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

RE: [redacted]

Submitted: September 2015

PANEL:

PATRICK J. LESAGE	)	Appeal Committee Member

APPEARANCES:

In writing	)	Appellant, [redacted]
In writing	)	Counsel for Canadian Investor Protection
	)	Fund Staff, James D.G. Douglas

DECISION AND REASONS

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 ("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, released on December 17, 2014.[1]

2. This appeal is an 'in writing' appeal.

3. [redacted] commenced investing in First Leaside Group entities, through FLSI in December 2006. Over a period from 21 December 2006 up to and including 17 October 2011, he invested approximately $1,300,000. He has recovered about $350,000. His net claimed loss is $993,381.54.

4. 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 a loss arising from insolvency. By letter dated 15 September, 2014, CIPF Staff denied compensation to the Appellant on the basis that his loss did not arise as a result of the insolvency of FLSI and thus was not covered under the CIPF Coverage Policy dated September 30, 2010.

5. The Appellant requests I consider his written material, any relevant background information that has been presented at earlier appeal hearings, as well as the arguments raised by Representative Counsel for investors of FLSI referred to in earlier hearings.

6. The Appellant's written submissions include the following:

   i. FLSI was, and had consistently marketed itself to customers such as myself as being a CIPF member since 2004. In fact, they consistently remarked how my investment is insured through CIPF from the beginning of my investment through to 2012.

   ii. I deposited money with FLSI on various dates starting on December 21, 2006, with the last deposit dated August 11, 2011 [sic]. By the time of the Member's insolvency, I had deposited approximately $1,342,496.01 (the "Claimed Funds") in account(s) held with FLSI through its carrying broker, Penson Financial Services Canada Inc., which funds 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.

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

iii. I have since learned that the Claimed Funds, all of which were deposited between December 2006 and August 2011 [sic], were not used for my intended investment purpose, but rather were unlawfully converted by First Leaside for its own use. In this regard, and unbeknownst to me, First Leaside was also the subject of an ongoing Ontario Securities Commission ("OSC") investigation from 2009 through 2011. The significant internal and regulatory concerns which lay at the heart of that investigation ultimately led to the retention of a consultant, Grant Thornton Limited ("Grant Thornton"), to review and prepare a report on First Leaside's operations and financial viability. Upon completing that review, Grant Thornton, in a report provided to First Leaside on August 19, 2011, concluded that without the infusion of new capital, First Leaside would be unable to continue to operate:

> The future viability of [First Leaside] is contingent on their ability to raise new capital…If [First Leaside] was restricted from raising new capital, it would likely be unable to continue its operations in the ordinary course as it would have insufficient revenue to support its infrastructure, staffing costs, distributions, and to meet their funding requirements for existing projects.

iv. Despite the concerns which had been identified by early 2009, and the release of Grant Thornton's report in August 2011, it was not until three months later, in November 2011, that I was first advised that the OSC had been investigating First Leaside and had told the company that it was "*not appropriate to use money raised from new investors to fund the operating losses, rehabilitation costs and distributions of existing limited partnerships*". Indeed, it was only at this late date that First Leaside was prevented from raising further capital, through FLSI, from customers such as myself. While this was discovered due to the investigation of FLSI, it was evident that FLSI was operating in this manner well before the investigation.

v. In fact, from my first investment in December 2006 through to November 2011, FLSI solicited, accepted and proceeded to use the Claimed Funds for its own purposes in a manner which was contrary to my rights in and to that money – all while intentionally

misleading me as to why First Leaside actually required, and how it intended to use my money. To date, only $349,114.46 of the Claimed Funds have been returned to me. It is my understanding that this includes the small fraction of the Claimed Funds that have been returned to me through the receivership process.

vi. FLSI's solicitation and use of the Claimed Funds represented an unlawful conversion of that money. In particular, in soliciting and accepting my money while knowingly concealing from me that First Leaside's financial viability was entirely contingent on FLSI's ability to obtain such further deposits, FLSI unlawfully induced me to deposit the Claimed Funds. In such circumstances, any direct or implied consent which I may have provided to withdraw the Claimed Funds from my account(s) in order to purchase investment products offered by First Leaside was vitiated and of no force or effect.

vii. There is no doubt that the insolvency (and related suspension of FLSI's registration) was effected, in large part, so as to protect future investors from the systemic misuse of funds by FLSI. There is similarly no doubt that that same insolvency rendered FLSI unable to return the Claimed Funds. In such circumstances, it cannot have been intended that existing FLSI customers such as myself (who are victims of the same misconduct which the regulators eventually acted to prevent) should alone have to bear the burden of that policy decision – particularly given CIPF's express mandate to contribute to the security and confidence of customers of Canadian investment dealers by maintaining adequate resources to return assets to eligible customers in cases where a Member becomes insolvent.

viii. In the result, I hereby seek recovery under CIPF's coverage policy in the full amount of the Claimed Funds (less any amounts which I have or may actually recover through future receivership processes) – being losses which I incurred solely as a result of the insolvency of FLSI and its failure to return funds rightfully belonging to me but wrongfully converted by FLSI.

7. It is to be noted that both IIROC and the OSC found David Phillips and John Wilson guilty of egregious conduct that violated rules, regulations and statutes that governed their professional involvement with the First Leaside Group of companies.

8. Counsel for CIPF Staff submit in their written materials that, CIPF, as explained in their brochure, makes clear that coverage applies only to losses suffered as a result of the insolvency of the broker, FLSI. It does not cover economic or other losses suffered by the entity in which the investment has, at the direction of the client, been made.

9. The amended, consolidated and related declarations of trust, the offering memoranda of the various First Leaside Funds in which [redacted] invested all provided authority for the specific fund to invest in or make loans to other First Leaside entities. We know from the materials now disclosed from the insolvency that many of the investments ended up with other entities other than the specific entity in which the investor may have invested.

10. Assuming for the purpose of this decision that [redacted] was deceitfully and fraudulently misled as to what use his invested money was to be put, it is clear the coverage policy does not compensate for losses occasioned by deceit, misrepresentation or fraudulent failure to disclose, or for the manner in which the investment entity used the client's investment monies.

11. Although many of [redacted]'s arguments are appealing, my task is to determine the outcome, based on the legal and factual interpretation of the coverage policy that applies. I have already referenced the fact that CIPF coverage does not compensate for losses occasioned by deceit, misrepresentation or fraudulent failure to disclose, but it does permit a claim in the event of unlawful conversion.

12. 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 First Leaside Fund (Series C) (Series A), First Leaside Expansion, First Leaside Fund (Series B), etc. etc. etc. for [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] or to transfer them at his direction. That is what FLSI did. Simply put, FLSI handled the monies

provided by [redacted] as directed by [redacted] and handled those certificates, the indicia of the investment, as directed by [redacted]. There was no unlawful conversion by FLSI.

13. 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 on the date of insolvency.

14. 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.

15. Whilst I have sympathy for the Appellant's position, it does not change the fundamental fact that this appeal does not meet the requirement of establishing a valid legal claim for coverage under the terms of the CIPF policy.

16. The appeal must therefore be dismissed. The decision of the CIPF Staff is upheld.

Dated at Toronto, this 17th day of December, 2015

P. J. Lesage

Patrick J. LeSage