CANADIAN INVESTOR PROTECTION FUND
INDUSTRY RISK COMMITTEE APPEAL

B E T W E E N:

THE CLAIMANT

Appellant

- and -

CANADIAN INVESTOR PROTECTION FUND

Respondent

BRIEF OF THE APPELLANT

PART I – NATURE OF APPEAL

1. This is an appeal by the Claimant (as such individual is defined in Schedule 'A' of the Claimant Information), from the decision of the Canadian Investor Protection Fund ("**CIPF**") denying compensation to the Claimant for losses suffered as a result of the insolvency of First Leaside Securities Inc. ("**FLSI**") in accordance with the CIPF Coverage Policy dated September 30, 2010 (the "**Coverage Policy**").

PART II – SUMMARY OF CLAIM

2. This is one of approximately 900 appeals arising from CIPF's rejection of compensation claims by the investors of FLSI (the "**Investors**"). The fundamental issue in these appeals is the interpretation of the Coverage Policy and the exercise of CIPF's discretion to compensate the victims of FLSI.

3. The Coverage Policy can clearly respond to the circumstances of these claims and CIPF's discretion can be exercised to achieve the objectives of CIPF's mission statement, being "[t]o contribute to the security and confidence of customers of IIROC

Dealer Members". Alternatively, the Coverage Policy can be interpreted in an extremely restrictive fashion, as has apparently occurred in the wholesale rejection of the Investor claims to date, such that it is nearly impossible to contemplate a compensation payment in any circumstance.

4. Based on the reasons for denying claims as set out in the CIPF claim rejection letters, the issue on this appeal is whether FLSI "unlawfully converted" cash that it received from the Investors. It is clear that the Claimant provided cash to FLSI which was to be converted to First Leaside products. However, it is equally clear that the Claimant did not consent to the cash being converted to First Leaside products in circumstances where there was material non-disclosure that: (1) the financial structure of First Leaside was a house of cards, dependent on new money being raised from future victims; and (2) the underlying real estate value was overstated and leveraged in such a fashion that there was little, if any, Investor equity. As such, the Claimant is entitled to the return of the cash that otherwise ought to have been in FLSI's client accounts.

5. The Claimant is of the view that the facts and submissions below clearly justify CIPF making compensation payments to the Claimant in accordance with the Coverage Policy, and that any discretion of the CIPF directors ought to be exercised in favour of the Claimant in accordance with CIPF's express mandate.

PART III – OVERVIEW OF FACTS

First Leaside Securities Inc.

6. First Leaside Wealth Management Inc., through its various affiliated companies, trusts and limited partnerships (the "**First Leaside Group**") provided investment and wealth management services to over 1,200 investors (the "**Investors**").[1] The Investors invested with the First Leaside Group through FLSI.

7. FLSI was an investment dealer governed by Ontario securities law and regulated by both the Ontario Securities Commission ("**OSC**") and the Investment Industry Regulatory Organization of Canada ("**IIROC**").[2] FLSI is a member of the Canadian Investor Protection Fund ("**CIPF**"). [3]

8. FLSI managed a portfolio of non-proprietary investment products, consisting generally of more conservative investments such as bonds, treasury bills and marketable securities (the "**Marketable Securities**"), as well as proprietary equity (such as limited partnership units) and debt securities issued by entities related to or under common control with FLSI, generally in respect of real estate holdings (collectively the "**FL Investments**").[4]

9. In total, since FLSI became an IIROC dealer, it solicited approximately $370 million from Investors. Of this total only $86 million dollars of the funds were invested in

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1 *Affidavit of Gregory MacLeod, Chief Restructuring Officer*, sworn February 22, 2012 without Exhibits except Exhibit B, Application Record of First Leaside Wealth Management Inc. returnable February 23, 2012, Tab 2, at para 4, at Compendium of The Investors, Tab 1["***MacLeod Affidavit"***].

2 *Macleod Affidavit,* para 6 at Compendium of The Investors, Tab 1.

3 Canadian Investor Protection Fund, "Current CIPF Members", (8 October 2014) , online: <http://www.cipf.ca/Public/MemberDirectory/CurrentMembers.aspx>, at Compendium of The Investors, Tab 2.

4 *MacLeod Affidavit* at para 6 at Compendium of The Investors, Tab 1.

publicly-traded securities including Marketable Securities, with the remaining amounts being converted into FL Investments.[5]

10. The FL Investments were intended to provide Investors with capital appreciation (based largely on acquisition and rehabilitation of real estate projects), potential tax deductions (in the case of equity investments) and consistent monthly distributions.[6]

The Investors of First Leaside Securities Inc.

11. All Investors who invested in FL Investments opened their accounts through FLSI (the "**FLSI Accounts**"). On the 'Relationship Disclosure for New Clients of [FLSI]' form it was made clear to Investors that "[FLSI] will be responsible for determining suitability and ensuring appropriate supervision is performed for all trading activity in client accounts."[7]

12. Investors transferred all money that was eventually used by FL Investments into the FLSI Accounts. When the money in the FLSI Account was converted to a FL Investment it was all cleared through the FLSI Account.[8] Furthermore, FLSI was the agent for each FL Investment transaction.[9] Marketable Securities were held through a carrying broker Penson Financial Services Canada Inc ("**Penson**").[10]

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5 *MacLeod Affidavit* at para 26 at Compendium of The Investors, Tab 1.

