

2004 BCSECCOM 447

COR#04/106

601949 B.C. Ltd., Gordon Howard Callies and James Lee MacDonald

Sections 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 April 22, 2004

Date of Decision July 28, 2004

Appearing

Kristine Mactaggart For the Executive Director

Decision

Background

¶ 1 This is a hearing under sections 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 601949 B.C. Ltd., James Lee MacDonald, Gordon Howard Callies, and others, contravened the Act and acted contrary to the public interest.

¶ 2 The allegations in the notice of hearing relate to distributions of securities of issuers, including 601949 and Cambria Bancorp Ltd. The distributions and the parties had a connection to Aspen Capital Management Inc., a dealer registered under the Act until September 2000. All but the three named parties entered into settlement agreements with the Executive Director (see *Re Smith* 2004 BCSECCOM 198, *Re Barnscher* 2004 BCSECCOM 217, *Re Knight* 2004 BCSECCOM 218, and *Re Leiske et al.*, 2004 BCSECCOM 229 and 230).

601949 and MacDonald

¶ 3 The Executive Director alleges that between March 13 and June 6, 2000, MacDonald and Walter Leo Barnscher, the President of 601949 and one of the settling parties, sold over 1.6 million shares of 601949 to 10 British Columbia investors (for an aggregate consideration of about \$240,000), that those shares were sold without registration and without a prospectus contrary to sections 34(1)

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and 61(1) of the Act, and that in doing so 601949 and MacDonald acted contrary to the public interest.

- ¶ 4 601949's intended purpose was apparently to participate in a proposed acquisition of Aspen. It has never filed a preliminary prospectus, prospectus, offering memorandum or a report of exempt distribution with the Commission. It appears that Barnscher, in directing the affairs of 601949, intended to rely on the private issuer exemption to sell the shares of 601949.
- ¶ 5 MacDonald held no office in 601949 nor was he a director. He was originally retained by Barnscher to recruit sales staff for Aspen (MacDonald's title was "sales manager"), at a compensation of \$10,000 per month, which he earned for about four and a half months.
- ¶ 6 Sometime after MacDonald started with 601949, Barnscher told him that 601949 needed to raise money, and that if MacDonald knew any people who might be able to invest, he should introduce them to Barnscher. As a result of this conversation, MacDonald introduced people he knew to Barnscher. MacDonald's role was limited to the introductions. Barnscher spoke to the people, had them sign agreements to subscribe for shares of 601949, and took their money. All of the 10 investors were previously known by MacDonald but were known to Barnscher only through their introduction to him by MacDonald. This description by MacDonald in an interview with Commission staff typified his approach to potential investors:
- I just wanted to present the opportunity to [the investor] and then it's up to Walter [Barnscher] if he wanted to accept him or not accept him. And I . . . gave Walter [the investor's] phone number and he to Walter's number. That was the end of it.
- ¶ 7 MacDonald also stated in his interview that he relied on Barnscher and others associated with 601949 to ensure that the sale of the 601949 shares was done legally.
- ¶ 8 After introducing some people to Barnscher, MacDonald stopped participating in the capital raising process because, he said, he was too busy with the job of attempting to recruit salespeople.
- ¶ 9 MacDonald had been a registered representative restricted to trading in mutual fund securities but he surrendered his registration in March 2000, just before joining 601949.

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Callies

- ¶ 10 Callies was a mutual fund salesman involved in another Aspen-related distribution. On the morning of the hearing, the Executive Director entered into an agreed statement of facts with Callies. In his agreed statement of facts, Callies acknowledges that:
1. He distributed to 14 investors securities of Cambria Bancorp Ltd., including 260,000 Cambria shares and a \$50,000 “investment certificate,” without registration or a prospectus, contrary to sections 34 and 61 of the Act.
 2. He perpetrated a fraud on an 86-year-old investor by converting \$30,000 of her funds to his own use, contrary to her instructions, and contrary to section 57(b) of the Act.
 3. In his capacity as a director of Cambria, he failed to ensure that Cambria complied with section 61 of the Act and therefore failed to exercise the care, diligence and skill of a reasonably prudent person as required by sections 118 and 135 of the *Company Act*, RSBC 1996, c. 62.
 4. His conduct was contrary to the public interest.

Analysis and Findings

601949 and MacDonald

- ¶ 11 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”. 601949 was therefore trading and distributing securities under the Act. MacDonald was also trading in the shares of 601949, and participating in the distribution, 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.
- ¶ 12 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.
- ¶ 13 601949 was not registered and did not file a prospectus, so, in the absence of an applicable exemption, it contravened sections 34 and 61 of the Act when it issued its shares to the 10 investors. MacDonald was not registered to sell the 601949 shares, so he also, in the absence of an applicable exemption, contravened sections 34 and 61 of the Act.

