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

RE: [redacted]

Heard: October 28, 2014

PANEL:

PATRICK LESAGE	Appeal Committee Member
ANNE WARNER LA FOREST	Appeal Committee Member
BRIGITTE GEISLER	Appeal Committee Member

APPEARANCES:

R. Shayne Kukulowicz Jane O. Dietrich	))	Counsel for [redacted]
James D. G. Douglas James Gibson	))	Counsel for Canadian Investor Protection Fund Staff
Brian Gover	)))	Independent Legal Counsel for the Appeal Committee of the Canadian Investor Protection Fund

DECISION AND REASONS

Introduction and Overview

1. Mr. [redacted] (the "Appellant") was a client 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 subject to regulation by the Ontario Securities Commission ("OSC") and was a member of the Investment Industry Regulatory Organization of Canada ("IIROC").[1] It was also a member of the Canadian Investor Protection Fund ("CIPF" or the "Fund") which is overseen by the OSC and is the compensation fund for investment dealers that are members of IIROC. FLSI was a member of CIPF until it was suspended by IIROC on February 24, 2014, the same date FLSI was declared to be insolvent.

2. The Appellant invested $50,000 with FLSI. Of that amount, he has recovered a total of $3,301.78 from the insolvency Trustee. The Appellant sought recovery from the CIPF on the basis that FLSI was a Member of CIPF and as such the Appellant was entitled to protection through the CIPF Fund that 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. The Appellant made a request to appeal the decision of CIPF Staff on February 20, 2014.

3. On October 28, 2014, a panel of the Appeal Committee (the "Panel") of the Canadian Investor Protection Fund ("CIPF" or the "Fund") heard an appeal to determine whether to depart from the decision of CIPF Staff which denied compensation for losses suffered by the Appellant. The appeal hearing took place at Neeson Arbitration Chambers in Toronto, Ontario and was open to the public. On the previous day, October 27, 2014, this Panel heard the appeal of another Appellant

[1] Consequently, a member of the Investment Industry Regulatory Organization of Canada is referred to below as an "IIROC Member" or a "Member".

and issued a decision in that matter on December 17th, 2014.[2] The general facts and arguments raised by the Appellant in this case are very similar to those we have addressed in that decision and as such, we will be referring to that decision in these reasons.

4. In furtherance of CIPF's mandate, its Board of Directors enacted a Coverage Policy which has been reviewed and amended from time to time. At the date of FLSI's insolvency, the Coverage Policy dated September 30, 2010 was in force.

5. The salient portions of the CIPF Coverage Policy are reproduced below:

> **Coverage**
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> CIPF covers customers of Members who have suffered or may suffer financial loss solely as a result of the insolvency of a Member. Such loss must be in respect of a claim for the failure of the Member to return or account for securities, cash balances, commodities, futures contracts, segregated insurance funds or other property, received, acquired or held by, or in the control of, the Member for the customer, including property unlawfully converted. The Board of Directors of CIPF may exercise its discretion in respect of determining the customers eligible for protection and the financial loss suffered.
>
> **Policy**
>
> This Policy has been adopted by the Board of Directors to describe the basis on which it intends to exercise its discretion in authorizing CIPF to make payments to customers of insolvent CIPF Members. The Directors' discretion may be exercised in a manner that is consistent with the right and extent to which a person may be entitled to claim against the customer pool fund of a Member under the Bankruptcy and Insolvency Act (Canada), subject to other restrictions in this Policy and the sole discretion of the Directors to determine protection by CIPF. CIPF and the Directors reserve the right to authorize or withhold payments in a manner other than as prescribed in this Policy.
>
> In the case of any question or dispute as to the eligibility of a customer, the financial loss incurred by a customer for the purposes of payment by CIPF, and the maximum amounts to be paid to a customer, the interpretation of this Policy by the Board of Directors shall be final and conclusive.

6. The Coverage Policy also provides for limitations in terms of coverage; two of these limitations are important in this context:

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[2] This decision can be found on the CIPF website and will be referenced herein as the October 27, 2014 decision.

i) Losses which do not result from the insolvency of a Member, such as, customers' losses that result from changing market values of securities, unsuitable investments, or the default of an issuer of securities;……

iv) securities or segregated funds that are not held by a Member, or recorded in a customer's account as being held by a Member.

