

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

RE: [REDACTED] and [REDACTED]

Heard: July 15, 2015

HEARD BEFORE:

Anne Warner La Forest

Appeal Committee Member

APPEARANCES:

James Gibson

)
)

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 (“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 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 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 July 15, 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 was heard by way of teleconference.

Chronology of Events Relevant to the Appellant(s)’ Claim

(i) The Appellants’ Investments and Claims

4. The Appellant, [REDACTED], has claimed an amount of \$95,815.71 in relation to the following investments:

- i. 25,000 units in the First Leaside Premier Limited Partnership purchased on March 4, 2009;
- ii. 25,000 units in the First Leaside Visions II Limited Partnership purchased on March 4, 2009;

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

iii. 5,000 units in First Leaside Fund (Series B) received from the Appellant, [REDACTED], on March 5, 2009; and

iv. 40,815.71 units in Wimberley Apartments Limited Partnership (“WALP”).

5. The investments in the First Leaside Premier Limited Partnership and the First Leaside Visions II Limited Partnership were held “off book” and certificates were delivered out to the Appellant on March 5, 2009. The units in the First Leaside Fund (Series B) were transferred to Fidelity in December of 2012. As to the WALP units, CIPF Staff was unable to identify any transactions related to these units in the available accounts statements. CIPF Staff do not have access to account statements created prior to March 1, 2004, the date when FLSI became a member of IIROC. CIPF Staff reserved the right to request further documentation in the event this Appellant is successful in this appeal. In any event, these units were held “off book” and a certificate dated December 31, 2009 was included in the materials provided to me. The offering memorandum, declaration of trust, and limited partnership agreements relevant to these investments authorized the use of funds by First Leaside Group.

6. The investments made by the Appellant, [REDACTED], in March of 2009 predate the commencement of the OSC investigation in the fall of 2009. The WALP investment that the Appellant claims was made in December 2009 was made after the commencement of the OSC investigation but before any request for third party valuations of FLSI was made in connection with that investigation.

7. The Appellant, [REDACTED], has claimed an amount of \$187,752.86 in relation to the following investments:

i. 30,000 units of Merrill Lynch & Co. Inc. INFL LKD VR29JN15 purchased on August 30, 2006;

ii. 78,000 units in the First Leaside Fund (Series C) purchased on September 11, 2006 and dividends for December 31, 2006 (2,496 units), December 28, 2007 (7,705 units), December 16, 2008 (8,445 units), December 31, 2009 (9,255 units) and April 15, 2011 (10,144 units). The Appellant also claims a further transaction of 8,980.78 units in relation to this Fund. CIPF Staff

was unable to identify any transactions in relation to this last investment and reserved the right to request further documentation;

iii. 2,600 units in the First Leaside Properties Fund (Class C) purchased on August 23, 2007 and dividends for December 28, 2007 (84 units), December 16, 2008 (251 units), December 31, 2009 (275 units) and April 15, 2011 (301 units). The Appellant also claims a further transaction of 275.08 units in relation to this Fund. CIPF Staff was unable to identify any transactions in relation to this last investment and reserved the right to request further documentation;

iv. 20,000 units in the First Leaside Fund (Series B) purchased on February 14, 2008. On March 5, 2009, 5000 of the units were transferred to Mr. DiMartile (see paragraph 4(iii)); and

v. 13,941 units in 90 King Street East MPOC 6% 6Feb16 (“King Street East”) purchased on March 9, 2011.

8. The Appellant’s investments in the units in Merrill Lynch & Co. Inc., King Street East, First Leaside Fund (Series C) and First Leaside Properties Fund (Class C) were held “on book” and were transferred to Fidelity in December of 2012. In terms of the First Leaside Fund (Series B), 5,000 units were held “on book” and these units were transferred to Fidelity in December of 2012. 10,000 of the units were held “off book” and delivered out to the Appellant on February 26, 2009. The declaration of trust, and prospectus relevant to the First Leaside Fund and the First Leaside Properties Fund authorized the use of funds by First Leaside Group. The documentation relevant to the investment in Merrill Lynch & Co. Inc. was not available and the investment in King St. East was not applicable.

9. All but one of the investments made by the Appellant, [REDACTED] [REDACTED], predate the commencement of the OSC investigation in the fall of 2009.

