2004 BCSECCOM 441

COR#04/104

Richard John Smith and Synlan Securities Corporation

Section 161(1) and 162 of the *Securities Act*, RSBC 1996, c. 418

Hearing

Panel	Brent W. Aitken	Vice Chair
	Neil Alexander	Commissioner
	John K. Graf	Commissioner
Date of Hearing	July 5, 2004	
Date of Decision	July 27, 2004	

Appearing

Lorne Herlin	For the Executive Director

Decision

Background

¶ 1 This is a hearing under section 161(1) and 162 of the *Securities Act*, RSBC 1996, c. 418. On February 20, 2004, the Executive Director issued an amended notice of hearing alleging that Richard John Smith and Synlan Securities Corporation contravened the Act. Smith is the president and a director of Synlan and is also its secretary and treasurer.

¶ 2 The allegations in the notice of hearing relate to Smith's conviction under the *Criminal Code of Canada* for theft and fraud, sanctions by the Ontario Securities Commission against Smith and Synlan, and a distribution of securities in British Columbia promoted by Smith and Synlan. On the basis of these allegations, the Executive Director is asking that we cease trade Synlan, remove exemptions from Smith, prohibit him from acting as a director or officer of any issuer, and prohibit him from engaging in investor relations activities, and order Smith and Synlan to pay administrative penalties and costs.

Smith's criminal conviction

¶ 3 Smith's criminal convictions stem from a failed financing of commercial real estate. In March 1988, Track Investment Corporation entered into an offer to

purchase property in downtown Toronto. Smith, who was an officer of Track, formed a limited partnership to finance the purchase. Investors invested in the limited partnership on the basis that their funds would be held in trust until all conditions precedent to the completion of the purchase were satisfied, including acquisition of title to the property. If any conditions were not satisfied, the limited partnership was to return the investors' funds.

¶ 4 Track withdrew investors' funds before all of the conditions were satisfied. In December 1989, Track failed to make a deposit when required and lost its right to acquire the property. However, Smith and another officer of Track continued to sell units in the limited partnership throughout most of January 1990.

¶ 5 As a result of these events, 31 investors in the limited partnership lost nearly $1.8 million.

¶ 6 In January 1997, Smith was charged with theft and fraud under the *Criminal Code of Canada* and in December 1997, he pled guilty in Ontario Provincial Court to 22 counts of theft over $5,000 and 10 counts of fraud. Smith was sentenced to a term of imprisonment of two years less a day (to be served conditionally) and ordered to perform 180 hours of community service.

Ontario Securities Commission sanctions against Smith and Synlan

¶ 7 Smith was registered with the Ontario Securities Commission as a limited dealer through Synlan. In renewing his registration in 1997 and 1998 he did not disclose to the OSC (in 1997) the criminal charges against him nor (in 1998) his convictions. As a result, the OSC renewed his registration in both years. When these facts came to the OSC's attention, it issued a temporary order in June 1998 suspending Smith's registration. In December 1998, the OSC terminated the registrations of Smith and Synlan, permanently cease traded both of them, and permanently removed their exemptions.

Distributions in British Columbia

¶ 8 Meanwhile, Smith, through Synlan, formed three limited partnerships to raise money to finance residential development units in the United States. Synlan was the promoter of the limited partnerships and owned the general partners of the partnerships. Each partnership was formed to finance a development in a specific community, two in Arizona (the West Valley of the Sun Limited Relationship and the Valley of the Sun Limited Partnership) and one in Florida (the Fairways (I) Limited Partnership).

¶ 9 None of Synlan, Smith, or any of the partnerships filed a prospectus under the Act, and neither Synlan nor Smith was registered under the Act. Between May 1996 and December 1997, units of the partnerships were sold to 14 residents of

British Columbia, purportedly in reliance on the registration and prospectus exemptions contained in sections 45(2)(5) and 74(2)(4) of the Act and sections 90(1) and 129(1) of the *Securities Rules* B.C. Reg. 193/97. Under those sections, the registration and prospectus requirements in sections 34 and 61 do not apply to a distribution if trade has an aggregate acquisition cost to the purchaser of not less than $97,000. Each partnership filed an offering memorandum with the Commission, as well as an exempt distribution report. Each investor paid US$32,000 in cash, and signed a promissory note for amounts ranging from US$85,000 to US$103,000, depending on the total cost of each unit. The offering memoranda stated that rental revenues were expected to be sufficient to cover operating costs as well as all principal and interest on the promissory notes. The memoranda went on to say that if operating costs were insufficient to do so, the promoter (Synlan) would loan the partnership funds sufficient to cover shortfalls, subject to a cap. Using exchange rates in effect during the period the partnership units were sold, US$32,000 was the equivalent of between C$42,000 and C$44,000.

