

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

IN THE MATTER OF:

**THE DEALER MEMBER RULES OF THE
INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA**

AND

DAVID CHARLES PHILLIPS & JOHN RUSSELL WILSON

NOTICE OF HEARING

TAKE NOTICE that pursuant to Part 10 of Dealer Member Rule 20 and Section 1.9 of Schedule C.1 to Transition Rule No.1 of the Investment Industry Regulatory Organization of Canada (“IIROC”), a set-date hearing will be held before a hearing panel of IIROC (“Hearing Panel”) on Wednesday, October 17, 2012 at the offices of IIROC, in the British Columbia Room, 121 King St. West, Suite 2000, Toronto, at 10 a.m., or as soon thereafter as this matter can be heard.

TAKE FURTHER NOTICE that, pursuant to Rule 6.2 of IIROC’s Dealer Member Rules of Practice and Procedure (“Rules of Practice and Procedure”), the hearing shall be designated on the:

- The Standard Track
- The Complex Track

THE PURPOSE OF THE HEARING is to determine whether David Charles Phillips and John Russell Wilson (together, the “Respondents”) committed the following contraventions that are alleged by the staff of IIROC (“Staff”) on behalf of IIROC:

Misrepresentation of Fund Products

- i. Between January 2009 and October 2011, David Charles Phillips (“Phillips”) misrepresented, and allowed First Leaside Securities Inc. (“FLSI”) sales staff to misrepresent to clients, that the proprietary fund products recommended and sold by the

firm were low or medium risk, when, in fact, they were high risk, contrary to Dealer Member Rule 29.1;

- ii. Between January 2009 and October 2011, John Russell Wilson (“Wilson”) misrepresented to clients that the proprietary fund products which he recommended and sold were low or medium risk, when, in fact, they were high risk, contrary to Dealer Member Rule 29.1;

Marketing Materials

- iii. Between November 2009 and September 2011, Phillips authorized the preparation and issuance of marketing materials for investment products sold at FLSI, which included statements which were misleading and failed to fairly present the potential risks of those products to the client, and provided these marketing materials to his clients, contrary to Dealer Member Rule 29.7(1);
- iv. Between November 2009 and September 2011, Wilson provided marketing materials for investment products sold at FLSI to his clients and potential clients, which included statements which were misleading and failed to fairly present the potential risks of those products to the client, contrary to Dealer Member Rule 29.7(1);

Risk Tolerance on NAAF

- v. In and throughout 2009, 2010 and 2011, Phillips and Wilson failed to ensure that the recommendations which were made and orders which were accepted were in accordance with the risk tolerance stated on clients’ New Account Application Form (“NAAF”), contrary to Dealer Member Rules 1300.1(o), (p) and/or (q);

Sales of Properties Fund

- vi. Between January 1, 2010 and May 1, 2011, Phillips and Wilson solicited sales of First Leaside Properties Fund from clients, while failing to ensure that those transactions were suitable for the clients or within the bounds of good business practice, and preferred their own interests ahead of the clients, contrary to Dealer Member Rules 1300.1(o) and (q) and 29.1; and

Conflict of Interest

- vii. Between January 2007 and October 2011, Phillips as the General Partner (“GP”) of certain First Leaside Limited Partnerships (“LPs”) was in a conflict of interest with clients who invested in those LPs, which was not addressed in a fair and equitable manner and in a manner that considered the best interests of the clients, contrary to Dealer Member Rule 29.1 and NI 31-103.

PARTICULARS

TAKE FURTHER NOTICE that the following is a summary of the facts alleged and to be relied upon by the Staff at the hearing:

A. OVERVIEW

- 1) David Phillips and John Wilson told clients they wanted to protect their clients' invested capital and maximize their returns and in so doing earned their clients' trust. They then proceeded to abuse that trust, and repeatedly and consistently placed their own interests ahead of those of their trusting clients. Contrary to their obligations to their clients and the industry, they misrepresented their products and failed to consider the suitability of their products for their clients. Phillips also acted in a direct conflict of interest in connection with some of his products.
- 2) Phillips owned and controlled a corporate enterprise called the First Leaside Group ("FL Group"). In 2010 and 2011, the FL Group was losing money. In order to ensure the ongoing viability of the FL Group, new investor funds were continuously required. During this time, Phillips solicited investment funds from clients without regard for the industry rules and regulations which exist to protect investors.
- 3) FLSI, an IIROC Dealer Member, was part of the FL Group. Phillips was the President and Ultimate Designated Person ("UDP") of FLSI. He approved all trades made by clients through FLSI. He was also an RR at FLSI and, as such, was directly involved in the sale of securities, as described more fully below, to his own clients.
- 4) Wilson was an RR at FLSI. However, he was not just an RR. Wilson had been an investor with the FL Group since 1991. He was Director, Investor Relations, for FLSI. He was also a part of the management of the FL Group and was a Director or a Trustee for several other FL Group entities which his clients invested in.
- 5) FLSI's main business was the sale of proprietary products manufactured by the FL Group. There were two main types of products – LPs and fund products ("Funds").
- 6) Consequently, FLSI's client accounts were principally invested in FL Group products.
- 7) Phillips, as UDP and an RR at FLSI, oversaw and was involved, as was Wilson, in the making of trade recommendations and the sales of the Funds to clients, all of which

