2003 BCSECCOM 656

COR#03/143

Reasons

James Nelson McCarney

Section 161 of the *Securities Act*, RSBC 1996, c. 418

Panel	Joyce C. Maykut, Q.C.	Vice Chair
	Joan L. Brockman	Commissioner
	Marc A. Foreman	Commissioner
Dates of Hearing	June 24 and 26, 2003	
Date of Reasons	September 30, 2003	

Appearing

Sean K. Boyle	For Commission staff
Howard Shapray, Q.C. Brad Cramer	For James Nelson McCarney

Introduction

¶ 1 On June 16, 2003, the Executive Director issued a series of temporary enforcement orders under section 161 of the Act against James Nelson McCarney.

¶ 2 The temporary orders directed McCarney to:

1. comply with or cease contravening the Act,
2. cease trading in, and be prohibited from purchasing any securities,
3. resign any position he may hold as a director or officer of any issuer, and not become or act as a director or officer of any issuer, and
4. not engage in any investor relations activities.

¶ 3 A notice of hearing for June 24, 2003, accompanied the temporary orders.

¶ 4 In summary, the notice alleged that the temporary orders were issued because:

1. McCarney had not satisfied any of the outstanding demands by staff to produce documents and information under section 144 of the Act, nor provided a satisfactory response to staff's request for a written explanation;

2. McCarney deliberately failed to comply with the series of outstanding demands and deliberately attempted to frustrate and delay the investigation of matters referred to in an investigation order made under section 142 of the Act;
3. McCarney's deliberate failure to comply with the demands for production and continued involvement in two companies under investigation was contrary to the public interest; and
4. the Executive Director determined that the length of time to hold a hearing under section 161(1) of the Act could be prejudicial to the public interest.

¶ 5 The temporary orders were set to expire on June 24, 2003. The notice stated that staff would apply on June 24, 2003 to extend the temporary orders until McCarney complies with the outstanding staff demands. The outstanding demands were particularized in the notice of hearing. The demands were made under section 144 of the Act.

¶ 6 At the hearing on June 24, 2003, staff testified that McCarney had complied with 95% of the outstanding demands.

¶ 7 At the hearing on the 24th we determined that it was not necessary and in the public interest to extend the temporary orders against McCarney. Accordingly, the temporary orders expired.

¶ 8 Although we declined to extend the temporary orders, McCarney argued that the allegations in the notice of hearing were unfounded and remained highly prejudicial to him if left answered. McCarney asked us to rule on whether the evidence supported them. We adjourned the matter to consider the evidence and whether any further orders were necessary.

¶ 9 On June 26, 2003, we found that Commission staff failed to establish their allegations that:

1. there has been a deliberate failure by McCarney to comply with a series of outstanding demands and a deliberate attempt by McCarney to frustrate and delay matters contained in an investigation order issued on January 6, 2003, and

2. McCarney's deliberate failure to comply with the demands for production and continued involvement in McCarney Technologies Inc. and 526053 BC Ltd. is contrary to the public interest.

¶ 10 We also determined that it was not necessary to make any further orders. However, we indicated that the issuance of temporary orders, without a hearing, to

compel production of documents and information during the course of an investigation, merits further written reasons.

¶ 11 These are our reasons.

Background

¶ 12 McCarney was a director and officer of McCarney Technologies, until December 19, 2002, is the sole director, officer and shareholder of 526053, was an officer of Autolab LLC and was a director of IVS Intelligent Vehicle Systems, during the period October 1992 through to July 1999. McCarney was also an officer of Autolab, a US company, for part of that period. Autolab was a wholly owned subsidiary of 526053. Of the companies, only McCarney Technologies is a reporting issuer. On March 3, 1999 the Commission issued a cease trade order against McCarney for failure to file insider trading reports. At the date of the hearing the cease trade order was still in effect.

¶ 13 Sometime in 1999, staff began requesting information from McCarney concerning money 526053 had borrowed from certain parties. In September 1999, following discussions between McCarney's counsel and staff, McCarney's counsel wrote to staff addressing these issues.