6 *MacLeod Affidavit* at para 8 at Compendium of The Investors, Tab 1.

7 First Leaside Securities Inc., *Relationship Disclosure for New Clients of First Leaside Securities Inc.*, First page of Client Copy, at Compendium of The Investors, Tab 3.

8 First Leaside Securities Inc., redacted Customer Statement ["***Customer Statement***"], at Compendium of The Investors, Tab 4.

9 *First Leaside Securities Inc* (22 February 2012), Toronto, online: <http://www.iiroc.ca/Documents/2012/1df4f681-08be-4e69-aadd-66b9762a4dbe_en.pdf> (Notice of Application in the Matter of An expedited hearing pursuant to Dealer Member Rule 20.42 of the Investment Industry Regulatory Organization of Canada and First Leaside Securities Inc.) ["***IIROC Notice of Application***"] at para 10, Compendium of The Investors, at Tab 5.

10 *MacLeod Affidavit* at para 7 at Compendium of The Investors, Tab 1.

13. FLSI Investors were mostly Ontario residents. Many of the Investors had the same profile - being unsophisticated investors at or near retirement age. Many of the Investors invested the majority of their retirement savings with FLSI. The following are examples of the types of clients who opened FLSI Accounts and were put into FL Investments:

(i) Investor A was 64 years old and preparing for retirement after selling his family's photo business and handing over the proceeds of nearly $2 million dollars to FLSI. Investor A had the bulk of his savings tied up in FLSI. Investor A was confident that his investment was safe with FLSI through the added protection against financial disaster through the CIPF and made investments in FLSI through September 2011.[11]

(ii) Mr. and Mrs. Investor B were a married couple that opened accounts with FLSI in 2008. Mrs. B advised representatives of FLSI that she did not want any risk in her account. Representatives of FLSI advised Mrs. B that the account was guaranteed by CIPF and that FLSI was "safer than the banks". As a result, and on John Wilson's recommendation, Mrs. B commuted her Ontario University pension and invested the entire proceeds with FLSI. Mrs. B ended up with 100% of her Ontario University pension invested in FL Investments. [12]

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[11] Barbara Shecter, "First Leaside Victims Fight for Lost Millions but Hopes are Dim", *Financial Post* (22 February 2013) online: <http://business.financialpost.com/2013/02/22/first-leaside-victims-fight-for-lost-millions-but-hopes-are-dim/>, accessed on October 8, 2013 at Compendium of The Investors, Tab 6.

[12] *First Leaside Securities Inc* (2 October 2012), Toronto, online: <http://www.iiroc.ca/Documents/2012/da08bf0b-f8cd-4b24-be58-58c4df219fc5_en.pdf> (Notice of Hearing in the Matter of The Dealer Member Rules of the Investment Regulatory Organization of

(iii) Mr. C opened an account at FLSI in 2007 when he was 45 years old. Mr. C had a medical condition which rendered him legally blind. Although he was able to work, he advised representatives of FLSI that his prognosis was unknown and at any time he could become completely blind and be unable to work. Consequently, his expectation was for secure investments which may ultimately be required to support him and his young family.[13] At September 2011, 59% of Mr. C's registered accounts were in FL Investments.

(iv) Mr. C's wife also opened an account around the same time as Mr. C with FLSI. Mrs. C had the same risk profile as Mr. C. As at September 2011, 58% of her Spousal Retirement Savings Plan was invested in FL Investments and 100% of her Tax Free Savings Account was in FL Investments.

OSC Investigates First Leaside – Investors are unaware

14. The OSC began investigating First Leaside in the fall of 2009.[14] In November 2010, staff of the OSC sought accurate third party market valuations of real property that was held by limited partnerships owned by the First Leaside Group.[15] Valuation

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Canada and David Charles Phillips & John Russell Wilson) ["***IIROC Notice of Hearing***"] at para 68, Compendium of The Investors, at Tab 7.

[13] *IIROC Notice of Hearing*, para 70 at Compendium of The Investors, Tab 7.

[14] *MacLeod Affidavit*, para 54 at Compendium of The Investors, Tab 1.

[15] *In the Matter of the Securities Act R.S.O. 1990, c. S.5, as amended and in the matter of David Charles Phillips and John Russell Wilson*, (4 June 2012) (Ontario Securities Commission) (Statement of Allegations, Staff of the Ontario Securities Commission) at para 20 ["***OSC Statement of Allegations***"] Compendium of The Investors at Tab 8.

reports in respect of the properties were delivered to the First Leaside Group by January 2011 (the "**Independent Valuation Reports**").[16]

15. In February 2011, due to concerns arising from the Independent Valuation Reports, the OSC urged the First Leaside Group to retain an independent accounting firm with expertise in restructuring and insolvency to conduct a viability study of the First Leaside Group.[17]

16. Investors were not told at this time that the First Leaside Group, including FLSI, was subject to the investigation of the OSC and FLSI continued to collect money from Investors.

Grant Thornton Limited is Retained to Review FLSI – Investors were unaware

17. In March 2011, Grant Thornton Limited was retained on behalf of the First Leaside Group to review, report on and make recommendations in respect of the business, assets, affairs and operations of the First Leaside Group, including FLSI. Between March and August 2011, Grant Thornton Limited performed its independent review of the First Leaside Group.[18]

18. Investors were unaware that Grant Thornton Limited was conducting an independent investigation in respect of the First Leaside Group.