were characterized as medium risk or low risk products when in fact, they were speculative and/or high risk.

- 8) Consequently, clients who had no tolerance for high-risk investments had a portion or all of their registered account(s) invested in the high risk Funds, which were unsuitable for them.
- 9) In addition, although the LPs were high risk investments, Phillips acting as both FLSI's UDP and an RR, and Wilson, acting as an RR, failed to ensure that only clients who had tolerance for high risk as recorded on their NAAF invested in these products.
- 10) Consequently, on the whole, client funds were invested in LPs and Funds in a manner that was inconsistent with the risk tolerances identified on the clients' NAAFs.
- 11) In connection with the sales of these high risk investments, Phillips and FLSI sales staff, including Wilson, also distributed marketing material to clients and the public which failed to fairly present the potential (or any) risks of those investments to clients. The marketing materials were also misleading with respect to their statements regarding the alleged success of Wimberly Apartments Limited Partnership ("WALP"), a First Leaside investment.
- 12) Phillips and other FLSI sales staff, for whom he was responsible, including Wilson, advised certain clients to sell a particular FL Group product for the sole purpose of allowing new clients to invest their funds with the FL Group.
- 13) Lastly, because of his many roles within the FL Group, Phillips had multiple conflicts, the most notable of which was with respect to fees which were paid from investors' funds. Phillips' conflict of interest with respect to fees he earned from the LPs, despite being disclosed to clients, were not addressed in a fair and equitable manner and was not in the clients' best interest. As such, that conflict ought to have been avoided by Phillips.

B. Membership in IIROC

FLSI

- 14) FLSI was admitted to membership in IIROC effective March 1, 2004, as a Dealer Member.

- 15) FLSI was an Introducing Broker with Penson Financial Services Canada Inc. as its Carrying Broker.
- 16) FLSI's head (and only) office was in Uxbridge, Ontario.
- 17) On February 23, 2012, a judge of the Ontario Superior Court of Justice granted an Order declaring that certain of the FL Group entities (including FLSI) were companies to which the *Companies' Creditors Arrangement Act* ("CCAA") applied and were insolvent. As a result, these entities are currently undergoing a court-supervised orderly wind-down of operations, under the direction of a court approved Chief Restructuring Officer ("CRO").
- 18) On February 24, 2012, IIROC Staff made an application to an IIROC Hearing Panel and was granted an order suspending FLSI's membership on the basis that it was in such financial or operating difficulty that it could not be permitted to continue to operate without risk of imminent harm to the public, other Dealer Members or the Corporation.
- 19) FLSI remains under suspension. It has limited staff remaining, and is not conducting any business. Under the terms of the suspension order, upon completion of the transfer of client accounts, and determination of any claims against FLSI, IIROC Staff may move, without notice to FLSI, for an order terminating the membership of FLSI.

Phillips

- 20) During the material time, Phillips was the directing mind of the FL Group and all of the entities within it, including FLSI.
- 21) He was the President and a director of the parent company of FLSI, First Leaside Wealth Management Inc. ("FLWM"). Phillips also owned FLWM.
- 22) As of the date of FLSI's suspension, Phillips was registered as the President and UDP of FLSI. He was also registered as an RR.
- 23) Phillips' registration history is as follows:

Marchmont & MacKay	November 1981-October 1984	RR
Midland Doherty Limited	October 1984-May 1985	RR

Moss Lawson & Co. Limited	May 1985-May 1987	RR
Richardson Greenshields of Canada	June 1987 – November 1988	RR
McConnell & Company Limited	November 1988 – December 1989	RR
McDermid St. Lawrence Limited	February 1990-October 1990	RR
F.L. Securities Inc.	February 1988 – February 2004	OSC Registration as LMD (RR)
First Leaside Securities Inc.	March 2004 – February 2012	UDP, RR

24) Phillips' registration with IROC ceased on February 29, 2012 when his employment was terminated by FLSI (through the CRO).