¶ 14 On the evidence before us, it does not appear that much happened on the file between September 1999 and 2001. Then from August 2001, through to January 6, 2003, staff made a series of written requests for documents and information. McCarney voluntarily responded to these demands.

¶ 15 In November 2002, McCarney initiated a plan to reorganize McCarney Technologies, 526053 and Autolab with a view to completing a reverse take over with a US public company. At that time, McCarney resigned as officer and director of McCarney Technologies and hired various professionals to run the companies' operations, facilitate the reorganization and deal with staff's request for documents. McCarney hired a chartered accountant to sort out 526053's poorly organized financial records and prepare financial statements. KPMG was retained to audit the financial statements of 526053 and Autolab for the proposed reorganization. 526053 retained Jonathan McCullough as special counsel to formulate a plan of arrangement.

¶ 16 On January 6, 2003, staff obtained an investigation order under section 142 of the Act. The investigation order authorized staff to investigate the business and affairs of 526053, McCarney Technologies, Autolab, Intelligent Vehicle Systems, McCarney, James Mead, Trevor Park, Cathy Sackville and Brent Edgson during the period from December 1, 1997 forward. The order was based on staff's

representation that the named parties may have violated sections 34(1)(a), 50(1)(b), 61(1), 50(1)(c)(i) and 57.1 (b) of the Act.

¶ 17 Staff now pursued their demands for documents under the authority of the investigation order. On January 7, 2003 staff sent McCarney's counsel a demand under section 144 of the Act directing McCarney to produce certain specified records in his possession relating to him, 526053 and McCarney Technologies. Subsequent demands followed January 14, and 28, 2003, February 17, 2003 and March 19, 2003. It is not necessary to describe in detail all of the demands or communications between staff and McCarney's counsel. However some description of the circumstances is necessary to put our reasons in context.

¶ 18 McCarney stated that he continued to voluntarily respond to staff's demands. The demands included requests for existing documents, documents to be created and explanations for certain transactions. His responses often precipitated further requests for documents or explanations of transactions. Many of the documents were in the possession of, and provided by, the accountant or special counsel.

¶ 19 The chartered accountant retained by 526053 stated that McCarney instructed her to cooperate fully in providing information and documents to staff. She stated that the difficulties she experienced in providing documents and information was because of the poor shape of the financial records. Staff investigator, Michael Pesunti, testified that despite the state of the records, the accountant was cooperative in dealing with his requests.

¶ 20 Special counsel stated that his instructions were to, and he did, communicate candidly with staff about the proposed reorganization. He stated he made clear to staff that McCarney and the companies wanted to work with staff to ensure the reorganization was completed. On June 6, 2003 a staff investigator and staff counsel, at special counsel's invitation, attended an information meeting relating to the reorganization of the companies.

¶ 21 For most of the investigation, it appears staff, counsel for McCarney, special counsel and the accountants worked cooperatively to process the demands for information while accommodating schedules and unforeseen circumstances.

¶ 22 At some point, although it is not entirely clear when, staff believed McCarney was deliberately delaying the production of documents and information. Specifically staff believed special counsel's April 14, 2003 response to their demand of March 19, 2003, was inadequate. There were further communications between staff and McCarney's counsel, although not all of the correspondence is before us.

¶ 23 In a letter dated June 10, 2003, McCarney's counsel explained why some of the demands were not, or could not be, met. He stated that some of the documents were not in McCarney's possession or control and some lists and financial statements were in the process of being compiled. McCarney's counsel also objected to staff's suggestion that McCarney was in violation of staff's demand in these circumstances. He reiterated McCarney's desire to cooperate with staff and invited staff to advise him if there was anything else he could do to assist.

¶ 24 Staff did not respond to counsel's June 10, 2003 letter. Pesunti testified that by June 6, 2003, (the date of the reorganization information meeting) issuing the temporary orders without a hearing "was in the works". Special counsel had asked staff, at the time the investigation order was issued, to provide him with notice of any impending action against the companies or McCarney to avoid any adverse affect on the reorganization. Staff did not notify McCarney's counsel or special counsel that they were contemplating temporary enforcement orders under the Act if McCarney did not comply with their demands.

