

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

RE: [REDACTED]

April 7, 2015

PANEL:

Patrick J. LeSage

Appeal Committee Member

APPEARANCES:

[REDACTED]

Appellant, on his own behalf

James Gibson

**Counsel for the Canadian
Investor Protection Fund
Staff**

DECISION AND REASONS

Introduction and Overview

1. [REDACTED] (the “Appellant”) was a client 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 Appellant invested \$100,000 in First Leaside Ultimate Limited Partnership (Ultimate) on December 29, 2010. He received return of capital of \$5,889.78. His claim therefore is \$94,110.22.

3. The Appellant sought recovery from CIPF on the basis that FLSI was a Member of CIPF and as such the Appellant was entitled to protection through the Fund, which was established to provide coverage in the event of insolvency. On June 18, 2014, CIPF Staff denied 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.

4. The Appellant requested that this appeal be considered on the basis of written materials, which he provided. As well, he relied on the arguments raised by Representative Counsel for the Investors of FLSI, which are referred to in the October 27, 2014 decision, in particular paragraphs 27 to 49. [REDACTED] made very forceful and articulate additional submissions orally.

5. Certificates representing this investment had been delivered and were not in the custody of the FLSI on the date of the insolvency. The investment made by [REDACTED] on December 29, 2010 occurred subsequent to the OSC commencing its investigation of the First Leaside entities and subsequent to the OSC seeking third party market valuations of real property owned by First Leaside in November 2010.

6. The essence of [REDACTED] submission is that the First Leaside Group of companies, of which FLSI was but one, was at least by the time of his investment nothing more than a fraudulent Ponzi scheme operating - to paraphrase - robbing [REDACTED] to pay First Leaside, rather than investing his money for the purpose they promised in their sales pitch.

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

7. Further, the Appellant submits that, in permitting the CIPF logo to be attached to both the promotional material and monthly statements without regulating and supervising the logo's use, CIPF gave its imprimatur and in effect indirectly became a party to First Leaside's deception and fraud. As a result of CIPF's passive acquiescence to the use of its logo, the Appellant argues that CIPF became legally responsible or at the very least morally responsible for what happened to the investors. Because of this, the Appellant submits, CIPF should on moral grounds exercise its discretion and compensate the investor victims of this First Leaside fraudulent scheme.

8. Further, the Appellant submits, the FLSI should not be viewed as a stand-alone legal entity; rather FLSI should be considered simply an adjunct of the First Leaside Group and 'unlawful conversion' should be assessed in terms of the deceitful, dishonest conduct of all the First Leaside Group, not solely FLSI. In essence, he submits that the corporate veil should be pierced and the totality of the transactions be taken into consideration in determining the liability of FLSI and the coverage available under CIPF.

9. Further, if CIPF coverage does not, as CIPF submits, include theft, deceit, falsehood and other fraudulent means (fraud) or other dealer misconduct then CIPF had an obligation to make clear that position in the material provided to the investor by the broker. In failing to control how its coverage is communicated to investors, the Appellant submits that CIPF allowed brokers such as FLSI to mislead its investors into believing that everything is covered, or as one of the investors related that he was told: the CIPF coverage made the investment 'safer than the bank'.

10. [REDACTED] further submitted that his investment was used by Ultimate for loans to other First Leaside entities, and to cover expenses relating to the operation of those companies rather than the purpose of his investment, the purchase of property in Texas.

11. [REDACTED] also submitted neither this appeal, nor the dozens if not hundreds of similar appeals flowing from the FLSI insolvency should be heard until the conclusion of the civil action against the OSC flowing from its role in the First Leaside losses.

12. [REDACTED] also submits all the claims arising from the FLSI insolvency should have been dealt with by the Appeal Committee at one hearing. His reasoning is that the result of the cases already dealt with would be different if the enormity of the loss and suffering, caused by the misleading, fraudulent conduct of FLSI and the First Leaside Group were to have been heard at one time.

13. Last and certainly not least, the Appellant submits that the conduct of FLSI amounted to an unlawful conversion.

14. Although many of [REDACTED] arguments are appealing, my task is to determine the outcome, based on the legal and factual interpretation of the coverage policy that applies. Let me deal first with unlawful conversion. Unlawful conversion at its simplest means the converting of another's property that is in your possession, to or for a purpose beyond the terms that govern that possession. For example [REDACTED] transferred money from himself to FLSI so they could purchase units of Ultimate for [REDACTED] [REDACTED]. That is what FLSI did. Further when FLSI received the documentation/certificates reflecting that investment its responsibility was to either hold the certificates in trust for [REDACTED] [REDACTED] or to transfer them at his direction. That is what FLSI did. Simply put FLSI handled the money \$100,000 as directed by [REDACTED] and handled these certificates, the indicia of the investment, as directed by [REDACTED]. There was no unlawful conversion by FLSI.

