return of the Appellant's property. In this

case, the Appellants' investments were held by FLSI at the date of insolvency and were subsequently transferred to Fidelity.

10. The Appellants also made submissions with respect to the assurances that were provided by FLSI regarding CIPF coverage. They noted that brochures produced by FLSI displayed both the CIPF logo and the IIROC logo, indicating that FLSI was a Member of both organizations. The principals of FLSI gave assurances that there was CIPF coverage for their investments, which gave them more confidence in investing with FLSI. They were also reassured that the board of directors of FLSI included at least one prominent Canadian businessman. They commented on the CIPF brochure which they felt was less than clear explaining the nature of the CIPF coverage. The Appeal Committee took note of their comments.

11. They also opined that there was an obligation on CIPF to ensure that its logo and explanations regarding its coverage not create unwarranted expectations. In response, it must be noted that CIPF is not a regulatory body. It provides strict guidelines as to the usage of its logo and has produced a brochure for Members to use to describe the limitation in its coverage. If misrepresentations as to coverage were made, those were by FLSI or the First Leaside Group, which are subject to the oversight of IIROC and the OSC, respectively.

12. The Appellants addressed what they felt were regulatory shortcomings with respect to FLSI. This included an obligation by the Ontario Securities Commission ("OSC") and IIROC to regulate the conduct of the First Leaside Group. They expressed the view that the fact that the First Leaside products were approved for investment in an RRSP was also an indication that the products were safe. The Appeal Committee noted that the determination of RRSP eligibility is not a securities regulatory function.

13. CIPF Staff pointed out the nature of CIPF's coverage, which 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. The documentation provided by the Appellants confirms that certificates representing their investments were transferred to accounts in the Appellants' names at Fidelity or were delivered to their possession.

14. The October 27, 2014 decision deals extensively with the Appellants' arguments and the reasoning in the October 27, 2014 decision is adopted by this Appeal Committee. As in the October 27, 2014 decision, while I have considerable sympathy for the Appellants' position, I conclude that their submissions in this appeal are not persuasive and do not give rise to a successful claim for compensation from CIPF.

Disposition

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

Dated at Toronto, this 1st day of May, 2015

Brigitte Geisler

Brigitte Geisler