FLSI Receives Grant Thornton Report – Investors were unaware

19. On August 19, 2011, Grant Thornton Limited delivered a report as a result of its independent review of the First Leaside Group (the "**Grant Thornton Report**"). Shortly

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[16] *OSC Statement of Allegations*, para 20 at Compendium of The Investors at Tab 8.
[17] *OSC Statement of Allegations*, para 21 at Compendium of The Investors at Tab 8.
[18] *MacLeod Affidavit* at para 56, 58 at Compendium of The Investors at Tab 1.

after the First Leaside Group received the report it was delivered to the OSC and IIROC.[19]

20. The Grant Thornton Report contains the following findings:

> The future viability of the [First Leaside] Group is contingent on their ability to raise new capital. One of the largest sources of revenue in the [First Leaside] Group is the fees it generates in [First Leaside Wealth Management Inc.] on the raising of new capital. If the [First Leaside] Group 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.
>
> […]
>
> We have prepared the Asset Valuation of the [First Leaside] Group, using the highest third party valuation figures available for the [Wimberly Apartment Limited Partnership] properties. In this regard, we have calculated an aggregate equity surplus (represented as asset FMV, less third party mortgages and investor debt) of approximately $67M, while there is raised equity in the [First Leaside] Group of approximately $200M. In this regard, there is a significant equity deficit based on the Asset Valuation. [20]

21. Nevertheless, FLSI continued to raise money from Investors - approximately $18.89 million dollars through the sale of FL Investments between August 22, 2011 and October 28, 2011 - while FLSI was in possession of the Grant Thornton Report but without sharing the contents with Investors.[21]

FLSI enters into a voluntary Cease Trade – Investors are unaware

22. In October 2011, in response to the Grant Thornton Report, the OSC informed First Leaside that if satisfactory arrangements were not made, they would take

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19 *MacLeod Affidavit*, para 64 at Compendium of The Investors at Tab 1.

20 Grant Thornton Limited, *Confidential Report of Consultant –Financial Review, First Leaside Group of Companies* dated August 19, 2011 ["***Grant Thornton Report***"], page 12, at Compendium of The Investors, Tab 9.

regulatory action and seek a cease trade. IIROC designated FLSI in discretionary early warning status on October 28, 2011 which prohibited FLSI from (among other things) reducing the firm's capital, opening new client accounts or making payments to directors or affiliates.[22] First Leaside agreed to a voluntary cease trade which was implemented on October 31, 2011.[23] On or around this time, Penson ceased providing a value for the FL Investments on the FLSI customer statements.

FLSI Communicates Material Information to Investors while subject to Cease Trade

23. On November 7, 2011, the First Leaside Group wrote a letter to all Investors (the "**November 2011 Letter**") at the request of the staff of the OSC and IIROC to provide an update regarding the operations of the First Leaside Group. For many Investors this was the first disclosure that FLSI and the First Leaside Group was being investigated by regulatory authorities and the value of the real estate investments had limited, if any, equity value.

24. The November 2011 Letter informed Investors for the first time that:

- Staff of the OSC had reviewed the financial condition of Wimberly Apartments Limited Partnership and various other First Leaside Group entities and required an independent, third party analysis of the viability of the First Leaside Group through the Independent Valuation Reports;[24]

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21 *OSC Statement of Allegations*, paras 25-26 at Compendium of The Investors at Tab 8.
22 *MacLeod Affidavit*, para 64 at Compendium of The Investors at Tab 1.
23 *MacLeod Affidavit*, para 66 at Compendium of The Investors at Tab 1.
24 Letter from First Leaside Group to First Leaside Investors (7 November 2011), Application Record of First Leaside Wealth Management Inc. returnable February 23, 2012 ["***November 2011 Letter***"], at page 365, at Compendium of The Investors, Tab 10.

- The Independent Valuation Reports stated that the value of the outstanding mortgages and promissory notes exceed the market value on certain properties by between USD $38.1 and $47.765 million;[25]
- Grant Thornton Limited had been retained to conduct a review of the assets, affairs and operations of the First Leaside Group and produced the Grant Thornton Report on August 19, 2011;[26]
- Grant Thornton Limited concluded in the Grant Thornton Report that the "future viability of the [First Leaside] Group is contingent on their ability to raise new capital";[27]
- The OSC staff advised the First Leaside Group that "in their view, it is not appropriate to use money raised from new investors to fund the operating losses, rehabilitation costs and distributions of existing limited partnerships"; and[28]
- Certain First Leaside Group entities had been a significant drain on the resources of the First Leaside Group and would require further cash to fund operations, distributions and rehabilitation of their properties. Certain entities had already used significant capital from other FL Funds to meet their cash flow requirements.[29]

FLSI seeks Protection under the Companies' Creditors Arrangement Act

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25 *November 2011 Letter*, page 365 at Compendium of the Investors, Tab 10.
26 *November 2011 Letter*, page 365 at Compendium of the Investors, Tab 10.
27 *November 2011 Letter*, page 366 at Compendium of the Investors, Tab 10.
28 *November 2011 Letter*, page 365 at Compendium of the Investors, Tab 10.
29 *November 2011 Letter*, page 366 at Compendium of the Investors, Tab 10.