Wilson

25) Wilson had been employed with FLSI since it became an IROC Dealer Member in December 2004. During his employment with FLSI, Wilson was registered with IROC as an RR.

26) During the material time, Wilson also held the title of "Director, Investor Relations" at FLSI. He was described by FLSI to clients as being "one of First Leaside's founding partners and a long-serving member of the Board".

27) Wilson was also considered a mentor within the entire FL organization.

28) Wilson had one of the largest books of business at FLSI. For the year ending 2010, in addition to his salary, he earned a bonus of almost \$800,000, while the next highest bonus paid to an RR was in the amount of \$177,000.

29) Wilson held the following positions within the FL Group:

- i. Director, Investor Relations at FLSI;
- ii. Director of FLSI;
- iii. Director of First Leaside Wealth Management Inc. (FLWM);
- iv. Director of the General Partner of Wimberly Apartments Limited Partnership (WALP);
- v. Trustee of FLEX Fund;
- vi. Trustee of FLWM Fund;
- vii. Trustee of FL Mortgage Fund; and

viii. Director of First Leaside Realty II, which is the General Partner for several FL LPs.

30) Prior to being registered with IIROC, Wilson was employed with F.L. Securities Inc. (“FL Securities”) an exempt market dealer, from November 2002. FL Securities was also part of the FL Group.

31) Wilson has no other securities industry experience.

32) Wilson’s registration with IIROC ceased on February 29, 2012, when his employment was terminated by FLSI (through the CRO).

C. The FL Group of Companies

33) There are over 100 entities within the FL Group; the relevant entities for this proceeding are:

- i. FLSI, the Dealer Member;
- ii. F.L. Securities Inc., the exempt market dealer;
- iii. FLWM, the parent company; and
- iv. FL Finance, the banking arm.

Attached as Appendix “A”, is a listing of the companies which were included in the CCAA application and a listing of the associated LPs.

34) Although clients purchased securities through FLSI, they were referred to by Phillips, Wilson, and other FLSI sales staff, and in marketing material as being clients or “partners” of the FL Group. There was no clear distinction made to clients between the role of FLSI and the role of the other entities within the FL Group with respect to client investments.

D. The Business of the First Leaside Group

The Products

35) The FL Group manufactured, marketed and sold the LPs and Funds primarily for real estate property investments (together, the “FL Products”). Each year, new LPs were formed and sold to clients.

36) With one exception, the FL Products were sold by Offering Memorandum (“OM”) as exempt securities.

- 37) All investors who purchased FL Products did so through client accounts at FLSI, and Phillips approved every trade.
- 38) There was no market/liquidity for the FL Products. In circumstances where a client wanted to sell his units, Phillips created a secondary market by using FL entities or other FL clients to buy those units. Except for WALP, these transactions always took place with the units priced at \$1.

FLSI – The Dealer Member

- 39) FLSI's main source of revenue was from its sale of FL Products. Specifically, FL Securities paid FLSI 'advisory fees' for each new FL Product that was sold, and FLSI received an 'agency fee' for each FL Product. The money to pay these fees came from the funds raised from investors.
- 40) Clients of FLSI generally held two types of securities: FL Products, and non-FL fixed income securities such as real return bonds, government bonds and treasury bills.
- 41) Generally, FLSI only recommended securities from the two categories described above. No other equities, mutual funds or other securities were solicited for purchase.
- 42) In the majority of cases, client holdings of FL Products were shown at \$1.00 per unit on their statements.

WALP – The Cornerstone of the FL Group

- 43) WALP was the cornerstone of the FL Group. It was the largest and oldest LP and figured prominently in all FL Group promotional material. WALP indirectly owns real estate properties in Texas, USA.
- 44) Since its formation in 1992, WALP has raised over \$100 million from investors.
- 45) Phillips was the President and a Director of the General Partner of WALP. Wilson was also a Director of the General Partner of WALP.

E. The High Risk Funds Were Misrepresented as Medium Risk or Low Risk

46) During the material time, Phillips, Wilson and FLSI misrepresented the risk assessment of the FL Funds as medium risk, when, in fact, they were all clearly speculative and/or high risk investments. The one exception was Mortgage Fund, which was misrepresented as low risk, when it was also high risk.

47) During the material time, FLSI sold units of the following Funds:

- i. First Leaside Wealth Management Fund (“FLWM Fund”);
- ii. First Leaside Expansion Fund (“FLEX Fund”);
- iii. Mortgage Fund;
- iv. First Leaside Fund;
- v. Wimberly Fund; and
- vi. First Leaside Properties Fund.

