NO FAMILY RESEMBLANCE: THE COURT OF APPEAL RULES ON INTERPRETATION OF "SECURITY" AND CUSTODIAL SENTENCES

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The Ontario Court of Appeal's recent decision in *Ontario Securities Commission v. Tiffin*[1] provides guidance on what constitutes a “security” under Ontario securities laws and how custodial sentences may be rendered for offences under the *Securities Act* (Ontario) (the “**Act**”).

At issue on appeal were whether the instruments traded were "securities" and whether imprisonment of six months was proper. The Court upheld the convictions of Mr. Daniel Tiffin (“**Tiffin**”) and his company Tiffin Financial Corp. (“**TFC**”) for trading and distributing securities in breach of securities law, but varied the six-month sentence of imprisonment.

Background

Tiffin was a financial advisor licenced to sell insurance and insurance-based investments through TFC. In 2014, the Ontario Securities Commission (“**OSC**”) imposed sanctions against Tiffin and TFC, finding that Tiffin and TFC had traded in securities without registration. The sanctions included financial penalties and a five-year cease trade prohibiting trading in securities or relying on exemptions in Ontario securities law.

While still subject to the OSC's order, Tiffin issued $700,000 of promissory notes with interest rates between 10-25% (the “**TFC Notes**”) to friends and clients, secured against Tiffin’s collection of toy soldiers.

In connection with the issuance of the TFC Notes, Tiffin and TFC were charged with trading in securities without registration and distributing securities without filing a prospectus in contravention of the Act, and trading in securities while prohibited from doing so by an OSC order.

Trial Decision – Acquittal

At trial, there was no dispute that Tiffin and TFC were not registered, did not file a prospectus, and were prohibited from trading in securities by the OSC order. The sole issue was whether the TFC Notes were "securities" as defined by the Act.

The trial judge found that the TFC Notes were not securities, adopting the “family resemblance” test

established by the United States Supreme Court in *Reves v. Ernst & Young*. The family resemblance test asks whether an instrument resembles a security based on four factors:[2]

1. whether there is motivation to make profit;
2. whether the plan of distribution resembles common trading for speculation or investment;
3. whether the investing public reasonably expects that the note is a security; and
4. whether there is another regulatory scheme that protects the investor.

The trial judge found that the TFC Notes were presumptively securities. After applying the *Reves* factors, however, the judge held that the TFC Notes were similar to notes secured by a lien on a small business or its assets, and therefore not securities. The charges against Tiffin and TFC were dismissed.

Appeal Decision of the Superior Court of Justice: Conviction

The OSC appealed the decision of the trial judge to the Ontario Superior Court of Justice.

The Superior Court held that the trial judge erred in importing the family resemblance test from *Reves v. Ernst & Young* into Ontario securities law. On appeal, the Court found that the TFC Notes were securities. The Court stated that it should not be creating exemptions that are not found in the statute, and that the Act has built-in exemptions such that it is neither necessary nor appropriate to formulate additional exemptions by applying a judicially constructed test.[3]

Tiffin was sentenced to 6 months imprisonment, and he and TFC were sentenced to 24 months probation and ordered to make full restitution for the full amount of the TFC Notes.

Court of Appeal Decision

Tiffin was granted leave by the Court of Appeal to appeal the decision, on the basis that the interpretive principles to be applied to whether an instrument is a "security" within the meaning of s. 1(1) of the Act is a matter of public importance.

As discussed below, the Court dismissed the appeal from the convictions, but allowed an appeal from the 6-month custodial sentence.

No Family Resemblance Test for the Definition of "Securities"

At the centre of the appeal was the Superior Court of Justice's refusal to apply the family resemblance test.

The Court acknowledged that American law can be useful in interpreting Canadian securities law, but cautioned that the differences between the two securities regulatory regimes must be kept in mind. US securities legislation was only intended to regulate investments, so the US courts have distinguished between

investment instruments, which are subject to the regime, and commercial instruments, which are not.

The Court noted several key distinctions between the Act and the *US Securities Exchange Act of 1934* (the "**Exchange Act**") indicating that the definition of a "security" in the Act is intended to be broader than that in the Exchange Act. First, the definition of a security in the Act opens with inclusive language, while the Exchange Act opens with language indicating an exhaustive definition.[4]

Second, the Exchange Act contains a statement in its definition of security permitting the finding of a security "unless the context otherwise requires". US Courts have relied upon this language in the past to narrow the definition of a security.[5] Such language is absent in the Act.

