

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

RE: [REDACTED] AND [REDACTED]

Heard: November 30, 2015

HEARD BEFORE:

ANNE W. LA FOREST

Appeal Committee Member

APPEARANCES:

Nicolas Businger

)

Counsel for Canadian Investor
Protection Fund Staff

)

[REDACTED]

)

On their 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 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”, making it a “CIPF Member”) until its suspension by IIROC on February 24, 2012, being 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. FLSI was declared to be insolvent on February 24, 2012. The Appellants sought recovery from CIPF on the basis that FLSI was a CIPF Member 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 November 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 and [REDACTED] made submissions on behalf of both of them.

Chronology of Events Relevant to the Appellants’ Claim

(i) The Appellants’ Investments and Claim

4. The claim arises from the Appellants’ purchase by [REDACTED] of \$40,000 in units of First Leaside Wealth Management Fund and by [REDACTED] of \$40,000 in units of First Leaside Wealth Management Fund. All of these units were purchased in February of 2011. The Appellants’ purchases were transferred to accounts in the names of the Appellants at Fidelity Clearing Canada ULC (“Fidelity”).

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

5. The Appellants confirmed that they had signed directions authorizing the purchase of these investments and that they received statements in relation to the investments.

(ii) The Appellants' Application for Compensation

6. The Appellants applied to CIPF for compensation for their losses in investments made through FLSI. By letters dated January 19, 2015 to each of the Appellants, they were advised that CIPF Staff were unable to recommend payment of their claim. 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. 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 Deal Member subsequent to February 24, 2012. Therefore, the loss is not one that is eligible for CIPF coverage, as indicated above.

Analysis

7. In his submissions, the Appellant [REDACTED] made a number of arguments addressing the criteria of the Coverage Policy. As outlined at the beginning of the hearing, the Coverage Policy requires at a minimum, the fulfillment of three elements:

- a. the claimant must have been a customer of an insolvent CIPF Member;
- b. the loss must have been caused by the insolvency of the CIPF Member; and

- c. 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. That includes property that has been unlawfully converted by the CIPF Member.

There is no question that the Appellants were customers of an insolvent CIPF Member and as such, their arguments focused on the other criteria.

8. The Appellants argued that their loss was caused by FLSI's insolvency as required by the policy. In this regard, the Appellants relied upon the Grant Thornton report of August 2011. In the Appellants' submission, this Report made it very clear that there was insolvency in the companies making up the First Leaside Group. In [REDACTED] words, it was not malfeasance that led to their losses but insolvency. Furthermore, he stated that the assertion of CIPF Staff that the Appellants' losses were due to market forces was incorrect because the assets in which the Appellants invested were not liquid; i.e., there was no market for these assets.

9. In terms of the insolvency point, counsel for CIPF Staff submitted that the difficulty in this case is that the Coverage Policy addresses property not returned by a member but does not redress the insolvency of the issuers in which investments are made. In short, the losses must be caused by the insolvency of FLSI and not those issuers that were part of the First Leaside Group. In response to the Appellants' point with respect to market forces, counsel for CIPF Staff did not disagree that the investments were "illiquid" given their nature but he did indicate that the value CIPF was referring to was the fair market value of the investments in the First Leaside Group.

10. In the October 27, 2014 decision, the Appeal Committee expressly considered this matter. To fall within the Coverage Policy, a loss must arise solely as a result of the insolvency of a Member. The Coverage Policy expressly excludes losses arising from changing market values of securities, unsuitable investments, or the default of a securities issuer.

11. The Appellants also argued that their property was not returned as a result of unlawful conversion. Specifically, their understanding of the investment they were making was that each

\$1.00 they paid for a unit in the First Leaside Management Wealth Fund was to be invested in real estate investments but was instead used to support payments to other investments. In their view, that constituted unlawful conversion of their investment into investments that were not authorized.

12. In response, counsel for CIPF Staff submitted that when they purchased their units in the First Leaside Wealth Management Fund, the Appellants confirmed that they had provided directions to do so, and that the offering material made clear that the funds could be used as they were used. The units purchased by the Appellants in First Leaside Wealth Management Fund were not missing at the date of insolvency and were transferred to Fidelity. In Staff's submission, the phrase "including property unlawfully converted" was never intended to cover fraud; it was meant to deal with the situation when a customer's property left with a Member is taken.

13. The Appellants' argument in relation to unlawful conversion is similar to the argument made by the Appellant in the October 27, 2014 decision and I rely upon that decision here. Ultimately, the difficulty in this case, as in many of the others that have come before the Appeal Committee is that the facts disclose a problem of misconduct on the part of the principals of FLSI. Unfortunately, while I have great sympathy for the Appellants' losses, they do not arise as a result of the insolvency of FLSI, nor has there been a failure to return property or an unlawful conversion.

14. [REDACTED] also stated that in making their investment, the Appellants had relied on the "CIPF badge" and that representations were made by principals of FLSI that CIPF constituted an insurance policy for their investment. In [REDACTED] words, CIPF either knew or ought to have known that the CIPF logo was being used inappropriately. In his view, CIPF Members other than FLSI, market their products using the CIPF logo and presenting it as insurance.

15. The Appeal Committee has addressed this argument in a number of other decisions including the October 27, 2014 decision. The CIPF brochure makes clear that the coverage only applies to loss that is suffered as a result of the insolvency of the CIPF Member.

16. Finally, in response to the submissions of counsel for CIPF Staff, [REDACTED] stated that he could not see how FLSI could be separated from the issuers in the First Leaside Group. In his submission, none of the companies at issue in this case are independent.

17. In effect, this is an argument that the corporate veil should be pierced and that the totality of the situation be taken into consideration in assessing the coverage available under the CIPF Coverage Policy. As has been indicated in another appeal decision dated April 5, 2015, an order “piercing the corporate veil” is not within this Appeal Committee’s jurisdiction. Even if that were possible, the claim would still be one of fraud, misleading and/or fraudulent misrepresentation which is not covered by the CIPF Coverage Policy.

Conclusion

18. In the end, the October 27, 2014 decision deals extensively with the Appellants’ arguments. This Appeal Committee adopts the reasoning in the October 27, 2014 decision. As such, 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

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

Dated at Toronto, this 22nd day of December, 2015

Anne Warner La Forest