25. On February 24, 2012, the First Leaside Group made an application to the Ontario Superior Court of Justice for protection under the *Companies' Creditors Arrangement Act* (the "**CCAA**"). On that date, the Court issued an order granting the First Leaside Group the protection of a stay of proceedings. Grant Thornton Limited was appointed as the monitor, and the Court confirmed the appointment of G.S. Macleod & Associates Inc., as the First Leaside Group's Chief Restructuring Officer.[30]

26. Under the same CCAA Order, representative counsel ("**Representative Counsel**") was appointed by the Court to act in the best interests of Investors of FLSI in connection with the CCAA proceedings. [31] The mandate was expanded and continued by Orders dated June 28, 2012, December 7, 2012 and March 14, 2014 and enabled Representative Counsel to assist investors with the filing of claims with CIPF and the coordination of the CIPF claims process with any future claims proceeds that may be conducted in the insolvency proceedings.[32]

27. As part of its mandate as court-appointed monitor, Grant Thornton Limited investigated the sources and uses of funds in the 98 bank accounts controlled by the First Leaside Group between August 19, 2011 (the date of the initial Grant Thornton Report) and November 1, 2011 as well as between November 1, 2011 and November 2,

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30 *In the matter of the Companies Creditors Arrangement Act plan of Compromise or Arrangement of First Leaside Wealth Management Inc*. (24 February 2012), Toronto, Ont SCJ CV-12-9930-00CL (initial order) ["***CCAA Initial Order***"] at paras 19, 25, 33, at Compendium of The Investors, Tab 11

31 *CCAA Initial Order,* para 42 at Compendium of The Investors, Tab 11.

32 *In the matter of the Companies Creditors Arrangement Act plan of Compromise or Arrangement of First Leaside Wealth Management Inc*. (28 June 2012), Toronto, Ont SCJ CV-12-9617-00CL (order: second extension of stay period), para 13 at Compendium of The Investors, Tab 12; *Receivership of First Leaside Wealth Management Inc*. (7 December 2012), Toronto, Ont SCJ CV12-9930-00CL (receivership order), para 27 at Compendium of The Investors, Tab 12;*Receivership of First Leaside Wealth Management Inc*. (14 March 2014), Toronto, Ont SCJ CV-12-9930-00CL (order), para 2 at Compendium of The Investors, Tab 13.

2011.[33] In a report dated May 1, 2012, Grant Thornton Limited analyzed the use of funds during these time frames in order to provide "high-level" details to Investors.[34] The uses of the funds during this time were not found to be investments in real estate, but rather were found to be a complex web of intercompany transactions that required a series of flow charts to be able to provide a high-level summary to Investors.[35]

Investors suffer Losses from FLSI Insolvency

28. As a result of the FLSI insolvency, Investors suffered substantial losses. Investor money was not invested by FLSI into real estate assets that could be realized upon in order to provide for a meaningful recovery to Investors, but rather had been used to fund, among other things, overhead costs and distributions to existing limited partnership units and other investors.[36]

29. Through the CCAA and subsequent receivership proceeding Investors of FLSI would receive $12,555,611.32.[37] This resulted in Investors receiving, on average, less than 7 cents on the dollar for their invested funds.

30. As a result, many Investors are facing serious financial struggles particularly as they deal with the loss of the majority of their retirement savings.

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[33] Grant Thornton Limited, *Confidential Report to Investors –First Leaside Group of Companies* dated May 1, 2012 ["***May Grant Thornton Report***"] at Compendium of The Investors, Tab 14.

[34] *May Grant Thornton Report,* page 1 at Compendium of The Investors, Tab 14.

[35] *May Grant Thornton Report* page 25-27 at Compendium of The Investors, Tab 14.

[36] *Grant Thornton Report*, pages 9 & 12 at Compendium of The Investors, Tab 9.

[37] *Receivership of First Leaside Wealth Management Inc*. (24 July 2013), Toronto, Ont SCJ CV-12-9930, 00CL (interim distribution order) and Third Report of the Receiver, dated July 17, 3013, page 60 at Compendium of The Investors, Tab 15.

Other Proceedings

31. Subsequent to the insolvency of First Leaside, both IIROC and the OSC commenced cases against the directing minds of the First Leaside Group. In the IIROC case *Re Phillips*, IIROC found that on a balance of probabilities, David Phillips and John Wilson, the directing minds of the First Leaside Group, including First Leaside, "abused the trust placed in them by their clients and enriched themselves at the expense of those clients most of whom were vulnerable elderly people."[38] Furthermore, IIROC found that both Phillips and Wilson are beyond redemption and should suffer substantial penalties.[39]

32. In the OSC proceeding, the OSC alleged in its Statement of Allegations that Phillips and Wilson effected approximately $18.89 million in sales while knowing that the future viability of the First Leaside Group was contingent on its ability to raise new capital.[40] The OSC alleged that the "fact that Grant Thornton was reviewing the First Leaside Group, the existence of the Grant Thornton Report and the Grant Thornton Report were important facts investors should have known."[41] Finally, it was alleged by the OSC that each of Phillips and Wilson breached Ontario securities legislation by directly or indirectly engaging or participating in an act, practice or course of conduct relating to securities which they each knew, or reasonably ought to have known, would perpetuate fraud on Investors.[42]

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[38] *Phillips (Re)* 2013 IIROC 52 at para 67, LNIIROC 52 ["***Re Phillips***"] at Compendium of the Investors, Tab 16.
[39] *Re Phillips* at para 67 at Compendium of the Investors, Tab 16.
[40] *OSC Statement of Allegations* at para 4, at Compendium of the Investors, Tab 8.
[41] *OSC Statement of Allegations* at para 5, at Compendium of the Investors, Tab 8.
[42] *OSC Statement of Allegations* at para 6, at Compendium of the Investors, Tab 8.