¶ 10 Smith held seminars to promote the sale of the partnerships. Smith also participated in seminars sponsored by Brian Costello, whom Smith and Synlan paid to promote the partnerships. Costello is a financial author, seminar speaker, radio personality and commentator on personal financial matters.

¶ 11 The homes were never built, and the partnerships did not return the investors' funds. The 14 British Columbia investors therefore lost a total of US$448,000 (about C$600,000, using the exchange rates during the relevant period).

¶ 12 Commission staff interviewed 10 of the 14 investors. Some did not realize they had signed a promissory note. Those who did had no expectation that they would ever be required to pay it, as they understood that cash flow from the partnerships would cover it.

Analysis and Findings

Criminal convictions and OSC sanctions

¶ 13 It is well established that a person's conduct in another jurisdiction, and criminal convictions and regulatory sanctions in other jurisdictions based on that conduct, are a legitimate basis for the Commission to make orders in the public interest.

¶ 14 In *Re Holoboff*, [1993] 29 BCSC Weekly Summary 7, the Commission made orders against the respondents on the basis of findings made, and sanctions imposed, by the Alberta Securities Commission, and their conviction by the Alberta criminal courts of offences under the *Securities Act (Alberta)*.

¶ 15 In *Re Bodnarchuk*, [1997] 27 BCSC Weekly Summary 7, the Commission made orders against Bodnarchuk after finding that his past conduct showed a pattern of disregard for securities regulation, as shown by sanctions imposed by securities regulators in three other provinces.

¶ 16 In *Re Boyle*, 2003 BCSECCOM 852, the Commission made orders against the respondents based on their convictions in Alberta criminal courts of offences under the *Securities Act (Alberta)* as a result of their conduct in that province.

Distributions of the partnerships

¶ 17 The Act, in section 1(1), defines "trade" to include "a disposition of a security for valuable consideration," and "distribution" as "a trade in a security of an issuer that has not been previously issued". Synlan, as the promoter of the partnerships, was therefore trading and distributing securities under the Act. Smith was also trading in the units of the partnerships, because the Act defines trade to include "any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of" a disposition of a security for valuable consideration.

¶ 18 Section 34(1) of the Act prohibits persons from trading in securities without being registered under the Act, and section 61(1) prohibits persons from distributing securities without filing a prospectus, and obtaining a receipt for it, under the Act.

¶ 19 These provisions are unchanged in all material respects from the act that was in force during the relevant period.

¶ 20 Neither Smith nor Synlan was registered under the Act and none of them nor any of the partnerships filed a prospectus, so, in the absence of an applicable exemption, Smith and Synlan contravened sections corresponding to 34(1) and 61(1) of the Act when the partnerships issued units to the 14 investors.

¶ 21 According to the exempt distribution reports filed by the partnerships, the distributions of the partnership units were made in reliance on the registration and prospectus exemptions that correspond to sections 45(2)(5) and 74(2)(4) of the Act and sections 90(1) and 129(1) of the Rules. Under those sections, the registration and prospectus requirements in sections 34 and 61 do not apply to a distribution if trade has an aggregate acquisition cost to the purchaser of not less than $97,000.

¶ 22 Section 8.4 of BC Policy 45-601 *Statutory and Discretionary Exemptions* states the following regarding the meaning of "aggregate acquisition cost":

> . . . the Commission takes the position that consideration may include a promise to pay only if the purchaser is certain, or virtually certain, to be

called upon to make payment. This would disqualify commitments under various tax oriented arrangements where the issuer or promoter has held out to the investor a hope or expectation that payment of a promissory note will be waived.

¶ 23 At the time of the distribution of the partnership units, identical language was contained in BC Interim Policy Statement 3-24.

¶ 24 In *Re Barclay Las Vegas Limited Partnership*, [1999] 11 BCSC Weekly Summary 5, the Commission considered the meaning of "aggregate acquisition cost" in the context of an exemption that required an aggregate acquisition cost of $25,000. In that case, limited partnership units were offered for $25,000 per unit. Investors paid $10,000 in cash and $15,000 by way of promissory note. The returns shown in the promotional materials were based on a $10,000 investment, and the commission paid to sales agents valued the units at $10,000. Investors testified that they expected cash flow from the investment to pay off the note. After noting that both the substance and the form of the offering must be considered in determining whether it meets the aggregate acquisition cost requirement, the Commission found that the Barclay offering had an aggregate acquisition cost of less than $25,000.