7. In summary, for a claim to be deemed eligible under the Coverage Policy, the following requirements must be satisfied:

- The claimant must have been a customer of an insolvent CIPF Member;
- The loss must have been caused by the insolvency of the CIPF Member; and
- The loss must have been due to the failure to have property held in the customer's account at the date of insolvency returned to the customer, including property unlawfully converted

Chronology of Events Relevant to the Appellant's Claim

(i) The Appellant's Investments and Claim

8. The Panel here focuses on the specific matters relevant to the Appellant and relies upon the detailed outline of facts set out in paragraphs 10 to 23 of our October 27, 2014 decision.

9. The Appellant, who was [redacted] years old on the date of the hearing, has claimed $50,000 from the Fund. This claim related to his investments in one security, namely $50,000 units in the Special Notes Limited Partnership ("Special Notes Units"). Of the $50,000 he invested, the Appellant has recovered a total of $3,301.78, so his net claim is $46,698.22.

10. The Appellant made his investment in the Special Notes Units on October 13, 2011 approximately four months prior to FLSI's being declared insolvent. A certificate for 50,000 Special Notes Units was issued to the Appellant and delivered out to him on October 20, 2011.

11. The context in which this investment was made can be briefly described as follows. In 2009, the OSC had begun investigating FLSI and in November of 2010 the OSC sought third party market valuation reports of the real property held by limited partnerships owned by the First Leaside Group. In February of 2011, FLSI was encouraged to retain an independent accounting firm to conduct a study of its viability as a result of concerns arising from the valuation reports. The firm of Grant Thornton Limited ("Grant Thornton") was retained to review, report on, and make recommendations in relation to the First Leaside Group's business, assets, affairs and operations. The review was completed in August 2011. IIROC designated FLSI in discretionary early warning status on October 28th 2011, just over two weeks after the Appellant had made his investment. The First Leaside Group agreed to a cease trade order by the OSC and this was implemented on October 31st, 2011.

12. The Appellant testified that at the time of his investment, he did not know that the OSC was investigating FLSI or that almost two months earlier, Grant Thornton had concluded that the viability of investments in the First Leaside Group was dependent on infusion of funds from new investors. When asked whether he would have made his investment, if this information been made known to him, the Appellant replied, “No, absolutely not.” It was only on November 7, 2011 that the First Leaside Group wrote a letter to all investors at the request of the OSC and IIROC disclosing that the First Leaside Group was being investigated by regulatory authorities and that there was limited, if any, equity in its real estate investments.

13. The Appellant’s undisputed evidence was that he did not receive an offering memorandum in connection with his investment in the Special Notes Units. He believed that he was purchasing a share in a real estate investment. He did not know that his funds would be used to pay fees or that his investment would be used for distributions to other investors.

14. On February 24, 2012, the First Leaside Group sought protection under the *Companies' Creditors Arrangement Act.* On that date, the 50,000 Special Notes Units were not recorded in the

Appellant's accounts or otherwise on the books and records of FLSI. As previously noted, the Appellant held his position in the Special Notes Units in certificate form

(ii) The Appellant's Application for Compensation

15. The Appellant applied to CIPF on August 10, 2012 for compensation for his losses in investments made through FLSI. There was further correspondence and exchange of documentation between the Appellant and the CIPF between that date and November 20, 2013. By letter dated December 23, 2013, the Appellant was advised that CIPF Staff were unable to recommend payment of his claim. The relevant part of the letter reads as follows:

> CIPF staff appreciate that you have suffered unfortunate financial losses. However, CIPF staff are bound by the terms of the CIPF Coverage Policy and Claims Procedures. Based on the information available to us, CIPF staff are not able to recommend payment for the reasons provided below.
>
> 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 security that you purchased was 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. This investment, like any security, was subject to market forces and, unfortunately, your loss appears to have been a loss caused by a change in the market value of your investment 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.

16. In addition, the letter indicated that the Appellant's investment in the Special Notes Limited Partnership, at the date of insolvency, was not held by, or in the control of FLSI.

Analysis

17. In our October 27, 2014 decision, our point of departure was that assessing claims for compensation from the Fund require interpreting the Coverage Policy. In so doing, we are to review the policy as a whole giving words their ordinary and grammatical meaning consistent with the surrounding circumstances. We concluded that the words of "one provision must not be read in isolation but should be considered in harmony with the rest of the contract and in light of its purposes and commercial context": *Sattva Captial Corp. v. Creston Moly Corp.*[3]

18. Many of the arguments raised by this Appellant are similar to those that were made to us at the [redacted] hearing and in this regard, we rely upon our analysis in that decision at paragraphs 27 through 49.