¶ 25 Staff stated it was not efficient to summon McCarney to a compelled interview until he responded to all of their demands. Instead, staff issued the temporary orders and notice of hearing on June 16, 2003, to compel McCarney to comply with their demands.

Discussion and reasons

¶ 26 The remaining issue we wish to comment on is the appropriateness of issuing temporary enforcement orders, without a hearing, to compel production of documents and information during the course of an investigation.

¶ 27 In considering this issue, it is useful to first consider the regulatory context.

¶ 28 Part 18 of the Act, *Enforcement,* provides the scheme for enforcement under the Act. The provisions in this part span a broad spectrum from purely regulatory or administrative sanctions to civil sanctions to quasi-criminal sanctions. In this case, only section 161, which deals with regulatory sanctions, is relevant.

¶ 29 Section 161(1) provides that the Commission or the Executive Director may, after a hearing, make any one of a variety of enforcement orders described in that section. These include orders of the kind made against McCarney. (For example, under section 161(1)(a) a person may be ordered to comply with or cease contravening a provision of this Act, the regulations or a decision.)

¶ 30 Section 161(2) provides that if the Commission or the Executive Director considers that the length of time required to hold a hearing under subsection (1) could be prejudicial to the public interest, they may make a temporary order,

without a hearing, to have effect for not longer than 15 days after the date the temporary order is made.

¶ 31 Section 161(3) provides for the extension of temporary orders, without a hearing, if the Commission or the Executive Director considers it necessary and in the public interest. Sections 161 (4) and (5) deal with notice.

¶ 32 The Commission and the courts have often commented on the purpose and proper application of these powerful regulatory provisions.

¶ 33 The Supreme Court of Canada in *Committee for Equal Treatment of Asbestos Minority Shareholders vs. Ontario (Securities Commission),* [2000] S.C.J. No. 38 (S.C.C.) discussed the Ontario Securities Commission's public interest jurisdiction under section 127 of the *Securities Act (Ontario),* a provision similar to section 161 of our Act. Iacobucci J., writing for the court beginning at paragraph 42, said:

> 42 … it is important to recognize that s. 127 is a regulatory provision. In this regard, I agree with Laskin J.A. that "[t]he purpose of the Commission's public interest jurisdiction is neither remedial nor punitive; it is protective and preventive, intended to be exercised to prevent likely future harm to Ontario's capital markets" (p. 272). This interpretation of s. 127 powers is consistent with the previous jurisprudence of the OSC in cases such as *Canadian Tire*, *supra*, aff'd (1987), 59 O.R. (2d) 79 (Div. Ct.); leave to appeal to C.A. denied (1987), 35 B.L.R. xx, in which it was held that no breach of the Act is required to trigger s. 127. It is also consistent with the objective of regulatory legislation in general. The focus of regulatory law is on the protection of societal interests, not punishment of an individual's moral faults: see *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154, at p. 219.
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> 43 Furthermore, the above interpretation is consistent with the scheme of enforcement in the Act. The enforcement techniques in the Act span a broad spectrum from purely regulatory or administrative sanctions to serious criminal penalties. The administrative sanctions are the most frequently used sanctions and are grouped together in s. 127 as "Orders in the public interest". Such orders are not punitive: *Re Albino* (1991), 14 O.S.C.B. 365. Rather, the purpose of an order under s. 127 is to restrain future conduct that is likely to be prejudicial to the public interest in fair and efficient capital markets. The role of the OSC under s. 127 is to protect the public interest by removing from the capital markets

> those whose past conduct is so abusive as to warrant apprehension of future conduct detrimental to the integrity of the capital markets: *Re Mithras Management Ltd.* (1990), 13 O.S.C.B. 1600. In contradistinction, it is for the courts to punish or remedy past conduct under ss. 122 and 128 of the Act respectively [for criminal offences and remedial civil applications]: see D. Johnston and K. Doyle Rockwell, *Canadian Securities Regulation* (2nd ed. 1998), at pp. 209-11.
> …
>
> 45 In summary, pursuant to s. 127(1), the OSC has the jurisdiction and a broad discretion to intervene in Ontario capital markets if it is in the public interest to do so. However, the discretion to act in the public interest is not unlimited. In exercising its discretion, the OSC should consider the protection of investors and the efficiency of, and public confidence in, capital markets generally. In addition, s. 127(1) is a regulatory provision. The sanctions under the section are preventive in nature and prospective in orientation. Therefore, s. 127 cannot be used merely to remedy *Securities Act* misconduct alleged to have caused harm or damages to private parties or individuals.