48) As a result of the misrepresentations and recommendations made by Phillips, Wilson and FLSI, FL Funds were purchased by clients who had no tolerance for high risk products, as evidenced by the information recorded on their respective NAAFs.

a) Representation of the Funds as “Medium Risk” or “Low Risk”

49) The FLSI NAAF contained four risk categories:

- i. Conservative Income/Low Risk;
- ii. Income/Low Risk;
- iii. Balanced/Medium Risk; and
- iv. Growth/High Risk.

50) The FLSI NAAF stated that “Balanced/Medium Risk” included (but was not limited to) First Leaside Fund products or their equivalent. The LPs were referenced in the “Growth/High Risk” category.

51) Some FLSI clients also received detailed proposals outlining their assets (non-FL) and proposed investments to be made in FL Products. These proposals were in spreadsheet form and contained a heading for “Medium Risk”. Wilson created this spreadsheet template and prepared such a detailed proposal for some of his own clients. Other FLSI RRs also provided this spreadsheet to their own clients.

52) Where a Fund product was part of the proposal, it was included in the column for “MEDIUM RISK – Income”. The only exception was Mortgage Fund which was listed as “Low Risk”.

53) None of the OMs or prospectus for the Funds (except for Mortgage Fund) contain a specific categorization as to the risk of the investment. The OM for Mortgage Fund indicates that it is a “speculative investment”.

54) Similarly, there is no indication of the risk rating of the investment and no discussion of risk factors in any of the marketing material for the Funds.

b) Factors Which Make All the Funds High Risk

55) The Funds, except for Mortgage Fund, shared the following factors which made them speculative and/or high risk:

- i. Their only assets were unsecured promissory notes from another FL entity;
- ii. Payment of the interest was not guaranteed;
- iii. The debtor company, at its discretion, could forego the interest payment and add the interest payable to the principal amount of the notes;
- iv. There was no secondary market for the units; and
- v. There was a credit risk that other FL Group members who have received or may receive loans from the Fund and the debtor company may not be able to repay those loans when due.

56) The OM for Mortgage Fund stated that it *intends* to acquire secured first mortgages. Although the OM describes Mortgage Fund as a speculative offering, Wilson and other FLSI sales staff advised clients it was a low risk investment.

57) As at December 31, 2011, \$11M had been invested in Mortgage Fund. However, only half of that amount had in fact been invested in mortgages, with the balance being loaned to “related parties” – i.e., another FL entity.

c) Additional High Risk Factors for the WALP Funds

58) FL Fund, Wimberly Fund and Properties Fund (together, the “WALP Funds”) had additional risks which contributed to their high risk profile, as a result of their associations with WALP.

59) The WALP Funds were debt vehicles for WALP, and each Fund lent monies to an entity within WALP.

60) Each of the financial statements for WALP for the years ended December 31, 2006 - 2010, all contained a “going concern note” disclosure which stated that WALP did

not have sufficient cash on hand to meet its obligations, including, among others, regular principal repayments of mortgages payable, redemptions of promissory notes (including those held by the WALP Funds) and other current liabilities and funding of future operating losses.

61) The “going concern note” also stated:

The Partnership has been experiencing significant negative cash flow from operations over a number of years and such negative cash flows are expected to continue as it proceeds with its plan to rehabilitate its properties.

62) Furthermore, the 2009 and 2010 Auditors’ Report contains the “Emphasis of Matter” paragraph to highlight the going concern issue:

Without qualifying our opinion, we draw attention to Note 1(a) in the consolidated financial statements which indicates the existence of material uncertainties that may cast significant doubt about the ability of Wimberly Apartments Limited Partnership to continue as a going concern.

63) The financial statements also contained the following information:

Year Ended	Partners Deficiency	Overall Loss For The Year
December 31, 2007 audited	\$32M	\$8M
December 31, 2008 audited	\$41M	\$7M
December 31, 2009 (draft as at September 2010)	\$61M	\$10M
December 31, 2009 audited	\$61M	\$18M
December 31, 2010 audited	\$77M	\$17M

64) For the WALP Fund purchasers, the financial health of WALP, and the fact that the going concern note specifically questioned WALP’s ability to fund redemptions of the promissory notes held by the WALP Funds, were particularly relevant and significantly increased the risk associated with these products.

d) Conclusion – Count 1

65) All of the Funds were speculative and/or high risk. However,

- i. The NAAF indicated the Funds were “balanced/medium risk”;
- ii. The proposal spreadsheets indicated the Funds were “medium risk” or “low risk”; and
- iii. Phillips, Wilson and the rest of the FLSI sales staff advised clients that the Funds were low, medium or moderate to high risk.