15. [REDACTED] also submits that it is wrong to to make the determination of coverage by looking only at the actions of FLSI. He urges me to treat all of the First Leaside Group of companies including of course , FLSI and Ultimate as one entity. His position is that all the First Leaside Group of legal entities, including FLSI were created, designed and operated as one giant Ponzi scheme to defraud the public. On that premise he submits that the corporate veil ought to be pierced. He submits his claim should be considered in light

of the conduct of all of the First Leaside Group of companies, including the promoters of these investments.

16. An order ‘piercing the corporate veil’ is not within this Committee’s jurisdiction. Even if the corporate veil were pierced, where would that leave the investors? Based on the appellant’s submission, it would be a claim of fraud, misleading and/or fraudulent misrepresentation. Perhaps even theft. None of which are covered by the CIPF policy.

17. The appellant’s submission concerning Ultimate’s misuse of his funds must be considered in light of the very broad terms set out in the promotional material regarding the objects of Ultimate. [REDACTED] recollection of the permitted uses of the monies invested in Ultimate was far more restricted than the actual objects of Ultimate that included, amongst many other things, loaning money to other FL Group entities. As I understand his submission, his \$100,000 investment was not used to purchase property in Texas, which appeared in the promotional material as a/the principal object of Ultimate. Even if the monies invested are utilized for purposes other than permitted by Ultimate, which is far from clear, and even if they were, as [REDACTED] submitted, fraudulently misappropriated, such losses are clearly not included in the FLSI CIPF coverage.

18. [REDACTED] submits that CIPF was, at a minimum negligent and at worst reckless in permitting its logo to be misused by both FLSI and the First Leaside Group. Further, the lack of oversight and regulation by CIPF, he argues, permitted the First Leaside Group to use the CIPF logo in a manner that purported or at least strongly suggested that CIPF coverage applied to the investment entities that were raising the funds.

19. Counsel for CIPF staff submits that the CIPF brochure makes clear, the coverage applies only to loss or losses suffered as a result of the insolvency of the broker FLSI. Further there is no suggestion or even a hint that it covers economic or other losses of the entities in which investments are made.

20. I agree with CIPF staff counsel on that issue. I also agree with CIPF staff counsel when he submits that CIPF is not a regulator in any sense of that word. Further, I understood the evidence of [REDACTED] to be, he had not read the brochure.

21. [REDACTED] also correctly submits that this Appeal Committee has a discretion to exercise, which could grant compensation to the investors even if CIPF is not technically or legally bound to so provide.

22. As attractive as that position is, particularly where so many investors have lost so much and the consequences of those losses have often been so devastating, it would in my view be beyond judicious discretion to cover the appellant's \$94,000+ loss in this case. In part I say that because if the Committee were to exercise that discretion for [REDACTED] it would be only reasonable to provide that same coverage to all the FLSI investor clients. The result would be an approximate \$200,000,000 discretionary payment. In any event, 'discretion' cannot be stretched to allow a whole new classification of coverage that is clearly not included in existing coverage. I decline to make such Order.

23. [REDACTED] also requested that all the investors' appeals be heard together and after the determination of the litigation between certain of the investors and the Ontario Securities Commission.

24. I am not convinced there is a persuasive, or practical reason to adjourn the Appellant's hearing, let alone all upcoming appeals to await the conclusion of the Ontario Securities Commission litigation. In the result I refuse [REDACTED] request in that regard.

25. As stated above, the purpose of CIPF coverage is limited to custodial coverage. As was indicated in the October 27, 2014 decision, the CIPF brochure outlines limitations on coverage. Furthermore, had any misrepresentations in relation to CIPF been made,

they were made by FLSI. Oversight of members is primarily the jurisdiction of IIROC, with additional oversight by the Ontario Securities Commission.

26. As in the October 27, 2014 decision, while I may have considerable sympathy for the Appellant's position, I conclude that his submissions in this appeal do not give rise to a legally valid claim for compensation from CIPF.

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

Dated at Toronto, this 19th day of June, 2015

Patrick J. LeSage