

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

RE: [REDACTED] and [REDACTED]

Heard: November 13, 2015, by teleconference

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

Nicolas Businger

)

Counsel for Canadian Investor
Protection Fund Staff

)

[REDACTED]

)

On his own behalf and on behalf of

)

[REDACTED]

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 November 13, 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 by teleconference. [REDACTED] represented himself and [REDACTED].

Chronology of Events Relevant to the Appellants' Claim

(i) The Appellants' Investments and Claim

4. The claim arises from the Appellants' investments in First Leaside Properties Fund (Class B and Class C) for a total value of \$125,074 by [REDACTED] and \$10,074 for [REDACTED]. In addition, claims are made for stock dividends in the amount of \$19,340 for [REDACTED] and \$743 for [REDACTED]. [REDACTED] had claimed the value of an investment in Merrill Lynch & Co. Inc. NT LKD for a value of \$10,130; however, he acknowledged that this investment had been transferred to his account at Fidelity Clearing Canada ULC ("Fidelity").

5. Certificates representing the Appellants' purchases were transferred to accounts in the names of the Appellants at Fidelity.

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

(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 December 10, 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, 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.

Analysis

7. [REDACTED] made reference to the submission of another CIPF Appellant ([REDACTED]) and also referred to the reply submissions of CIPF Staff. His main argument appeared to be that the Appellants' investments had value which was then depleted as part of the insolvency processes for the First Leaside Group entities. As a result, although the certificates representing the Appellants' purchases were transferred to Fidelity, they were not in the same financial condition as at the time the Chief Restructuring Officer for the First Leaside Group was appointed.

8. [REDACTED] observed that the excessive fees paid to the insolvency trustee, accountants and lawyers had an impact upon the value of the Appellants' investments. He suggested that CIPF's compensation should address the difference between the book value of the investments prior to the insolvency process and any payout which might be received from the insolvency trustee.

9. The value of the Appellants' investments at any particular point in time is uncertain. The account statements which were regularly received continued to show a value of \$1.00/unit invested. It is clear from the Grant Thornton report that the various First Leaside Group entities were in some financial difficulty in 2011 and accordingly, that value would be questioned. How that financial difficulty would have reflected upon the true value of the units held in the various entities is unknown. In any event, the Coverage Policy clearly excludes "losses that result from changing market values of securities, unsuitable investments, or the default of an issuer of securities".

10. [REDACTED] also submitted that the Madoff² decision supported the proposition that compensation by SIPA (a U.S. fund generally equivalent to CIPF) compensated for losses as a result of fraud and that a similar approach should be taken in the FLSI appeals. The Appeal Committee's October 27, 2014 decision, in paragraph 32, stated that fraud was not covered:

After careful consideration, we conclude that fraud, material non-disclosure and/or misrepresentation, as alleged in this case, are not covered by the words "including property unlawfully converted" under CIPF's Coverage Policy. The Appeal Committee does not find the phrase to be ambiguous. It is clear that the intent of the Coverage Policy is to return property in the Customer's account to the Customer in the event of the insolvency of the Member. The inclusion of the phrase simply recognizes that circumstances may arise where the Customer has provided investment funds or other property to the Member for deposit to their account, but the funds were not posted to the Customer's account; in other words, the property has been "unlawfully converted".

11. The written submission referenced the insolvency of Essex Capital Management Limited ("Essex"), wherein compensation was paid to customers in circumstances of fraud. Those circumstances differ not only for these Appellants but for other FLSI Appellants. In the Essex matter, 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. 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

² *In re Bernard L. Madoff Investment Securities LLC*. (2011) 654 F.3d 230 (2nd Circ.)

and CIPF coverage, but CIPF specifically does not provide coverage in instances of broker misconduct.

12. The kind of claim that is eligible for compensation from CIPF is one that arises from circumstances described in the Essex matter; that is, where customer funds have been diverted from their intended objective. 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 this is not an issue of CIPF coverage. It is most unfortunate that the property has lost almost all of its value.

13. [REDACTED] noted that the FLSI account statements showed the CIPF logo, implying that First Leaside was covered by CIPF. Counsel for CIPF Staff explained the nature of the CIPF coverage, as described above. [REDACTED] suggested that CIPF could do a better job at ensuring that the narrowness of its coverage is understood by industry participants. As has been stated in other Appeal Committee decisions, this sort of observation by Appellants is taken seriously by the CIPF Board of Directors.

14. I have 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 23rd day of November, 2015.

Brigitte Geisler