

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

RE: [REDACTED] and [REDACTED]

Heard: December 9, 2015

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

Graeme Hamilton

)

Counsel for Canadian Investor
Protection Fund Staff

)

[REDACTED]

)

On her own behalf

)

On his own behalf

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 (“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 the

day after 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. 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 December 9, 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. The Appellants were in attendance.

Chronology of Events Relevant to the Appellants' Claim

(i) The Appellants' Investments and Claim

4. The claim arises from the Appellants' investments in various First Leaside Group entities for a total net claim of \$251,775.18 by [REDACTED] and \$345,195.23 by [REDACTED]. These claims include claims for stock dividends and for other amounts which CIPF Staff were unable to verify but are acknowledged by the insolvency trustee.

5. Certificates representing the Appellants' purchases were transferred to accounts in the names of the Appellants at Fidelity Clearing Canada ULC or were delivered to their possession.

(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 January 16, 2015, the Appellants were advised that CIPF

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

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....

....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.

Analysis

7. 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 projects. [REDACTED] noted that the Grant Thornton report had stated that raising new money was necessary to pay disbursements to earlier investors. She felt that this was probably happening for the 5 year period during which the Appellants had made their investments.

8. The adoption of these arguments suggests that the claim is 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. [REDACTED] noted that previous appeal hearings had stated that CIPF coverage does not include fraud; however, in his view, fraud had clearly taken place in the First Leaside Group. While he acknowledged that the Offering Memoranda would include powers of the various entities to loan

funds among themselves, he believed that this didn't create value for the investor but rather, generated worthless pieces of paper. He believed that, as in the Madoff situation, the First Leaside Group entities created fictitious statements with a false sense of value. He felt that what had occurred with the First Leaside Group was an elaborate Ponzi scheme. In addition, he referred to the IIROC and OSC decisions regarding the FLSI principals which suggested that monies from investors were improperly used to fund a lavish personal lifestyle for Mr. Phillips, which is an allegation made in litigation against Mr. Phillips, but has not yet been proven.

10. Counsel for CIPF Staff distinguished the circumstances of the Essex case in which CIPF made compensation payments in circumstances of fraud. In the Essex case, customers' funds were misappropriated and removed from their accounts without authorization; this is a fraud. CIPF coverage was applicable, not because it was a fraud *per se*, but because the customers' property was unavailable to be returned. In the case of FLSI, customers purchased specific investments relating to specific First Leaside Group entities and received certificates representing their investments. There may have been misconduct by agents of FLSI with respect to representations regarding the suitability of the investment in a particular First Leaside Group entity and CIPF coverage, but CIPF specifically does not provide coverage in instances of broker misconduct.

11. The Appellants submitted various analogies in an attempt to show that their investments in the First Leaside Group were lost or diminished in value due to a failure to return their property. For example, they suggested that making the investment was akin to giving a paper-wrapped candy to FLSI, and all they received back was the wrapper. To elaborate upon the analogy, FLSI would have given the candy to the designated First Leaside entity to which the customer had directed the investment and received back the wrapper. As to what the First Leaside entity did with the candy, that becomes part of their business judgment. The wrapper remains with FLSI and can be returned to the customer, as was the case with the Appellants. The analogy has merit; the problem is that there was no guarantee that the candy would be retained in its original form and returned, although the Appellants had that expectation, as all investors do when they make an investment.

12. As stated above, CIPF does not guarantee the value of an investment. We have heard from many appellants who have stated that they were told that their investments were safe because there was CIPF coverage. It is correct that their investments were safe, in that they would be returned to the investors in the event of an insolvency, but it seems that it was implied and believed by many investors that the coverage extended far beyond a return of property and included a “guarantee” of the principal of their investment. It does not.

13. Counsel for CIPF Staff explained 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. The Appellants have received their property; accordingly the issue of CIPF coverage is not applicable. It is most unfortunate that the value of the property is uncertain; however, the Coverage Policy clearly states that CIPF does not cover “changing market values of securities, unsuitable investments, or the default of an issuer of securities”.

14. I have considerable sympathy for the losses suffered by the Appellants; however, I conclude that the Appellants’ submissions in this appeal are not persuasive and do not give rise to a successful claim for compensation from CIPF.

Disposition

15. The appeals are dismissed. The decisions of CIPF Staff are upheld.

Dated at Toronto, this 21st day of December, 2015.

Brigitte Geisler