¶ 25 It is clear from the offering memoranda of the three partnerships, and from the investor interviews, that it was not certain, or virtually certain, that the investors would be called upon to make payment under the promissory notes. On the contrary, investors were encouraged to believe, and did believe, that cash flow from the partnerships would discharge the promissory notes. We therefore find that the aggregate acquisition cost of the partnership units was US$32,000 per unit, or between C$42,000 and C$44,000 using exchange rates in effect at the time of the distribution, well short of the minimum aggregate acquisition cost of $97,000 required by the exemption. Therefore the exemption does not apply and, given that there is no evidence that other exemptions applied, Smith and Synlan contravened the sections of the act in force at the time that correspond to sections 34 and 61 of the Act when the partnerships issued units to the 14 investors.

Decision

¶ 26 In *Re Eron Mortgage Corp.*, [2000] 7 BCSC Weekly Summary 22, the Commission cited a non-exhaustive list of factors that are usually relevant to making orders against a person under sections 161(1) and 162. They are:

- the seriousness of person's conduct,
- the harm suffered by investors as a result of the person's conduct,

- the damage done to the integrity of the capital markets in British Columbia by the person's conduct,
- the extent to which the person was enriched,
- factors that mitigate the person's conduct,
- the person's past conduct,
- the risk to investors and the capital markets posed by the person's continued participation in the capital markets of British Columbia,
- the person's fitness to be a registrant or to bear the responsibilities associated with being a director, officer or adviser to issuers,
- the need to demonstrate the consequences of inappropriate conduct to those who enjoy the benefits of access to the capital markets,
- the need to deter those who participate in the capital markets from engaging in inappropriate conduct, and
- orders made by the Commission in similar circumstances in the past.

¶ 27 Smith and Synlan are threats to the capital markets of British Columbia. In the Track situation, Smith was involved in the misuse of investor funds, and continued to raise funds from investors after it was clear that the premise of the investment could not be achieved. The 31 investors involved lost nearly $1.8 million.

¶ 28 A registrant has a duty to inform the regulator of material changes in the information relevant to the registration. By omission, Smith failed in that duty by misleading the OSC as to his suitability as a registrant, first in 1997 by failing to disclose the criminal charges against him, and again in 1998 by failing to disclose his convictions. The OSC regarded this conduct as so serious that it terminated the registrations of Smith and Synlan and cease traded them and removed their exemptions on a permanent basis.

¶ 29 Meanwhile, Smith and Synlan promoted the distribution of securities in British Columbia in contravention of sections 34 and 61 of the Act, leading to losses to 14 investors of about $600,000.

¶ 30 All of this shows on the part of Smith and Synlan a pattern of deceit and disregard of securities regulatory requirements. Their conduct is serious, they have harmed investors, and have damaged the integrity of British Columbia's capital markets. They are not fit to participate in our capital markets. We must also make orders that will have an appropriate deterrent effect.

Orders

¶ 31 Therefore, considering it to be in the public interest, we order:

Smith

1. under section 161(1)(c) of the Act, that the exemptions described in sections 45 to 47, 74, 75, 98 and 99 of the Act do not apply to Smith permanently;

2. under section 161(1)(d)(i), that Smith resign any position he holds as a director or officer of any issuer, except an issuer owned solely by himself or his family;

3. under section 161(1)(d)(ii), that Smith be prohibited permanently from becoming or acting as a director or officer of any issuer except an issuer owned solely by himself or his family;

4. under section 161(1)(d)(iii), that Smith be prohibited permanently from engaging in investor relations activities;

5. under section 162, that Smith pay an administrative penalty of $250,000;

6. under section 174, that Smith pay, jointly and severally with Synlan, costs of or related to the hearing in the amount of $10,312;

Synlan

7. under section 161(1)(b), that all persons cease trading in, and be prohibited from purchasing, the securities or exchange contracts of Synlan permanently;

8. under section 161(1)(c), that the exemptions described in sections 45 to 47, 74, 75, 98 and 99 of the Act do not apply to Synlan permanently;

9. under section 162, that Synlan pay an administrative penalty of $500,000; and

10. under section 174, that Synlan pay, jointly and severally with Smith, costs of or related to the hearing in the amount of $10,312.

¶ 32 July 27, 2004

¶ 33 For the Commission

Brent W. Aitken
Vice Chair

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Neil Alexander
Commissioner

John K. Graf
Commissioner