19. The Appellant's submissions focussed on the second sentence in the Coverage Policy,[4] and in particular, the words "including property unlawfully converted". The argument is that the Appellant gave cash to FLSI and that it was then converted into the Special Notes Units. In turn, the conversion was unlawful because the Appellant did not consent to his cash being converted into First Leaside Group products in circumstances where he was not made aware of the absence of underlying assets and when the viability of his investment was dependent on receipt of new investors' money. Counsel submitted that while CIPF could have used language clearly excluding misrepresentation and deceit, it chose not to do so and instead referred to "property unlawfully converted". The Appellant submitted that the *contra proferentum* rule of contractual interpretation applies to contracts of adhesion and should apply in this case because of the ambiguity in the meaning of the phrase "including property unlawfully converted".

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[3] [2014] S.C.J. No. 53; *Geoffrey L. Moore Realty Inc. v. Manitoba Motor League (c.o.b. CAA Manitoba)*, [2003] M.J. No. 191, [2003] 9 W.W.R. 385 at para. 12 (Man. C.A.), citing *National Trust Co. v. Mead*, [1990] S.C.J. No. 76, [1990] 2 S.C.R. 410 (S.C.C.), quoted in Geoff R. Hall, *Canadian Contractual Interpretation*, Markham: LexisNexis Canada, 2012.

[4] "Such loss must be in respect of a claim for the failure of the Member to return or account for securities, cash balances, commodities, futures contracts, segregated insurance funds or other property, received, acquired or held by, or in the control of, the Member for the customer, including property unlawfully converted."

20. The Appeal Committee is of the view that the Appellant's claim is one of fraud, material non-disclosure and/or misrepresentation and does not fall within the meaning of the phrase "including property unlawfully converted". Such an interpretation would in effect create a new head of coverage. Furthermore, we have concluded that the phrase is not ambiguous and simply recognizes that circumstances may arise where a customer has provided investment funds or other property to a member firm for deposit but the funds were not posted to the customer's account.

21. The Appellant's further submitted that the Coverage Policy confers a discretion on the Board of Directors and that as such, the Appeal Committee can authorize CIPF to compensate him for his loss. The Appellant's position was that we should interpret the Coverage Policy and exercise that discretion in a fair and reasonable way. The Appellant submitted that the discretion provided for in the Coverage Policy can and should extend to authorizing coverage for losses incurred due to misrepresentations made by FLSI's principals and agents. The Appellant submitted that given its mission statement and the language in its brochure, CIPF's purpose is to protect investors and that this is a perfect case in which to grant a remedy. It was argued that it is open to CIPF to amend the Coverage Policy if it does not want to cover situations such as this in the future.

22. 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. In addition, it is important to state that the Appeal Committee is not capable of engaging in the necessary fact-finding processes to assess whether there has or has not been misrepresentation. Further, it is not a court of inherent jurisdiction and thus cannot apply principles of equity that would afford a broader form of discretion. Thus, our discretion is limited to the Coverage Policy which, in general terms, provides for the return of the Appellant's property to him. In this case, the Appellant received the Certificate representing his investment in the Special Notes Units.

23. The Appellant argued that the exercise of the Board's discretion should not be constrained by considerations arising out of Part XII of the BIA. The argument is that the Coverage Policy applies for losses relating to a Member's insolvency and not simply bankruptcy and that insolvency is a much broader concept than bankruptcy as provided for under the BIA. The Appeal Committee's view is that the reference in the Coverage Policy to the BIA merely confirms that customers of a securities firm have priority claim over the customer pool fund as of the date of bankruptcy.

24. Finally, the Appellant disputed the submission of CIPF Staff that the coverage extended by the Coverage Policy is only custodial in nature. The Appeal Committee has concluded that the Coverage Policy offers compensation for losses arising from a Member's failure as a custodian of customer property and that the CIPF does not cover losses due to bad investment advice or fraud on the part of IIROC Members.

Disposition

25. The appeal is dismissed. The decision of the CIPF staff is upheld.

Dated at Toronto, this 13th day of February, 2015.

Patrick LeSage

Brigitte Geisler

Anne Warner La Forest