33. Finally, an action was commenced by entities in the First Leaside Group, including First Leaside (the "**FL Plaintiffs**"), against David Phillips, his wife Margaret Davis and 970877 Ontario Inc., a company owned by Phillips.[43] In this action, the FL Plaintiffs allege that Phillips exercised his powers over the FL Plaintiffs to improperly divert funds away from the FL Plaintiffs to Phillips to fund his extravagant lifestyle, including to fund salaries of household staff, and the purchase of rare wines and expensive art for Phililips and Davis' personal benefit. The FL Plaintiffs allege that this conversion of the FL Plaintiff's funds for the personal use of Phillips and Davis amounted to an unlawful conversion of the FL Plaintiff's funds.[44]

PART IV – CIPF CLAIMS

The Investors were Purportedly Protected by CIPF

34. Investors were repeatedly told that in addition to FLSI being "safer than banks", that additional protection was afforded to Investors by the Canadian Investor Protection Fund.[45] Marketing materials used by FLSI assured Investors that their investments were covered by CIPF. Brochures were given to Investors displaying with prominence that FLSI was a CIPF member and bore the CIPF logo in multiple locations. These brochures read:

> "CIPF is the great brokerage firm equalizer. Smaller firms become, in a sense, more secure than large ones, because the bankruptcy of a smaller firm has less

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[43] *First Leaside Wealth Management Inc., First Leaside Finance Inc., First Leaside Securities Inc and FL Securities Inc. v David Phillips, Margaret Davis an 970877 Ontario Inc.* (28 August 2012), Toronto, Ont SCJ CV-12-9821-00CL (statement of claim) ["***Statement of Claim against Phillips et al.***"], Compendium of the Investors at Tab 17.

[44] *Statement of Claim against Phillips et al.* at para 77, Compendium of the Investors at Tab 17.

[45] *IIROC Notice of Hearing,* para 68 at Compendium of the Investors, Tab 7.

potential to exhaust the fund before all of the firm's clients receive the maximum allowable coverage for their accounts"[46]

35. Each account statement of the FLSI Accounts given to Investors included as one of the largest graphics on the page that FLSI was a 'CIPF Member', providing additional assurances for the Investors.[47]

36. As a result of the CCAA filing by the First Leaside Group, CIPF sent a notice to Investors that customers with accounts at FLSI who had suffered or may suffer a financial loss may be eligible for CIPF coverage and set an initial deadline for FLSI customer claims of August 22, 2012.[48] On August 16, 2012, CIPF advised Investors that it was extending this customer claims deadline as it was "working with [Representative Counsel] for FLSI customers to establish a coordinated claims process."[49]

37. Leading up to the CCAA claims process, which was approved by the Court on December 7, 2012, Representative Counsel had initial discussions with CIPF counsel and staff members the possibility of a dual CIPF and CCAA claims process ("**Dual Claims Process**"). Despite the commercial efficiencies that would accompany a Dual Claims Process for all interested parties, CIPF counsel communicated to Representative Counsel and the Court that CIPF was unwilling to partake in a Dual

[46] First Leaside Group of Companies, "The First Leaside Solution" (2010) at page 10 at Compendium of the Investors, Tab 18; CIPF Information Brochure, Compendium of The Investors at Tab 19.

[47] *Customer Statement* at Compendium of The Investors, Tab 4.

[48] CIPF Notice to Customers of First Leaside dated February 24, 2012 at Compendium of The Investors, Tab 20.

[49] CIPF Notice to Customers of First Leaside dated August 16, 2012 at Compendium of The Investors, Tab 21.

Claim Process, and all Investors would be required to file separate claim forms in order to receive a distribution under the receivership and apply for CIPF compensation.[50]

38. As a result, although they were already embroiled in an extensive claims process in respect of the CCAA proceedings, FLSI Investors were required to submit separate claims to CIPF outlining the basis for their claim under the fund. These Investors, as previously described, being mostly unsophisticated investors at or nearing retirement age, were required to gather papers and make out their factual claim to CIPF while already having to prepare claims under the CCAA proceedings. This created a significant burden and confusion for Investors and was an additional obstacle for them to assert a claim for compensation under the CIPF Coverage Policy.

39. On April 15, 2013, Representative Counsel sent a letter to CIPF which outlined the basis for Investor Coverage and requested a meeting with CIPF staff, and if appropriate the CIPF board of directors, to discuss a global resolution to the claims that Investors filed with CIPF.[51] Representative Counsel received a response to this letter from CIPF on June 14, 2013 whereby CIPF addressed the procedural aspects of the Coverage Policy and stated that "allegations must be advanced by customers on a case-by-case basis" and "CIPF must (and will) assess customer claims on a case-by-case basis based on the particulars of any alleged loss."[52]

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[50] *Receivership of First Leaside Wealth Management Inc*. (19 July 2013), Toronto, Ont SCJ CV-12-9617-00CL, (second report to the court of representative counsel to the investors) ["***Second Report***"] at para 14, at Compendium of The Investors, Tab 22.

[51] *Second Report* at para 14 at Compendium of The Investors, Tab 22.

[52] *Second Report* at para 18 at Compendium of The Investors, Tab 22.