66) Phillips and Wilson knew or ought to have known that the Funds were high risk and/or speculative investments. Nonetheless:

- i. Phillips as UDP allowed the NAAFs and spreadsheets to be provided to clients which clearly indicated that the Funds were less than high risk;
- ii. Wilson created the spreadsheet template and provided spreadsheets to his clients which clearly indicated that the Funds were less than high risk;
- iii. Phillips and Wilson failed to advise his clients who purchased the Funds that they were high risk investments; and
- iv. Phillips failed to ensure that the sales staff knew and understood the product they were selling and that it was high risk.

67) Consequently, during the material time, clients were not informed that the Funds were high risk, and almost 100 FLSI clients, including clients of Wilson, who had no indication at all of high risk on their NAAF purchased Funds. Many other clients had some high risk tolerance (including clients of Wilson) but had that amount exceeded by purchases of the Funds.

e) Examples of Clients Impacted by Count 1

68) Clients Mr. and Mrs. A opened accounts with FLSI in 2008. Mrs. A advised Wilson that she did not want any risk in her account. Wilson advised her that her account was guaranteed by CIPF and that FLSI was “safer than the banks”. As a result, and on Wilson’s recommendation, Mrs. A commuted her Ontario university pension and invested the entire proceeds with FLSI.

69) The pension proceeds were transferred to her LIRA account at FLSI, where she initially purchased exclusively Canadian Treasury Bills (“T Bills”). Subsequently, in the summer of 2010, she sold the T Bills and used the proceeds to purchase two FL

Products, including Mortgage Fund. Consequently, the risk profile of that account rose to 100% high risk.

- 70) Mr. B opened an account at FLSI in 2007 when he was 45 years old. Mr. B had a medical condition which rendered him legally blind. Both Phillips and Wilson were aware of his condition. Although he was able to continue to work, he advised Wilson that his prognosis was unknown, and at any time he may become completely blind and unable to work. Consequently, his expectation was for safe and secure investments which may ultimately be required to support him and his young family.
- 71) Mr. B's risk tolerance as recorded on his NAAF was 15% high risk, 20% medium risk and 65% low risk for his registered accounts.
- 72) Mr. B purchased various FL Funds in his registered accounts. As at September 2011, 59% of the monies invested in his registered accounts (approximately \$150,000) were in FL Funds, thereby causing the accounts to be 59% high risk.
- 73) Mr. B's wife also opened her accounts at the same time with the same risk tolerances. Wilson was also RR responsible for her account. As at September 2011, 58% of her Spousal RSP (\$107,000) was invested in high risk FL Funds, and 100% of her TFSA was invested in high risk FL Funds.

F. Marketing Material Was Misleading

- 74) Various forms of marketing material were made available to FLSI clients, including:
- i. One page marketing sheets specific to individual FL products (the "One-Pagers");
 - ii. A brochure for FLWM and the First Leaside Group of Companies; and
 - iii. Brochures specific to individual FL products (including WALP).
- 75) The One-Pagers were in multi-colour and showed the rate of return in very large font (the largest font used on the page). The One-Pagers were also available on the FL Group's website.
- a) *Misleading with respect to WALP*
- 76) Much of the FL Group marketing material that was made available to existing and prospective investors during the material time emphasized the historical success of WALP.

77) Despite the fact that the financial statements showed major losses for WALP, and demonstrated that WALP was not funding its distributions during the material time through its revenues, marketing material continued to tout the alleged success of WALP.

78) Marketing material dated 2010 stated:

Wimberly Partners, as well as participants in subsequent First Leaside partnerships, have enjoyed some of the highest investment returns generated by our industry. Since 1992, an original Wimberly Partner has received a rate of return of more than 9%, net of tax, per annum.

79) Marketing material for First Leaside Fund dated 2009 stated:

*First Leaside's Wimberly Apartments Limited Partnership (WALP) has a proven **16-year** track record and more than a **9% after-tax** annualized return. Since inception, Wimberly has produced more than **190 consecutive monthly cash distributions**.*

80) Marketing material for Wimberly Fund, dated 2010 contained similar content:

*Wimberly Fund is a RRSP/RRIF/RESP/TFSA-eligible investment that participates in the performance of a large apartment portfolio in the Dallas-Fort Worth Metroplex: Wimberly Apartments Limited Partnership (WALP). As First Leaside's original real estate partnership, WALP owns and manages approximately 2,200 apartments, with a proven **18-year** track record of success in the real estate industry. Since inception, this partnership has produced more than **200 consecutive monthly cash distributions**.*

81) Marketing material for First Leaside Universal Limited Partnership and First Leaside Ultimate Limited Partnership, dated 2010, and for First Leaside Global Limited Partnership dated 2011, state:

... Wimberly Apartments Limited Partnership still generates – after 18 years – continuous monthly cash distributions for hundreds of investing partners.

