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# No Family Resemblance Here: Tiffin Overturned on Appeal

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Securities regulators must be breathing a sigh of relief. An earlier decision in *Ontario Securities Commission v Tiffin*1 was the cause of no small amount of consternation in the cubicles and corridors of the OSC, opening as it did the possibility that certain promissory notes may be exempt from the application of the Securities Act. The Ontario Superior Court has now overturned that lower court decision,2 confirming what regulators have long asserted: promissory notes, as evidence of indebtedness, are indeed securities. The appeal decision reiterates, with considerable emphasis, the idea that securities legislation is complex, but complete and comprehensive, and judicial attempts to interpret its statutory provisions in a way that is inconsistent with the plain language of the Act constitutes an error of law.

The case arises from the misadventures of an outfit named Rezwealth Financial Services Inc. which held itself out as being in the foreign exchange business. Rezwealth issued various instruments purporting to be investments, including debentures and promissory notes, and Daniel Tiffin, through his firm Tiffin Financial Corporation (TFC), traded in the notes in violation of Ontario securities law. Mr. Tiffin was a financial advisor, licensed to sell life insurance and related investment products, but was not a securities registrant at the time of the offences.

Following an investigation, the OSC issued a final decision imposing sanctions against various persons involved in the Rezwealth scheme, among them Tiffin and TFC. Included were prohibitions against trading in securities and relying on exemptions for a period of five years. As a result, Mr. Tiffin found himself in dire financial straits and appealed to his clients, to whom he had sold insurance products, for help. Some of them agreed to lend him money, and Tiffin had TFC issue promissory notes to them to evidence the debt. The security for the notes was unusual, consisting as it did of an interest in a “toy soldier collection” belonging to TFC. As a result of issuing these notes, Tiffin and TFC were charged with trading in securities contrary to the provisions of the Act.

The trial judge dismissed the charges on the ground that the promissory notes in question were made in connection with a “simple private loan agreement” and hence were not “securities” within the meaning of the Act. This despite the definition of “security” in the Act, which specifically includes “a bond, debenture, note or other evidence of indebtedness…” In finding for Tiffin and TFC, the trial judge accepted their submission that reading the statutory definition of “security” to include the promissory notes “casts too wide a net and is inconsistent with the purpose of the Act”. In reaching his decision, the trial judge rejected a “literal interpretation” approach to statutory interpretation. Instead, seeking to give effect to the purpose and intent of the legislation, he examined the substance of the transaction and concluded that these types of private loan agreements could not have been intended to be captured. The trial judge relied on a “family resemblance test” from the U.S. decision Reves v Ernst & Young3. Under this test, a note is presumed to be a security unless it falls within a “judicially crafted” category. The judge found that Tiffin’s promissory notes were similar to notes secured by a lien on a small business and thus exempt from regulation under the Act.

The OSC appealed the decision. Charney J. allowed the appeal and substituted a conviction. The court rejected the "family resemblance" test, stating unequivocally that "the trial judge erred in law by importing the American 'family resemblance' test into Ontario securities law to determine whether the promissory notes issued by TFC were excluded from the statutory definition of 'security'". The court went on to observe that "the word 'security' is defined in the Ontario Act, and prior to this case, no court in Ontario or decision of the Ontario Securities Commission, had found that an instrument that meets the statutory definition of 'security' … should be exempted from the Act by the application of extra-statutory judicially crafted criteria." To make the point absolutely clear, Charney J. noted that, far from "casting too wide a net", the "breadth is deliberate, and consistent with the remedial purpose of the act. In the absence of a constitutional challenge for overbreadth, this is not an invitation for the creation of judicially crafted criteria to scale back the scope of the law."

Anyone who was left wondering if, after the first Tiffin decision, promissory notes issued in connection with a small business loan were "securities" under the Act can stop wondering now. The Ontario Superior Court of Justice has answered forcefully in the affirmative.

We should note here that the decision is not as unfriendly to small business as may at first appear. There are exemptions in the securities legislation which permit a borrower to give security for a loan or debt obligation. For example, the definition of "trade" or "trading" generally excludes a transfer, pledge or encumbrance of securities for the purpose of giving collateral for a debt made in good faith. National Instrument 45-106 provides a prospectus exemption for a distribution of a security of an issuer to a lender, pledgee, mortgagee or other encumbrancer from the holdings of a control person of the issuer for the purpose of giving collateral for a bona fide debt of the control person. There are other exemptions, which operate so that a promissory note issued in the course of a secured loan or other business transaction is generally not trading in a security contrary to securities law. Most small businesses will end up complying with securities law without realizing that they are doing so. Lawyers, though, would be well advised to make sure of it.

[1] *Ontario (Securities Commission) v Tiffin*,2016 ONCJ 543.
[2] *Ontario Securities Commission v Tiffin*, 2018 ONSC 3047.
[3] *Reves v Ernst & Young*, 494 US 56 (1990).

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