(ii) The Appellants' Application for Compensation

10. The Appellants applied to CIPF for compensation for their losses in investments made through FLSI prior to the October 12, 2013 deadline for submitting claims that was set by the CIPF Board of Directors. The Appellants also provided additional information regarding the claim. On their Claim Form dated August 4, 2012, it was indicated that the amount claimed was due to the default of the issuer of the securities. The Appellants also provided an explanation in a Claim Form that was initially dated August 7, 2009 and then subsequently re-dated January 8, 2014.

11. Letters dated April 7, 2014 advised the Appellants that CIPF Staff were unable to recommend payment of his/her/their claim. The relevant parts of the letter reads 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. 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 or the conversion of your property. 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.

With respect to the securities that you purchased and which [were held "on book"], they were properly recorded in the books and records of FLSI at the date of insolvency. Those securities were transferred to an account [accounts] in your name at another IIROC Dealer Member subsequent to February 24, 2012.

Furthermore, at the date of insolvency, the securities [that were held "off book"] were not held by, or in the control of, FLSI. Therefore, the loss is not one that is eligible for CIPF coverage, as indicated above.

In addition, you indicated that your loss, or part of it, was a result of "the default of an issuer of securities". As mentioned above, losses resulting from the default of an issuer of securities are not covered by CIPF.

12. On April 18, 2014 the Appellants instituted an appeal in relation to CIPF Staff's decision. In this regard, they submitted written submissions supporting their appeal dated June 10, 2015.

Analysis

13. The arguments raised by the Appellants in their Claim Forms are similar to those that were addressed in the October 27, 2014 decision and in this regard, I rely upon our analysis in that decision at paragraphs 27 through 49.

14. The Appellants emphasized two points in their written submissions dated June 10, 2015 and at the hearing.

15. First, the Appellants submitted that they had engaged in considerable due diligence before deciding to invest their retirement funds with FLSI; they were very concerned that these funds be placed only in safe investments. In their words, they took every reasonable step to check the background of the individuals involved at FLSI and to assess its business practices. Among other things, they contacted CIPF to ensure that FLSI was a member in good standing before investing. Initially, their investments were in government bonds. Ultimately, however, they were persuaded to invest in First Leaside Group products in part because CIPF logos were on the materials they reviewed and in part because John Wilson of First Leaside had told them that they were protected. Conversely, they were not told that their funds would be used to pay back other investors. The Appellants believe that their investments should be covered by the CIPF because its role is to protect investors. The Appellants in effect argue that there was nothing else that they could do to prevent their losses.

16. Second, the Appellants took the position that since FLSI was authorized to use the CIPF logo, the latter has a duty to validate that the business practices of its members are legal and appropriate.

17. For his part, counsel for CIPF Staff referred to the Coverage Policy and stated that the CIPF does protect investors in the event of insolvency of a member such as FLSI but the loss that is protected must be one where the CIPF member fails to account for securities or cash held by or in

the control of the member. In this case, it was acknowledged by the Appellants that those investments that were held “on book” had been transferred to Fidelity in December of 2012 and that they held the certificates for those investments that were held “off book”. Counsel for CIPF Staff did not question that the Appellants had done their due diligence and indeed suggested that they had done more than most reasonable people would have done. His submission was simply that the Coverage Policy does not cover misconduct or misrepresentations by FLSI. As to the second argument, counsel for CIPF Staff stated that the role of the CIPF is to make payments where a claim falls within the Coverage Policy and that other organizations are primarily responsible for regulating the business practices of members.

18. The role of the Appeal Committee is to assess whether the Appellants’ losses fall within the Coverage Policy. Both at the hearing and in their written submissions, the Appellants’ admitted that they invested in First Leaside Group products because they relied on assurances made by FLSI both about the investments and the role of the CIPF. As we have indicated on several occasions, the Coverage Policy does not provide protection for a claim for losses suffered as a result of fraud, material non-disclosure and/or misrepresentations by FLSI. The CIPF does not have control over how the scope of coverage is described by others. Furthermore, oversight of members is within the jurisdiction of IIROC. While there is no question that the principals of FLSI acted wrongfully, those actions constitute regulatory breaches and are not within the scope of the Coverage Policy.

19. The Appeal Committee has considerable sympathy for the Appellants. I concur with counsel for CIPF Staff that the Appellants engaged in more due diligence than is often the case. Unfortunately, their submissions do not give rise to a successful claim for compensation from CIPF.

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

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

Anne Warner La Forest