COR#01/071

IN THE MATTER OF THE SECURITIES ACT
R.S.B.C. 1996, c. 418

AND

IN THE MATTER OF DIRK ALAN RACHFALL AND MICHAEL KEVIN PATTERSON

PANEL
Brent W. Aitken
John K. Graf
Roy Wares

DATE OF HEARING
June 12, 2001

DATE OF DECISION
June 19, 2001

APPEARING FOR COMMISSION STAFF
Chilwin C. Cheng

APPEARING FOR DIRK ALAN RACHFALL AND MICHAEL KEVIN PATTERSON
Robin N. McFee

DECISION

[para 1]
This is a hearing under section 161(1) of the *Securities Act*, R.S.B.C. 1996, c. 418 under a notice of hearing dated July 13, 1999. Commission staff is seeking orders in the public interest that the respondents, Dirk Alan Rachfall and Michael Kevin Patterson:

(a) be denied the use of the exemptions under the Act,
(b) be prohibited from acting as directors or officers of any issuer,
(c) be prohibited from engaging in investor relations activities,
(d) pay an administrative penalty, and
(e) pay the costs of the hearing.

BACKGROUND

[para 2]
Until July 1999 Rachfall and Patterson were salespersons registered under the Act and employed by Pacific International Securities Inc. Rachfall had been a broker since 1985; Patterson, since 1979. Rachfall is about to turn 40; Patterson is 46. Until the incident that is the subject of this hearing, neither Rachfall nor Patterson had any disciplinary history with the Commission or any self-regulatory organization.

[para 3]
In 1997, Rachfall and Patterson were faced with personal liability of approximately $300,000 each for stock bought on margin for clients who had defaulted. They began looking for someone to

buy the basket of stocks formerly held by the defaulting clients. The pivotal stock was Orlando Supercard, Inc., which traded on the NASD OTC Bulletin Board.

[para 4]
They found David Houge, a Pacific International client, who they knew as a stock promoter. Houge was willing to buy the stock, but only if he could acquire essentially all of Orlando's public float. Rachfall and Patterson then made a coordinated effort with other Vancouver brokers so that enough stock could be offered to Houge to complete the deal. On this basis, Houge bought the Orlando stock at a price sufficient to make Rachfall and Patterson and the other brokers whole. Rachfall and Patterson closed their eyes to the prospect that Houge's intent in buying the Orlando stock was to manipulate its price.

[para 5]
As it turned out, this is just what Houge did.

[para 6]
Houge's activities became part of a criminal investigation by the United States Federal Bureau of Investigation. In 1999, the United States issued an indictment naming several individuals alleged to be connected with organized crime. Rachfall and Patterson were also named. Houge assisted the prosecutors as a cooperating witness and was not charged.

[para 7]
In June 1999, Rachfall and Patterson were arrested in the United States and charged under the indictment. Two consequences quickly ensued: their employment with Pacific International ended, and the Executive Director made temporary orders against them. The temporary orders

- denied them the use of the exemptions under the Act,
- prohibited them from acting as a director or officer of any issuer,
- prohibited them from engaging in investor relations activities, and
- suspended their registrations.

[para 8]
The Commission later extended these temporary orders until now.

[para 9]
In April 2000, Rachfall and Patterson entered plea agreements in which they plead guilty to one count in the indictment, being that they "engaged in acts which operated as a fraud upon members of the investing public, in connection with purchases and sales of securities of Orlando Supercard, Inc.". The remaining counts were dismissed.

[para 10]
As a result of the plea agreements, Rachfall and Patterson were imprisoned for five months, ordered to serve a further year of supervised release (their present status) and ordered to pay restitutional fines of about U.S.$130,000 each.

[para 11]
In connection with their guilty pleas, Rachfall and Patterson made admissions (called "allocutions") on the record. The allocution process is conducted before a judge, whose task is to ensure defendants understand their rights and that the facts admitted are sufficient to support a finding of guilt.

[para 12]
This is an excerpt from Patterson's allocution:

"DEFENDANT PATTERSON: . . . I understood our coordination of the Vancouver brokers meant that [Houge's] purchase would give him control of all or substantially all of the freely traded shares of [Orlando]. However, I purposely closed my eyes to the high probability that his intent in inquiring [*sic*] so much [Orlando] stock was to control the market and sell his shares at an artificially inflated price and manipulated price. I knew that the artificial price inflation and manipulation was wrong.