¶ 34 See also: *Brosseau v. Alberta Securities Commission*, [1989] 1 S.C.R. 301; *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 at 589; *British Columbia Securities Commission v. Branch*, [1995] 2 S.C.R. 3 at 26; *Global Securities Corp. v. British Columbia (Securities Commission)*, [2000] 1 S.C.R. 494.

¶ 35 In *Re: Fairtide* 2002 BCSECCOM 993, the Commission considered the purpose of temporary orders under section 161(2) and their extension, without a hearing, under section 161(3). At paragraphs 22 and 25 to 27 it stated:

> 22 Section 161(2) was intended to give securities regulators the power to act quickly if there is a threat to the integrity of the capital markets or the public interest. However, the section makes clear that the power to exercise this discretion is not open ended. Firstly, the regulators must have a reasonable belief that the length of time to hold a hearing 'could be prejudicial to the public interest' and secondly, the temporary orders cannot stay in effect for more then 15 days.
>
> 25 An extension order made under section 161(3) is not limited to a specific period as in section 161(2), but can be made until the

> hearing under section 161(1) is held and a decision is rendered. Again this discretion is not open ended. The Commission may make an extension order only if it meets the two-pronged test of being 'necessary and in the public interest'. The evidentiary threshold to conclude that an extension order is 'necessary and in the public interest' is obviously greater than that necessary to conclude (when first issuing the temporary order) that the length of time to hold a hearing 'could be prejudicial to the public interest'.
>
> 26 The case of *Re: Petrowest Resources Ltd. et al* (Corporate and Financial Services Commission Weekly Summary September 10, 1975) illustrates the point. In that case there was sufficient evidence for the Superintendent of Brokers (now Executive Director) to have a "well-founded suspicion" that there was a threat to the public interest that warranted immediate intervention by way of a temporary cease trade order. However, on an appeal of the Superintendent's decision to extend the temporary orders without a hearing, the Corporate and Financial Services Commission found that this evidence alone was not sufficient to extend the orders. The Commission concluded, even assuming that there was a breach of the legislation, that the evidence for the extension had to demonstrate a reasonable basis for apprehending a future threat to the public interest.
>
> 27 Furthermore, we recognize that the power to intrude upon, and disrupt, persons' lives and businesses by issuing section 161(1) enforcement orders before a hearing is held, is a significant one and must be justified …

¶ 36 Part 17 of the Act, *Investigations and Audits* provides the statutory scheme for investigations under the Act. Provisions under Part 17 give the Commission, and persons it appoints, several regulatory tools including, the power to investigate, inquire into, examine witnesses, obtain records and information and freeze property. The general purpose of these provisions is to discover, and gather evidence of, securities related misconduct and to preserve assets while that is taking place. Included are specific provisions that enable the Commission, and persons it appoints, to enforce compliance with the investigative process.

¶ 37 The following sections of Part 17 relevant to this case follow.

> 142 (1) The commission may, by order, appoint a person to make an investigation the commission considers expedient

(a) for the administration of this Act,
(b) to assist in the administration of the securities or exchange contracts laws of another jurisdiction,
(c) in respect of matters relating to trading in securities or exchange contracts in British Columbia, or
(d) in respect of matters in British Columbia relating to trading in securities or exchange contracts in another jurisdiction.

…

143 (1) An investigator appointed under section 142… may, with respect to the person who is the subject of the investigation, investigate, inquire into, inspect and examine

(a) the affairs of that person,
(b) any records, negotiations, transactions, investigations, investments, loans, borrowings and payments to, by, on behalf of, in relation to or connected with that person,

…

144 (1) An investigator appointed under section 142 … has the same power

(a) to summon and enforce the attendance of witnesses,
(b) to compel witnesses to give evidence on oath or in any other manner, and
(c) to compel witnesses to produce records and things and classes of records and things

as the Supreme Court has for the trial of civil actions.

