

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

██████████, ██████████ and ██████████

May 13, 2015

PANEL:

Patrick J. LeSage

Appeal Committee Member

APPEARANCES:

██████████

For all Appellants

James Gibson

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

DECISION AND REASONS

1. ██████████, ██████████ and ██████████ (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 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. Each of the Appellants invested in First Leaside Group entities through FLSI. [REDACTED] investments, totalling \$78,572 were made in February 2009 and in February, July and December 2010. [REDACTED] investments, totalling \$78,572, were made in February 2009, February, October and December 2010. [REDACTED] (the Business) investments, totalling \$150,000, were made on June 8 and September 29, 2011. The total claimed by the two individuals and the Business was \$307,144.

3. 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 a loss arising from insolvency. By letters on July 8 and November 12, 2014, CIPF Staff denied compensation to the Appellants on the basis that their 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. [REDACTED] requested that these appeals be considered on the basis of the Appellants' written submissions, the last of which were introduced at the hearing on May 13, 2015, as well as on his oral submissions. Although not specifically requested by [REDACTED], I inferred from his argument that he also relied on the submissions of Representative Counsel for the Investors of FLSI, which are referred to in the October 27, 2014 decision, in particular paragraphs 27 to 49.

5. [REDACTED] provided an articulate commentary of the events surrounding the Appellants' investments. He brought attention to the IIROC Recognition and Ancillary Orders of the OSC in May and June 2008, and the obligations imposed on IIROC and its members by those Orders. He submitted that David Phillips of the First Leaside Group misused the funds the Appellants invested. He said that those funds were unlawfully converted by Phillips and the First Leaside Group as well as by FLSI. He submitted that the most glaring example of the unlawful conversion was when Phillips came to the

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

Appellants' offices and sold the Appellants First Leaside product on September 29, 2011. This meeting was one month and ten days after Phillips had received Grant Thornton's August 19, 2011 report, which disclosed the financial difficulty faced by Phillips/First Leaside Group and their businesses and its products. The contents of that report had not been disclosed to potential investors such as the Appellants or other members of the public, but they were known to Phillips at the time he persuaded the Appellant to invest.

6. [REDACTED] submitted that David Phillips, FLSI and First Leaside Group all knew that monies invested, certainly after August 19, 2011, if not long before, were not going to be utilized for investment. Rather, those monies would be used to pay already-incurred expenses or to prop up a multitude of First Leaside entities. Thus, he submitted Phillips/FLSI and First Leaside Group not only misled the Appellants, they actually used the invested money for purposes other than the investors had intended. This, [REDACTED] submitted, is unlawful conversion. Further, he submitted that the Appellants' clear, unequivocal direction to FLSI was that their investments were to be 50% low risk and 50% medium risk. Nevertheless, FLSI sold them investments that, most charitably, could only be described as high risk.

7. The Appellants' position, it seems to me, relates to the failure on the part of FLSI and perhaps as well as on the part of Phillips and First Leaside Group to disclose the financial difficulties in particular at the September 29, 2011 investments.

8. Assuming for the purpose of this decision that the Appellants were deceitfully or fraudulently misled by any or all of FLSI, First Leaside Group, and David Phillips, which lies at the heart of the allegations, CIPF does not extend coverage for deceit, misrepresentation, or fraudulent failure to disclose or for the manner in which the investment entity used the invested monies. However, it must also be recognized that the investment entities' disclosed use of the invested monies was exceedingly broad and extensive. For example, First Leaside Wealth Management Fund and Wimberly Fund in which the Appellants invested had as one of its objects ... "To deal with promissory notes issued by First Leaside Entities or otherwise with First Leaside Securities'. The

other entities in which the Appellants invested, had as one of their objects ... “to deal with securities related to real property in Canada in the U.S.”.

9. All the certificates of the Appellants’ purchases were either transferred as directed by the Appellants or by the Receiver at the time of insolvency. Any cash and or certificates in the accounts were or have been returned to the Appellants. When asked by Mr. Gibson, counsel for CIPF staff, if the product purchased on the Appellants’ behalf by FLSI was what they directed FLSI to purchase [REDACTED] agreed that it was. It is not an unlawful conversion when the Appellants, as in this case, transfer monies to FLSI to purchase specific products. And FLSI did just that.

10. As stated in earlier decisions flowing from this FLSI insolvency, the coverage policy offers compensation for losses occurring from a member’s failure as a custodian of the customer’s property and for unlawful conversion. It is coverage for what should be in one’s account at the date of insolvency.

11. CIPF coverage is limited to custodial coverage. As was indicated in the October 27, 2014 decision, the CIPF brochure outlines this limitation on coverage. Any misrepresentations of the coverage that may have been made were not made by CIPF but by FLSI and/or the promoters of the First Leaside Group who were selling the product. Oversight of brokers is primarily the jurisdiction of IIROC with additional oversight by the Ontario Securities Commission.

12. As in earlier decisions, while I have sympathy for the Appellants’ position, it does not change the fundamental fact that their appeal does not meet the requirement of establishing a valid legal claim for coverage under the terms of the CIPF program.

13. These appeals must therefore be dismissed. The decisions of the CIPF Staff are upheld.

Dated at Toronto, this 29th day of June, 2015

Patrick J. LeSage