Third, treatment of short-term debt instruments under the Exchange Act shows that the Act has broader definition of a security, as there are certain exclusions from the US definition that do not exist in Ontario.[6]

The Court also noted that Tiffin and TFC sought to apply the family resemblance test not because of an absence of applicable exemptions, but because they were barred from relying on such exemptions under the OSC order.[7] As such, interference with the definition of "security" under the Act was unwarranted.

The Court found that these structural differences weigh against importing the family resemblance test. The use of the family resemblance would undermine the scheme of the Act. The Court stated that:[8]

> In my view, importing the family resemblance test into the interpretation of the term, "security", would raise a risk of unintended consequences and litigation inherent when tinkering with a definition central to a complex regulatory scheme. Moreover, and importantly, there is no need to run this risk given the statutory mechanisms through which the legislator has seen fit to achieve the goals which animate securities regulation. In short, while American securities jurisprudence may be a useful source of persuasive authority in some cases, it is not necessary or advisable to import the family resemblance test into the definition of security in the Ontario context.

The TFC Notes were held to be securities under the Act and the convictions of Tiffin and TFC were upheld.

Six Months of Prison Demonstrably Unfit

While the conviction stood, the sentence was overturned on appeal. The Court found the sentence of 6 months imprisonment to be demonstrably unfit and held that a probation and restitution order were sufficient to achieve the sentencing objectives in the circumstances.

The Court applied a standard set out by the Supreme Court of Canada and held that it could vary a sentence on appeal if it is demonstrably unfit.[9] A sentence is demonstrably unfit if it represents a "substantial and marked departure from a proportional sentence properly arrived at based on the correct application of the principles

and objectives of sentencing".

The Court began by reviewing the sentencing principles applicable to regulatory offences and, in particular, when imprisonment is necessary. The Court reviewed concepts of proportionality[10] and restraint[11].

The Court also considered a distinction that has sometimes been drawn between merely careless offenders and designedly evasive deliquents, arising from common law treatment of the *Rex v. Bowman and Thibaudeau* decision.[12] This distinction has been relied on to determine the necessity of imprisonment. The Court held that, "moral blameworthiness is relevant, but it cannot be the sole focus" of a regulatory sentencing judge.[13]

The Court reviewed factors that made Mr. Tiffin's imprisonment unfit. Mr. Tiffin:

- did not attempt to deceive;
- acknowledged he engaged in the conduct complained of;
- had paid some money and was likely to continue repaying his clients;
- was supported by recipients of the promissory notes; and
- expressed remorse.[14]

Non-compliance with a previous OSC order alone did not require a minimum custodial sentence. The Court held that the absence of deceit was a "unique mitigating factor". A fit sentence in this case had to reflect reduced responsibility for the offences that flowed from the absence of deceit. A sentence including probation and restitution was sufficient.

Conclusion

The Ontario courts have generally accepted that the scheme of the Act is “catch and exclude”. A broad range of instruments and activities fall within the regulatory scope, then the Act contains specific exclusions. The definition of “security” in the Act is broad, and the decision in *Tiffin* shows a disinclination to narrow that definition to avoid interfering with the "catch and exclude" object and intention of the Act.

When it comes to sentencing, principles of proportionality and restraint must apply even where there is an interest in deterrence. That restraint and proportionality may be evident in how the court will sentence non-deceitful conduct. While the Court eschewed the categorization of offenders as "careless" or "designedly evasive delinquent", the absence of deceit was a prominent factor in the Court's refusal to permit a custodial sentence. Deceit, in fact, took precedence over the Superior Court's focus on recidivism - a view that may not be favoured by regulators but may be more reflective of proportionate individual sentencing for regulatory offences.

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[1] 2020 ONCA 217 [*Tiffin Appeal Decision*].
[2] *Ibid* at para 13.
[3] *Ontario Securities Commission v Tiffin*, 2018 ONSC 3047 at para 46.
[4] *Tiffin Appeal Decision*, *supra* note 1 at para 41.
[5] *Ibid* at para 42.
[6] *Ibid* at paras 43-44.
[7] *Ibid* at paras 33-35.
[8] *Ibid* at para 48.
[9] *Ibid* at para 66, citing *R v Lacasse*, 2015 SCC 64 at paras 11, 52.
[10] *Ibid* at para 54.
[11] *Ibid* at para 55.
[12] *Ibid* at paras 57-60.
[13] *Ibid* at para 62.
[14] *Ibid* at para 67.

a cautionary note