82) However, from 2007-2010, WALP was not generating adequate cash flow from operations to pay the distributions to clients in those years, including payment of the interest to the WALP Funds.

83) Despite these losses, WALP continued to pay the following amounts in distributions and interest to unitholders of WALP and the WALP Funds:

Year	Overall Loss	Distributions Paid	Interest Paid
2007	\$8M	\$1.1M	\$1.3M
2008	\$7M	\$1.2M	\$1.5M
2009	\$18M	\$2.7M	\$3.2M
2010	\$17M	\$2M	\$4.9M

84) These distributions and interest payments were not funded by revenue from operations in WALP. In fact, the source of these payments was partly monies borrowed from other FL Group entities, which received funds from other investors.

85) Investors were unaware that the distributions and interest payments they were receiving were funded in this manner.

86) The references to WALP having “investment returns”, “generating” or “producing” distributions is misleading given WALP’s financial state during the material time, and the fact that it relied on money borrowed from other FL Group entities to pay those distributions.

b) Rate of Return and No Mention of Risk

87) Furthermore, each “One-Pager” contains a reference to the annual distribution or interest rate of the product, with no indication that this is not a guaranteed rate of payment to clients.

88) While the OMs for the FL Products (which were anywhere from 87 to 168 pages long) contained discussions of the risks associated with those Products, there was no mention of those risks in the more accessible, easier to read One-Pagers.

89) There is no indication in the marketing materials as to the risk (or any risk) associated with these investments. The marketing materials fail to fairly present the potential risks to the client.

90) While the marketing materials describe the alleged success of WALP and the years of paying distributions, none of the marketing material made available to clients contains any discussion of the potential risks associated with the various investments, nor of the actual financial situation of WALP and the risks associated therewith.

G. Lack of Consideration Given to Risk Tolerances Recorded on NAAF

- 91) FLSI RRs, including Phillips and Wilson, completed a NAAF for each client who opened a registered and/or non-registered account.
- 92) As set out above, there were four risk categories on the NAAF. The NAAF stated that *“All First Leaside account holdings will be compared to the RISK and OBJECTIVES percentages indicated in this table”*.
- 93) The NAAF required that a percentage figure be entered for each risk category and for each type of account (i.e., registered and non-registered). For each account, the percentages were required to total 100%.
- 94) As set out above, the NAAF made specific reference to “First Leaside limited partnerships” in the High Risk category.
- 95) However, based on a sampling of 70 client accounts, 84% of client accounts were found to have purchased securities that exceeded the client’s risk tolerance documented in their NAAFs as at October 2011.
- 96) Based on the same sample, over 75% of Wilson’s client accounts were found to have purchased securities that exceeded the client’s risk tolerance documented in their NAAFs as at October 2011.
- 97) Within the sample some clients had no high risk tolerance recorded on the NAAF yet had purchased only FL LPs which caused their account and their holdings to be 100% high risk.
- 98) The accounts in the sample included those for which Phillips, Wilson and 8 other FLSI RRs were responsible.
- 99) Phillips and Wilson and other FLSI sales staff repeatedly recommended and solicited the purchase of FL LPs or Funds which would cause and did cause the client’s risk tolerance, as identified on the NAAF to be exceeded.
- 100) Phillips and Wilson and the FLSI sales staff, for which Phillips was ultimately responsible, failed to give due consideration to the risk tolerances of clients as recorded on the NAAF.

Example of Clients Impacted by Count 3

- 101) Mr. B (referenced above in paragraphs 61-63), also opened a cash account with FLSI. His risk tolerance for that account, as recorded on his NAAF was 50% medium risk and 50% high risk.
- 102) Mr. B purchased LPs and First Leaside Wealth Management Preferred Shares, all of which were high risk investments. As at October 2011, 100% of the monies (\$460,000) which had been invested in Mr. B's cash account were invested in high risk products.