"We helped [Houge] obtain the [Orlando] stock that enabled him to execute his scheme and we consciously avoided knowing the real reason for [Houge's] purchase from us.
. . .

"THE COURT: In other words, but your main concern was regardless of the consequence to other investors you wanted out of [Orlando]?

"DEFENDANT PATTERSON: Yes, sir."

[para 13]
Rachfall's allocution was essentially the same.

[para 14]
Houge apparently had a history of stock manipulation, but Rachfall and Patterson deny knowing of it at the time, and there is no evidence to the contrary. They also deny knowing Houge's actual intentions when he acquired the Orlando stock, and there is no evidence to the contrary.

ISSUES AND FINDINGS

[para 15]
The notice of hearing recites a number of allegations based on charges in the indictment and the complaint leading up to it. It then alleges:

"1.9 The Complaint and Indictment contain information indicating that the Respondents have engaged in or participated in a transaction or series of transactions relating to trades in or acquisitions of shares of Orlando . . . that:

"1.9.1 the Respondents knew, or ought reasonably to have known, resulted in or contributed to a misleading appearance of trading activity in, and an artificial price for, the shares of Orlando . . .;

"1.9.2 perpetrated a fraud on persons; and

"1.9.3 was contrary to the public interest."

[para 16]
To prove these allegations, Commission staff has relied solely on documents related to the criminal proceedings in the United States. Rachfall and Patterson have acknowledged the relevance and authenticity of these documents.

[para 17]
For the purpose of our factual findings, we have relied solely on the plea agreements and the related allocutions. At the hearing Commission staff made various statements about other

charges in the indictment and the others charged. None of this is relevant. Apart from the fact of the respondents' conviction for securities fraud in the United States, the only relevant consideration for us is their conduct as admitted in their allocutions.

[para 18]
Based on these documents, we find that Rachfall and Patterson:

1. are guilty of securities fraud under the laws of the United States,
2. knew there was a "high probability" that Houge was acquiring the Orlando stock with the intention of carrying out a manipulation,
3. deliberately failed to make appropriate inquiries of Houge,
4. did not know of Houge's reputation as a stock manipulator, and
5. did not know Houge's actual intentions.

[para 19]
Commission staff alleges that the respondents' conduct is contrary to the public interest, and that they contravened section 57.1 of the Act, which says:

"57.1 A person in British Columbia must not, directly or indirectly, engage in or participate in a transaction or series of transactions relating to a trade in or acquisition of a security . . . if the person knows, or ought reasonably to know, that the transactions or series of transactions

"(a) results in or contributes to a misleading appearance of trading activity in, or an artificial price for, any security . . . or

"(b) perpetrates a fraud on any person anywhere."

Conduct contrary to the public interest

[para 20]
It is well-established that registrants must act in the best interests of the market. Section 48(1) of the *Securities Rules*, B.C. Reg. 194/97, requires a registrant to "learn the essential facts relative to every client", including the client's reputation. Rule F.1.01 of the rules of the Canadian Venture Exchange says:

"F.1.01 Every member and approved person shall use due diligence

"a. to learn the essential facts relative to every client, every order or account accepted;

"b. to ensure that the acceptance of any order for any account is within the bounds of good business practice . . . ."

[para 21]
The Investment Dealers Association of Canada has similar requirements.

[para 22]
In Notice to Members #48/89 dated May 3, 1989, the Exchange spoke of registrants' roles as "gatekeepers". It said:

"However, the R.R. must also act in the best interests of his company and through this the whole Securities Industry. From this it follows that if the R.R. becomes aware through his knowledge of the client or otherwise, that the intention or effect of the trading by a client would be in breach of

the Securities Act or impugn the integrity of the market place, then it is incumbent on the R.R. in his capacity as "Gatekeeper" within the Securities Industry, to draw the matter to the attention of Management of his firm or the Stock Exchange. Further, willful blindness on the part of the R.R., may equally be construed as failure to meet his responsibilities."