40. Although CIPF could have had access to Investor records without a separate claims process, CIPF requested that the Receiver consent to an order dated November 25, 2013 where CIPF staff were given full access to Investor records retained by FLSI.[53]

41. CIPF's mission statement provides that CIPF's mission is to "contribute to the security and confidence of customers of IIROC Dealer Members by maintaining adequate sources of funds to return assets to eligible customers in cases where a Member becomes insolvent."[54]

42. CIPF'S Coverage Policy in effect at the time of the FLSI insolvency (effective September 30, 2010) stated that:

> "CIPF covers customers of Members who have suffered or may suffer financial loss solely as a result of the insolvency of a Member. Such loss must be in respect of a <u>claim for the failure of the Member to return</u> or account for securities, <u>cash balances</u>, commodities, futures contracts, segregated insurance funds <u>or other property, received</u>, <u>acquired or held by</u>, or in the control of, <u>the Member for the customer,</u> <u>including property unlawfully converted</u>. The Board of Directors of CIPF may exercise its discretion in respect of determining the customers eligible for protection and the financial loss suffered."[55] [emphasis added]

43. CIPF's Coverage Policy is permissive in that it allows the CIPF Board of Directors to exercise discretion to allow Investor compensation stating that:

> "This Policy has been adopted by the Board of Directors to describe the basis on which it intends to exercise its discretion in authorizing CIPF to make payments to customers of insolvent CIPF Members. The Directors' discretion may be exercised in a manner that is consistent with the right and extent to which a person may be entitled to claim against the customer pool fund of a Member under the Bankruptcy and Insolvency Act (Canada), subject to other restrictions

[53] *Receivership of First Leaside Wealth Management Inc*. (25 November 2013), Toronto, Ont SCJ CV-12-9930-00CL (order: CIPF access to client files) at Compendium of The Investors, at para 2, Tab 23.

[54] Canadian Investor Protection Fund, "CIPF Mission Statement", online: <http://www.cipf.ca/Public/AboutUs/CIPFMissionStatement.aspx> at Compendium of The Investors, Tab 24.

[55] Canadian Investor Protection Fund Coverage Policy as of September 30, 2010 ["***CIPF Coverage Policy***"], page 1 at Compendium of The Investors, Tab 25.

> in this Policy and the sole discretion of the Directors to determine protection by CIPF. CIPF and the Directors reserve the right to authorize or withhold payments in a manner other than as prescribed in this Policy. In the case of any question or dispute as to the eligibility of a customer, the financial loss incurred by a customer for the purposes of payment by CIPF, and the maximum amounts to be paid to a customer, the interpretation of this Policy by the Board of Directors shall be final and conclusive." [56]

44. In response to FLSI Investor claims to CIPF, Investors have received rejection letters in substantially the same form denying their claim for compensation under the CIPF Coverage Policy. These rejection letters from Ilana Singer, the Vice-President of CIPF on behalf of CIPF make clear that despite the permissive wording of the Coverage Policy and the discretion of the Board of Directors, the position that CIPF has adopted is to categorically deny Investor claims for coverage on the basis that:

- "It does not appear to [CIPF] that any property held by FLSI for [the Investor] was converted or otherwise misappropriated."
- Securities that were 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.
- The FL 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 investment and not a loss resulting from the insolvency of FLSI"

[56] *CIPF Coverage Policy*, page 1 at Compendium of The Investors, Tab 25.

- Certain securities as at the date of insolvency "were not held by, or in control of FLSI"[57]

45. CIPF has lived up to part of its Mission Statement is so far as it has "maintained adequate sources of funds to return to assets to eligible customers in cases where a Member becomes insolvent". The Chief Executive Officer of CIPF, Rose Reszel has stated to the media that "the plan has a general fund of $440-million invested in bonds, and a line of credit with two banks for $125-million."[58]

46. Unfortunately, CIPF's decision to categorically deny coverage has done nothing to "contribute to the security and confidence" in accordance with its Mission Statement and utilize its reserve of funds to provide any security or confidence to the Investors of FLSI. In fact, CIPF has put up unnecessary roadblocks to Investors including:

- Requiring each Investor to file a separate claim with CIPF, rather than using a unified claims process coordinated with the insolvency proceedings resulting in approximately 900 individual Investor claims;
- Refusing to engage in any constructive dialogue with Investors to determine if a global resolution was possible, notwithstanding a number of overtures from Representative Counsel;
- Denying individual Investor claims with a standard form rejection letter and template reasons.

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57 Canadian Investor Protection Fund, sample redacted Investor Rejection Letters ["***Rejection Letters***"] at Compendium of The Investors, Tab 26.

58 Rob Carrick, "What protection do you have if your broker goes broke", *Globe and Mail* (25 July, 2014) online: < http://www.theglobeandmail.com/globe-investor/investment-ideas/what-protection-do-you-have-if-your-broker-goes-broke/article19783968/> at Compendium of The Investors, Tab 27.

47. Despite concerted efforts from the Investors to come to an expedient resolution, CIPF staff have not taken steps to "contribute to the security and confidence" of the Investors of FLSI but instead taken a $3.6 million dollar administrative reserve for administration costs and expenses in handling claims of Investors of FLSI.[59]

PART V – PROFILE OF THE CLAIMANT

48. The Claimant is an Investor of First Leaside. Schedule 'A' of the Claimant Information outlines the Claimed Amount (as defined therein) of the Claimant. The Claimant acknowledges that the facts outlined in paragraphs 1 to 36 hereof are directly applicable to the Claimant's claim for the Claimed Amount and provides the additional factual information in respect of the Claimant's claim as outlined on Schedule 'A' of the Claimant Information.