(2) The failure or refusal of a witness

(a) to attend,
(b) to take an oath,
(c) to answer questions, or
(d) to produce the records and things or classes of records and things in the custody, possession or control of the witness

makes the witness, on application to the Supreme Court, liable to be committed for contempt as if in breach of an order or judgment of the Supreme Court.

…

¶ 38 In reading the powerful provisions of Part 17 and 18 together, it is clear that temporary enforcement orders were not intended to be the regulatory tool to compel compliance in the investigative process. Instead, express powers in Part 17 make clear that the appropriate regulatory tool to deal with non-compliance in the investigative process is an application for contempt to the Supreme Court under section 144(2) of the Act.

¶ 39 We find that the evidence did not demonstrate an immediate threat to the public interest that would warrant the kind of intrusive regulatory orders issued by the Executive Director against McCarney.

¶ 40 Section 144(2) of the Act provides an appropriate remedy when a witness fails or refuses to attend, take an oath, answer questions, or to produce the records and things. When these circumstances are present staff may apply to the Supreme Court to have the witness committed for contempt as if in breach of an order or judgment of the Supreme Court.

¶ 41 Our conclusion that it was not appropriate in these circumstances for staff to issue temporary enforcement orders to compel production of documents and information during the course of an investigation is consistent with the reasoning of the Supreme Court of Ontario (High Court of Justice) in *Ontario (Securities Commission) v. Biscotti* [1988] O.J. No. 1115 and 40 B.L.R. 160. In that case the mere threat of a cease trade order by staff of the Ontario Securities Commission in order to compel a potential respondent to testify, invoked the censure of the Court.

¶ 42 Biscotti had been a senior securities trader, officer and director of a dealer registered under the Ontario securities legislation for several years. In early 1987, the dealer advised the OSC that it was aware of certain allegations against Biscotti who was being suspended pending an investigation into his possible wrongdoing. The dealer also requested the OSC to initiate its own investigation and advised that it would conduct an internal review. Shortly thereafter, the OSC made an order under the Act appointing certain individuals to conduct an investigation into the affairs of Biscotti.

¶ 43 Later that year, counsel for Biscotti was advised by counsel for the OSC that the OSC intended to conduct an examination of Biscotti under the provisions of the legislation that were comparable to section 144 of our Act. The examination was adjourned by consent. In the meantime, counsel for Biscotti requested details of the investigation. OSC staff provided some information, but Biscotti alleged it was inadequate. OSC then declined to provide further information.

¶ 44 When Biscotti attended the examination, together with his counsel, he declined to answer questions following the administration of the oath and the reading of his rights.

¶ 45 The OSC applied to the court for an order under provisions of the Ontario securities legislation that Biscotti re-attend and answer questions put to him under the Act. By cross-application, Biscotti raised several constitutional questions regarding these provisions. He also raised other objections concerning the way the provisions had been applied to him. Although the court determined the case on the constitutional questions, its comments on one of Biscotti's other issues, which the court entitled *"The Threat"*, are relevant to this case.

¶ 46 It is useful to quote at length.

> THE THREAT
>
> Following the abortive attendance of Biscotti for examination, there was an exchange between the applicant and the solicitors for Biscotti which finds its reflection in correspondence between them. On March 24th, the solicitors for Biscotti wrote to Groia [counsel for the OSC] a letter which reads in part as follows:
>
> > Subsequently you advised that you intended to take proceedings under Section 11 of the Securities Act. We agree that such a proceeding is the appropriate route to resolve the legal dispute between us.
> >
> > You also advised that you would likely recommend that steps would be taken to suspend our client's registration and the exemptions that apply to and permit persons in this province to buy and sell securities for their own account, for the reason that our client refused to testify on the grounds described above.
> >
> > You also advised that you would likely recommend that steps would be taken to suspend our client's registration and the exemptions that apply to and permit persons in this province to buy and sell securities for their own account, for the reason that our client refused to testify on the grounds described above.
> >
> > Such a recommendation if approved would, (i) deprive our client of the livelihood he has depended upon for the past 38 years and (ii) would in addition prevent him from trading in securities, a right basic to all residents of this province. As we