H. Solicited Sales of Properties Fund With No Consideration of the Best Interests of the Client

- 103) First Leaside Properties Fund ("Properties Fund") was the only First Leaside product sold by prospectus. Accordingly, Properties Fund was the only First Leaside product which non-accredited investors could purchase.
- 104) Properties Fund held unsecured promissory notes from another FL entity, FL Master Sherman Ltd.
- 105) The prospectus for Properties Fund was dated March 16, 2009. According to the prospectus, the initial closing date was March 26, 2009. The final closing was on or about June 3, 2009.
- 106) In 2010 and 2011, there were no units of Properties Fund available for sale from the initial offering, and there was no other FL Product available for purchase by FLSI clients who did not meet the accredited investor requirements.
- 107) FL had non-accredited investors holding cash in their RRSP and TFSA accounts at FLSI. As it was not invested, this cash was not available to Phillips and the FL Group.
- 108) Rather than develop a new FL product which would require a prospectus, Phillips and Wilson decided to arrange for the sales of units of Properties Fund from existing clients.
- 109) As a result, Phillips and Wilson began to solicit sales of Properties Fund from clients who were already accredited investors and could purchase any other FL Product (the "Selling Clients").

- 110) This then allowed other FL clients who were not accredited to purchase Properties Fund. This was the basis for the solicitations and recommendations to sell. Phillips discussed this with Wilson and was aware that Wilson was also soliciting the sales.
- 111) Generally, the Selling Clients had their units purchased by FL Finance or F.L. Securities Inc. Those units were in turn sold by FL Finance or F.L. Securities to the non-accredited clients.
- 112) Phillips and Wilson then recommended to the Selling Clients that they purchase another FL product with the proceeds from the sale.
- 113) All of these transactions took place with the units priced at \$1.
- 114) In 2010 and 2011, 65 clients sold units of Properties Fund.
- 115) Phillips and Wilson contacted clients who held units of Properties Fund and recommended that they sell their units without any consideration of whether such a trade was in the Selling Client's best interests, and whether such a trade was suitable for the client. In so doing, Phillips and Wilson placed their own interests and those of FLSI and the FL Group ahead of the interests of their clients, and/or preferred one client's interest over another.

I. Fees Paid to Phillips and FL Entities Created A Conflict

- 116) Several of the LPs offered for sale during the material time were what are known as 'blind pool' investments, for which there was no specific use to which the investment funds would be put at the time the capital was raised. These included, but are not limited to:
 - i. First Leaside Select LP ("FL Select");
 - ii. First Leaside Investors LP ("FL Investors");
 - iii. First Leaside Progressive LP ("FL Progressive"); and
 - iv. First Leaside Premier LP ("FL Premier").
- 117) Phillips was the President and controlling shareholder of the General Partner for each of these LPs.
- 118) The OMs for these LPs indicated that certain fees would be paid to FL entities for business development and project evaluation.

- 119) Although the OM did not contain a set limit as to the percentage of the monies raised that would be used for the payment of FL-related fees, in describing the use of net proceeds an estimate of 35% in fees was used as an illustration. That illustrative percentage was frequently exceeded and in one case, described below, it was exceeded by over 25%.
- 120) The working capital available for these LPs was immediately reduced by the amount of fees described above.
- 121) The fees were typically paid to FLSI and FL Securities.
- 122) The fees charged were as follows:
- i. 5% to FLSI as agent;
 - ii. estimated 15% to related parties for “Business Development Fees”; and
 - iii. estimated 15% to FLSI or FL Securities for promotion and project evaluation.
- 123) The “Business Development Fees” included payment to FLSI or FL Securities of \$75,000 per project for “evaluating” each project.
- 124) The “promotion and project evaluation” fees, included payment to FLSI or FL Securities of \$50,000 per market for evaluating each potential market.
- 125) As directing mind of these FL entities, Phillips would decide when, how and in what amount these fees would be billed to the LPs.
- 126) As the GP of the LPs, Phillips would decide when, how and in what amount these fees would be paid.
- 127) For example, for the following 4 LPs, as at December 31, 2010, fees of over 45% of the total capital raised had been paid to FL entities:

FL LP	Fees Paid (as percentage of capital raised)
FL Select (2007)	61.6%
FL Investors (2008)	54.2%
FL Progressive (2009)	46.0%
FL Premier (2009)	47.1%

- 128) As at December 31, 2010, the only assets owned by FL Select and FL Premier were cash plus promissory notes from another FL Group entity.
- 129) As at December 31, 2010, FL Investors' primary assets were revenue producing properties and cash. However, the revenue producing properties represented only 42% of the total capital raised from investors and debt.
- 130) As at December 31, 2010, the only assets owned by FL Progressive were cash, monies due from other FL entities and investments in other FL LPs.
- 131) In addition, distributions were paid to unitholders in those LPs, also from the total capital raised. Ultimately, the working capital available for each of these entities was considerably reduced.
- 132) In causing in excess of 50% of the capital raised to be paid in fees to companies he controlled, Phillips preferred his own interests ahead of his clients.
- 133) There existed an inherent conflict between Phillips and FLSI clients who purchased these LPs. Phillips, as RR and UDP, was required to act in the best interests of his clients.
- 134) However, as GP, he had the ability and opportunity to determine how much of investor funds would be paid to himself, through companies which he owned and/or controlled.
- 135) This was a conflict which Phillips failed to address in a fair, equitable and transparent manner and consistent with the best interest of the client and, as such, ought to have been avoided by Phillips.