PART VI – POSITION OF THE CLAIMANT

49. The Claimant raises the following issue on appeal, namely that CIPF staff erred in applying its Coverage Policy and concluding that the Claimant did not have a compensable claim against CIPF as a result of the inability of FLSI to account for the funds to the Claimant – funds that were unlawfully converted by FLSI.

50. This claim is not, as alleged by the CIPF staff, a claim based on the change in the market value of an investment. This is a claim that Investors, including the Claimant, gave money to FLSI for the purposes of investing their money in products with underlying real estate assets. It is beyond argument that approximately $300 million dollars of Investor money was given to FLSI for this investment purpose. This is a claim

[59] Canadian Investor Protection Fund, "CIPF Member Insolvencies", online: <http://www.cipf.ca/Public/AboutUs/HistoryofCIPF/CIPFMemberInsolvencies.aspx> at Compendium of

for Investor monies, and specifically the amount set out in Schedule A in respect of the Claimant – that were unlawfully converted by FLSI and used, for among other things, to fund operating losses and perpetuate the existence of FLSI, all of which was done without the knowledge or the consent of Investors, including the Claimant. In this regard, this claim centers on the fact that FLSI unlawfully converted the money of the Claimant, without the consent of the Claimant, and accordingly such money on the date of the insolvency of FLSI was owed by FLSI to the Claimant.

51. The CIPF Coverage Policy, provides coverage for :(i) customers of Members, (ii) who have suffered financial loss solely as a result of the insolvency of a Member and (iii) such loss must be in respect of a claim for the failure of the Member to return or account for securities, cash balances, commodities… or other property received, acquired or held by, or in control of, the Member for the customer, including property unlawfully converted.

52. It is clear, and is not contentious, that FLSI is a 'Member' of CIPF and that the Claimant, being an Investor of FLSI, is a customer of the Member who is eligible for coverage within the terms of the Coverage Policy. In addition, FLSI was deemed to be insolvent pursuant to the Initial Order and accordingly, the Member was unable to return the Claimant's monies.

53. The issue on this appeal is whether FLSI unlawfully converted the Claimant's funds. What constitutes property 'unlawfully converted' to be afforded coverage in accordance with CIPF's Coverage Policy is not clearly defined within the four corners of the Coverage Policy. Furthermore, there have been (i) no public decisions posted by

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The Investors, Tab 28.

CIPF that would aid in the interpretation of their Coverage Policy, (ii) no demonstrative examples as to how the Coverage Policy has been previously applied by CIPF in a case of unlawful conversion; and (iii) no judicial consideration of CIPF's Coverage Policy to serve as a precedent for how 'unlawful conversion' within the ambit of the Coverage Policy is to be interpreted.

54. On review of the jurisprudence surrounding the term 'unlawful conversion', it appears that 'unlawful conversion' is a term that is used in a myriad of claims including fraud, theft, negligence, tortious acts, criminal acts, landlord disputes and breach of trust claims. As this term has been so widely utilized, the jurisprudence is of limited assistance in informing what property 'unlawfully converted' is for the purpose of the Coverage Policy.

55. In situations where a policy is ambiguous, such as the case of the Coverage Policy at hand, courts have stated that a policy is interpreted in a two-step process involving (i) application of the general rules of contractual interpretation and (ii) if the general rules of contractual interpretation are inconclusive, the application of the *contra proferentem* rule.[60] The rule of *contra proferentem* provides that where a provision is sufficiently ambiguous it will be construed against the party responsible for drafting the policy.[61] This rule operates to protect a party from ambiguous or confusing drafting on

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[60] *Consolidated Bathurst Export Limited v. Mutual Boiler & Machinery Insurance Co.*, [1980] 1 SCR 888, 112 DLR (3d) 49, para 25 at Compendium of the Investors, Tab 29.

[61] *Manulife Bank of Canada v. Conlin,* [1996] 3 SCR 415, 139 DLR (4^{th}) 426 ["***Manulife Bank of Canada***"], para 8, at Compendium of the Investors, Tab 30.

the part of another party, who could have amended their documents to ensure they were free from ambiguity.[62]

56. Dictionary definitions are a useful starting point to determine the plain meaning of the words to determine how a policy is to be interpreted in accordance with the general rules of contractual interpretation.[63] In this regard, Black's Law Dictionary defines conversion as "[t]he act of changing from one form to another; the process of being exchanged."[64] 'Unlawful' is broadly defined in Black's Law Dictionary as being not authorized by law; illegal, criminal or involving moral turpitude.[65] On the plain meaning of the words, an unlawful conversion of property is the changing from one form to another in a manner that is 'wrong' whether by the standards of moral turpitude, or otherwise not authorized by law.

57. The interpretation of unlawful conversion in this manner is consistent with the overall intention of CIPF as demonstrated by their mission statement. By interpreting property that was 'unlawfully converted' based on the plain meaning of the words, CIPF is covering customer losses resulting from the insolvency of a CIPF member for property that was unlawfully converted by the member in an manner that is 'wrong' whether by the standards of moral turpitude, or otherwise not authorized by law.

58. Applying this approach to the case at hand, in using the Claimed Funds in a manner that was inconsistent with intentions of the Claimants and on the basis of

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[62] *Manulife Bank of Canada,* para 8 at Compendium of the Investors, Tab 30.