> understand it, this is founded on the premise that it is prejudicial to the public interest for a person such as our client to rely upon his legal and constitutional rights.
>
> It is with the gravest of concern that we respond to this concept. We consider it to be abusive to suggest that reliance upon one's legal and constitutional rights is prejudicial to the public interest. In our respectful opinion such a position is ill-founded in law. If taken it would have a serious affect on our client's reputation and his ability to earn a living. If you intend to pursue this highly prejudicial course of conduct, we see no reason for this issue not to be determined by the court since it is a legal one. If you see fit to have it determined by the Commission we require adequate notice of such a proceeding so that we can appear and respond to your position. We see no good reason why the public interest would require that such a matter be dealt with without notice.

Groia replied by letter of the same date. In that letter is found the following:

> However, Mr. Biscotti has the privilege of trading securities in a regulated capital market. Those privileges carry with them the responsibility to participate in the regulatory structure. Mr. Biscotti, unlike other participants in the marketplace, now says that on the advice of his counsel, he will not be regulated, except in accordance with his counsel's views of the scope of this Commission's power to regulate.
> …
>
> In these circumstances, we are prepared to agree that any proceeding to remove these privileges will be taken before the Commission by way of public notice and public Hearing. This concession however is based on the facts as are presently known to us and we must reserve our right to act without prior notice should the public interest so require.

Solicitors for Biscotti wrote on March 29th. The following is a portion of that letter:

> … However you may wish to gild the lily in your letter dated March 24, the issue remains that you suggest it is appropriate to recommend the suspension of our client's trading privileges

> because he takes the position that the proposed regulatory proceeding is contrary to his legal and constitutional rights. The fact that you may disagree with our position does not change the substance of the issue.

This exchange was concluded by letter of March 30th from Groia to Biscotti's solicitors. From it I quote the following paragraph:

> We have been advised that Mr. Biscotti will be retiring from Dominion Securities on March 31, 1988. We understand that this decision was made prior to his attendance on March 23, 1988. In these circumstances, the staff of the Commission does not consider it necessary or appropriate to take any further regulatory action in connection with his refusal to answer questions, at this time. We are, of course, reserving our right to review these issues, should the circumstances change.

The essence of the argument before me is consistent with this exchange of correspondence. The position of Biscotti is that the suggestion that his trading privileges would be suspended was an improper and punitive suggestion which was motivated by the desire to compel his attendance to be examined. It was common ground between the parties that the appropriate mechanism for accomplishing that purpose was an application such as the one which is now before me. The position of the Commission is that they were concerned because Biscotti had seen fit not to co-operate with the Commission, and that this was a legitimate area for concern on the part of the Commission in its capacity as a regulatory body.

In my view, what was said by Groia was in the nature of a threat and was unwarranted in the circumstances. I do not accept that he was merely expressing a concern about the failure of Biscotti to co-operate with the Commission, a concern related to the regulatory function of the Commission. What was said was related to Biscotti's refusal to submit to examination, an examination sought by the enforcement section of the Commission, and could not be taken otherwise than as a form of pressure to submit. To compel submission to the examination, the Commission had open to it the sanction provided by the Act; an application such as that which is now before me. To seek to apply indirect pressure was not appropriate.

> However, I am not disposed to make any declaration, which would now serve no useful purpose. That phase is past. Biscotti resigned; there is no suggestion that it was in response to what was said by Groia. I think it improbable that there will be any similar incident in the future.

¶ 47 As in *Biscotti,* staff had open to them a sanction under section 144(2) the Act to compel McCarney to meet their demands. To apply indirect or direct pressure by issuing temporary orders to compel him to meet their demands was inappropriate.

¶ 48 September 30, 2003

¶ 49 **For the Commission**

Joyce C. Maykut, Q.C.
Vice Chair

Joan L. Brockman
Commissioner

Marc A. Foreman
Commissioner