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- 136) On November 7, 2011, Phillips advised FLSI clients that the FL Group had agreed to voluntarily stop trading units in all LPs and Funds. No payments have been made since that date.
- 137) On November 28, 2011, Phillips advised FLSI clients that all payments to investors (including interest payments and distributions) would be stopped immediately.
- 138) Phillips also advised FLSI clients that as at December 31, 2010, it appeared that WALP's liabilities exceeded the appraised value of its assets. Phillips also advised clients that WALP had been a significant drain on the resources of the FL Group.

139) As at June 2011, there were approximately 1200 FLSI clients, who had invested a total of \$284M in FL Products since 2004.

GENERAL PROCEDURAL MATTERS

TAKE FURTHER NOTICE that the hearing and related proceedings shall be subject to IROC's Rules of Practice and Procedure.

TAKE FURTHER NOTICE that, pursuant to Rule 13.1 of the Rules of Practice and Procedure, the Respondents are entitled to attend and be heard, be represented by counsel or an agent, call, examine and cross-examine witnesses, and make submissions to the Hearing Panel at the hearing.

RESPONSE TO NOTICE OF HEARING

TAKE FURTHER NOTICE that the Respondents must serve upon Staff a Response to the Notice of Hearing in accordance with Rule 7 of the Rules of Practice and Procedure within twenty (20) days (for a Standard Track disciplinary proceeding) or within thirty (30) days (for a Complex Track disciplinary proceeding) from the effective date of service of the Notice of Hearing.

FAILURE TO RESPOND OR ATTEND HEARING

TAKE FURTHER NOTICE that if the Respondents fail to serve a Response or attend the hearing, the Hearing Panel may, pursuant to Rules 7.2 and 13.5 of the Rules of Practice and Procedure:

- (a) proceed with the hearing as set out in the Notice of Hearing, without further notice to the Respondents;
- (b) accept as proven the facts and contraventions alleged by the Staff in the Notice of Hearing; and
- (c) order penalties and costs against the Respondents pursuant to IDA By-laws 20.33, 20.34 and 20.49 and/or IROC Dealer Member Rules 20.33, 20.34 and 20.49.

PENALTIES & COSTS

TAKE FURTHER NOTICE that if the Hearing Panel concludes that the Respondents or any of them did commit any or all of the contraventions alleged by the Staff in the Notice of Hearing,

the Hearing Panel may, pursuant to IDA By-laws 20.33 and 20.34 and/or IIROC Dealer Member Rules 20.33 and 20.34, impose any one or more of the following penalties:

Where the Respondent is/was an Approved Person:

- (a) a reprimand;
- (b) a fine not exceeding the greater of:
 - (i) \$1,000,000 per contravention; and
 - (ii) an amount equal to three times the profit made or loss avoided by such Approved Person by reason of the contravention.
- (c) suspension of approval for any period of time and upon any conditions or terms;
- (d) terms and conditions of continued approval;
- (e) prohibition of approval in any capacity for any period of time;
- (f) termination of the rights and privileges of approval;
- (g) revocation of approval;
- (h) a permanent bar from approval of the IIROC; or
- (i) any other fit remedy or penalty.

Where the Respondent is/was a Member firm:

- (a) a reprimand;
- (b) a fine not exceeding the greater of:
 - (i) \$5,000,000 per contravention; and
 - (ii) an amount equal to three times the profit made or loss avoided by the Member by reason of the contravention;
- (c) suspension of the rights and privileges of the Member (and such suspension may include a direction to the Member to cease dealing with the public) for any period of time and upon any conditions or terms;
- (d) terms and conditions of continued Membership;
- (e) termination of the rights and privileges of Membership;
- (f) expulsion of the Member from membership in the IIROC; or
- (g) any other fit remedy or penalty.

TAKE FURTHER NOTICE that if the Hearing Panel concludes that the Respondents or any of them did commit any or all of the contraventions alleged by the Staff in the Notice of Hearing,

the Hearing Panel may pursuant to IDA By-law 20.49 and/or IIROC Dealer Member Rule 20.49 assess and order any investigation and prosecution costs determined to be appropriate and reasonable in the circumstances.

DATED at Toronto, this 2nd day of October, 2012.

JEFFREY KEHOE
VICE-PRESIDENT, ENFORCEMENT
INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA
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