[para 23]
Rachfall and Patterson failed to meet these obligations. They knew there was a "high probability" that Houge was acquiring the Orlando stock with the intention of manipulating its price. It was their responsibility to make due inquiry to satisfy themselves that Houge's intentions were legitimate. Had they been unable to satisfy themselves on that point, it would have been their duty not to proceed with the trades.

[para 24]
However, Rachfall and Patterson were focused on their personal liability under the margin calls and they were not about to do anything to scotch the one deal that could solve their problems. Their concern with their own financial position rendered them blind and indifferent to the victims of Houge's intended manipulation.

[para 25]
We therefore find that Rachfall and Patterson acted contrary to the public interest in failing to meet their responsibilities as gatekeepers.

Contravention of section 57.1

[para 26]
Rachfall and Patterson are guilty of securities fraud in the United States. This alone is an appropriate basis for us to consider making orders against them in the public interest. We have also found that they acted contrary to the public interest in failing to meet their gatekeeper responsibilities. We see little to be gained by determining whether their conduct, as described in their allocutions, also constitutes a breach of section 57.1. Accordingly we make no finding on this issue.

DECISION

[para 27]
The respondents' failure to meet their gatekeeper responsibilities is a serious failure to meet the obligations expected of registrants. That failure, especially in combination with the consequences that flowed from it, would normally attract significant orders.

[para 28]
Commission staff has suggested orders barring Rachfall and Patterson from the market for 20 years and imposing an administrative penalty of $50,000. In our opinion this is completely out of line with precedent and ignores the circumstances of this case.

[para 29]
In considering what orders, if any, are appropriate in the public interest, we have considered the following factors:

1. Rachfall and Patterson allowed concern for their personal financial situation to overcome their duty to act as gatekeepers. They consciously put their own interests ahead of the market.

2. They have paid dearly for their error. They have been jailed, they have criminal records and their careers are in ruins. As a result of their unemployment and the costs of defending themselves in the U.S. courts, they are financially devastated.

3. They are responsible for paying restitutional fines of over U.S.$130,000 each.

4. Had they fulfilled their obligations, the manipulation may not have happened, but they were not aware of it and were not the ones who planned it, executed it or profited from it.

5. Their firm also had compliance responsibilities. There is nothing before us concerning the role of the firm or its compliance officer, so nothing ought to be inferred from this statement other than the observation that Rachfall and Patterson did not have exclusive responsibility for the gatekeeping function.

6. Until this incident, both had unblemished records after many years in the industry – nearly 15 years in Rachfall's case, 20 in Patterson's.

7. Both are middle aged and have families to support. They have no skills or experience in any industry other than the securities industry. Orders removing them from the market for a significantly long period will effectively end their opportunity to earn a living in their only field of expertise.

8. They have been out of the markets for nearly two years as a result of the temporary orders.

[para 30]
Had these been the only proceedings to which Rachfall and Patterson had been exposed as a result of their error, their conduct would have attracted orders barring them from the markets for a significant period. Had their conduct been found to contravene the Act or the Rules, it is likely an administrative penalty would have been levied. It is likely they would have been ordered to pay costs.

[para 31]
However, that is not the case. In light of the factors listed above, we do not believe the public interest will be served by making any orders under section 161(1). The purpose of orders under that section is to protect the public interest, not to punish or exact retribution. Considering the consequences that Rachfall and Patterson have suffered as a result of their conduct, we think it unlikely that they would pose a threat to the market were they to rejoin the securities industry. If anything, their experiences should make them unusually vigilant. We hope so.

[para 32]
Neither do we consider it in the public interest to order any administrative penalty under section 162. Whatever purpose might have been served by ordering an administrative penalty has been addressed by the restitutional fines imposed by the U.S. courts. We also recognize the financial consequences suffered by Rachfall and Patterson as a result of their conduct. There is also the technical difficulty that the notice of hearing does not specifically allege, and we have not found, a contravention of any provision of the Act or the Rules.

[para 33]
In the circumstances, we do not consider it appropriate to make any order for costs.

[para 34]
Therefore, considering it to be in the public interest, we make no orders under sections 161(1), 162 or 174. The temporary orders are revoked.

June 19, 2001

[para 35]
FOR THE COMMISSION

Brent W. Aitken, Commissioner

John K. Graf, Commissioner

Roy Wares, Commissioner