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Tiffin doubt: Just what is a 'security'?

By Neill May

It sometimes seems as if the line between acting as corporate securities counsel and being the deal participant whose primary value-add is unnatural fussiness about typos can be fairly thin. I have said previously that lawyers are in the unusual position professionally of benefiting by lack of clarity in their area of expertise: If everything were settled and comprehensible, there would be less need for legal advice.

That there is continuing uncertainty on the central question as to what constitutes a "security" may nevertheless surprise those not in the industry. At the metaphorical cocktail party, if a securities lawyer is fortunate enough to warrant a second question after admitting their chosen vocation, as a profession we have to hope that the second question is not "What is a security?" because if the answers are "I'm not really sure" or even "That is a truly fascinating question," I expect that the inquisitor is as likely to pull the fire alarm as to prolong the conversation.

Still, despite the unneeded complexity it adds to my notional social life, the uncertainty as to what constitutes a "security" endures, as reflected in the recent decision of the Ontario Court of Justice in *Ontario Securities v. Tiffin*. In that case, six parties agreed to advance an aggregate of $700,000 to Tiffin Financial Corporation, a company wholly owned and controlled by Daniel Tiffin, pursuant to interest-bearing promissory notes. Tiffin was at the time subject to a cease trade order issued by the Ontario Securities Commission, as a result of prior proceedings relating to an issuance of promissory notes by another company, which prohibited both TFC and Tiffin from trading in securities or relying upon exemptions under Ontario securities laws (and imposed financial penalties). TFC's notes, though, made reference to a reliance on the accredited investor exemption (an exemption from the requirement to issue a prospectus in connection with a distribution of *securities*). The funds advanced were said to be for Tiffin's personal use and to keep TFC operating.

The general statutory framework for defining the scope of securities laws, as noted by the court in *Tiffin*, is "catch and exclude." The concept of "security" is defined very broadly, and then a series of exemptions is provided so that securities laws do not intrude where there is no policy reason for their application. Consistent with that approach, the statutory definition of "security" includes "any note or other evidence of indebtedness" and other elements that would appear to capture the TFC promissory notes.

> ***...DESPITE THE UNNEEDED COMPLEXITY IT ADDS TO MY NOTIONAL SOCIAL LIFE, THE UNCERTAINTY AS TO WHAT CONSTITUTES A 'SECURITY' ENDURES, AS REFLECTED IN THE RECENT DECISION OF THE ONTARIO COURT OF JUSTICE IN [TIFFIN].***

The *Tiffin* court took the position that the statute should be purposively (and not strictly literally) interpreted, taking into account the legislative mischief. Applying that approach, the court adopted the "family resemblance test" used by the U.S. Supreme Court to determine whether a promissory note is subject to securities laws. The factors in that test, at a high level, turn on the parties' motivations, the activities undertaken to distribute the alleged security, the reasonable expectations of the investing public and the existence of other protective legal frameworks.

These determinations will necessarily be very fact-specific. In *Tiffin*, the court concluded that although the notes were interest-bearing and for general business use, there was no sense of investment or interest in the TFC business beyond the terms of the loan. The court also noted, among other things, that the notes were issued to existing customers who considered Tiffin to be a friend (which, it can be noted, might have formed the basis for reliance on an exemption); that contract and tort law would apply to the loans.

Interestingly, it appears from the decision that the lenders who gave evidence sided with Tiffin. This relates to the type of practical consideration (e.g. the likelihood of complaint and the nature of the parties' relationship) that might also influence assessments of the application of securities laws. In the *Tiffin* case, another factor of this nature may have been the cease trade order, but that appears not to have affected the outcome or the parties' perspectives.

One other detail of the *Tiffin* judgment that may amuse practitioners is the court's treatment of the fact that the terms of the notes themselves contemplated reliance on the accredited investor exemption. The court refers to evidence that no party actually relied on the exemption and that counsel that drafted the paper knew that the exemption was unavailable, and it concludes that the references don't make sense in context and are simply examples (among others) of reckless drafting and editing by the lawyers.

It is hard to reconcile that fact with my stereotype about fussiness with typos, but maybe I can worry a bit less about drafting mistakes I might have made years ago.

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