[63] CED 9th (online) *Contracts,* "Interpretation of Contract: Other Principles Respecting Contract Terminology" at § 612, at Compendium of the Investors, Tab 31.

[64] Bryan A Garner, ed, *Black's Law Dictionary,* 9th ed (St. Paul, MN, USA: Thomson Reuters 2009) [*"**Black's**"*], pages 381-382 at Compendium of the Investors, Tab 32.

[65] *Blacks*, page 1678 at Compendium of the Investors, Tab 32.

material non-disclosure, FLSI wrongfully converted the funds by exercising unauthorized control over the use of the Claimed Funds without the knowledge of the Claimant; including, but not limited to, utilizing the Claimed Funds not to primarily invest in real estate but rather to fund operating losses, rehabilitation costs and distributions to existing limited partnerships.[66] This view is substantiated by the OSC Staff who advised the First Leaside Group that "in their view, it is not appropriate to use money raised from new investors to fund the operating losses, rehabilitation costs and distributions of existing limited partnerships."[67]

59. The Claimant did not and could not have consented to the use of Claimed Funds in such a manner, as FLSI withheld material information from the Claimant and utilized the Claimed Funds to perpetuate the guise of financial health of FLSI. First Leaside did not disclose that their financial structure relied on funding provided by new investors, and that the underlying value of the real estate was very limited.

60. Investors were not aware of the activities of FLSI and the First Leaside Group in a manner to which they could have provided consent to FLSI to use their money to purchase FL Investments. FLSI unlawfully converted the Claimed Funds to perpetuate a guise of financial health of the First Leaside Group in a manner that was not authorized by the Claimant. In this regard, this is clearly an unlawful conversion that falls squarely within the CIPF coverage policy.

61. CIPF staff erred in their application of the Coverage Policy. Instead of construing the policy based on the plain meaning of the words and the overall intention that the

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[66] *Grant Thornton Report,* pages 9, 12, at Compendium of the Investors, Tab 9.
[67] *November 2011 Letter,* page 365, at Compendium of the Investors, Tab 10.

Coverage Policy is trying to achieve, CIPF staff categorically denied the Claimant's claim stating that "it does not appear to us that any property held by FLSI for you was converted or otherwise misappropriated" without actually addressing or even trying to address the nature of the Claimant's claim.[68]

62. Among other things, CIPF staff contend that losses caused by "dealer misconduct" are not covered by CIPF.[69] However, this contention is completely inconsistent with the requirement that in order to be eligible for compensation under the policy, the Investor's funds must have been unlawfully converted. It is difficult to imagine a scenario in which both of these requirements can be met.

63. The interpretation of the Coverage Policy in this narrow fashion leads to an absurd result whereby it is unclear if a claim of a customer will ever fit within the Coverage Policy as interpreted by CIPF staff. Based on CIPF's interpretation, every instance of insolvency of a Member must not involve any misconduct on the part of the dealer nor a compliance failure or breach of securities regulatory requirements in respect of the distributions of securities.

64. In this regard, if the Appeal Committee finds that the interpretation of the Coverage Policy is not sufficiently clear by applying the ordinary principles of contractual interpretation, the policy should be interpreted in light of the rule of *contra proferentem*. The rule of *contra proferentem* provides that if a provision is sufficiently ambiguous that it is capable of more than one construction, then it will be constructed against the party responsible for the drafting of the document and in favour of the

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[68] *Rejection Letters* at Compendium of the Investors, Tab 26.
[69] *Rejection Letters* at Compendium of the Investors, Tab 26.

opposite party.[70] In circumstances such as this, when CIPF has discretion as to the Claimant's eligibility under the Coverage Policy, their discretion should be exercised in a way that is consistent with this rule of contract interpretation.

65. The Coverage Policy at hand can be differentiated from a normal contract or policy of insurance as the terms of the Coverage Policy are unilaterally determined by CIPF without the ability of the customer to negotiate the terms of the policy and CIPF, the party drafting the policy, is solely responsible for determining if a claim falls within the policy it created. This ambiguous policy was solely drafted by CIPF, and therefore the relative bargaining power of the two parties is unequal. In situations like this, when terms are offered on a 'take it or leave it' basis, the Courts have found that in applying the rule of *contra proferentem*, an ambiguity should be resolved against party drafting the policy, in this case CIPF.[71] In this regard, deference should be shown to the interpretation of the ambiguities in favour of the Claimant given the relative unequal bargaining position the Claimant in respect of the Coverage Policy.

66. As has been demonstrated above, the losses of the Claimant fall squarely within the CIPF Coverage Policy and CIPF staff wrongfully applied the Coverage Policy to deny the losses suffered by the Claimant as a result of the insolvency of FLSI. Furthermore, ambiguities in the CIPF Coverage Policy should be interpreted in favour of the Claimant and thus further support that the losses of the Claimant fall within the ambit of the Coverage Policy.

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[70] *Manulife Bank of Canada,* para 8 at Compendium of the Investors, Tab 30.

[71] Craig Brown, *Canadian Insurance Contract Law in a Nutshell* (Toronto: Thomson Carswell, 1995) at page 67, Compendium of the Investors at Tab 33.

PART VII - RELIEF REQUESTED

67. The Claimant hereby asks that in accordance with the CIPF Coverage Policy, that CIPF cover the Claimant for the full amount of the Claimed Funds in the total amount of the Claimed Amount as detailed in Schedule A.