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- ¶ 14 Section 46(j) of the Act provides that registration is not required to trade securities of a private issuer if the securities are not offered to the public. Section 75(a) contains the corresponding prospectus exemption. These together are commonly referred to as the “private issuer exemption”, the exemption that Barnscher was apparently intending to rely on in raising funds for 601949.
- ¶ 15 At the relevant time, the Act defined “private issuer” in section 1(1) as one whose securities are subject to restrictions on transfer contained in the issuer’s constating documents, or in agreements among securityholders, and whose securities are held beneficially by not more than 50 persons.
- ¶ 16 It appears that 601949 was a “private issuer” as defined. However, the private issuer exemption applies to the sale of securities only if the securities are not offered to the public. Were the 10 investors members of the public? If so, the exemption did not apply to the distribution of 601949 shares to the 10 investors.
- ¶ 17 The Commission considered the meaning of the “public” in *Re Bilinski et al.*, 2002 BCSECCOM 102 as follows (at para. 437):

The term ‘public’ is not defined in the Act. However, the Commission discussed who is the ‘public’ for the purposes of the private issuer exemption in section of 4.2 of Local Policy 3-24, now BCP 45-601. The policy stated that the ‘common law interpretation of the public, in the context of securities trading, is very broad. Whether a person is a member of the public must be determined on the facts of each case based on the “need to know” and “common bonds” tests that have developed in the common law.

. . . .

The ‘need to know’ test is met when persons have access to the kind of information that would normally be disclosed in an offering document or when persons have a certain amount of sophistication about making investment decisions enabling them to fend for themselves. These kinds of persons do not need the statutory protections a prospectus would provide. The ‘common bonds’ test focuses on the relationship between the seller of the securities and the persons to whom the securities are being offered. Frequently the ‘common bonds’ test is met when the person:

1. has known the officer or director for a number of years,
2. through personal knowledge and friendship, is in a position to assess the capabilities and the trustworthiness of the officer or director, and

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3. is likely to receive the same moral commitment from the officer or director as would a family member of the officer or director.

. . . .
A purpose of securities legislation is to protect the public. When the persons to whom the offer is being made do not have, or do not have access to, the kind of information that an offering document would provide, then they are considered to be the public.

- ¶ 18 In an interview with Commission staff, Barnscher admitted that the 10 investors were MacDonald's friends, not his. This means that the investors were not friends of anyone holding a director or officer position at 601949. This is not a mere technicality. The policy purpose behind the exemption is that there is a personal bond of familiarity and trust between the investor and the mind and management of the issuer. MacDonald's role in 601949 was very limited, and the investors' relationship with him was not sufficient to establish a "common bond" between the investors and 601949.
- ¶ 19 Therefore, vis-à-vis 601949, the investors were members of the public, so the private issuer exemption did not apply to the distribution of the 601949 shares to them. Therefore, given that there is no evidence that other exemptions applied, 601949 and MacDonald contravened sections 34 and 61 of the Act.

Decision

- ¶ 20 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

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- orders made by the Commission in similar circumstances in the past.

601949

- ¶ 21 Apparently 601949 is, or is about to be, dissolved as a result of failing to file its annual corporate information returns. However, corporations so dissolved can be reinstated, so it is appropriate to make orders to cover that eventuality.

MacDonald

- ¶ 22 The conduct of MacDonald that is before this hearing is his introduction of investors to Barnscher. Although it is true that none of the 10 investors would likely have become investors in 601949 without MacDonald's intervention, it is clear that Barnscher was running the show, not MacDonald.
- ¶ 23 Applying the *Eron* criteria, we have found that MacDonald contravened sections 34 and 61 of the Act, but his role in the distribution was very small. His role was limited to putting potential investors in contact with Barnscher. In separate interviews with Commission staff, both he and Barnscher described his primary job with 601949 as the recruitment of salespeople for Aspen. Introducing potential investors to Barnscher was incidental to that – the suggestion he do so came up only after he was hired, and after a month or so he discontinued his participation in capital raising in favour of concentrating on the recruitment of salespeople. Once he made the introductions, he had no role in soliciting or completing the investments. His compensation arrangements were also consistent with this interpretation. He was paid a set salary per month – his compensation, as described by both him and Barnscher, was not tied in any way to his introduction of investors to Barnscher.
- ¶ 24 More problematic is that we had no evidence of the harm, if any, to those investors that MacDonald introduced to Barnscher. All we have before us is their names and the amounts they invested. There is no oral testimony, witness statements or other evidence from which we could determine the circumstances that led them to invest (including anything relevant about MacDonald's conduct), the outcome of their investment, and the financial impact of the investment. The Commission regards factors such as these as highly relevant when considering what orders, if any, to make in the public interest.
- ¶ 25 MacDonald had been a registrant, and was aware of the basic registration and prospectus requirements, but he was relying on Barnscher and others associated with 601949 to ensure that the distribution was legal. Given his limited role, and that introducing investors was incidental to his primary duties, we find that it was reasonable for him to do so.

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- ¶ 26 The Executive Director suggested that we order that the exemptions in the Act be removed from MacDonald, that he be prohibited from acting as a director or officer of any issuer, and that he be prohibited from engaging in investor relations activities, all for a period of 4 years, that he pay an administrative penalty of \$5,000, and pay hearing costs. By way of comparison, the Executive Director entered into a settlement with Barnscher in which Barnscher agreed to a removal of exemptions and prohibitions for 3 years, and a monetary sanction of \$10,000, of which \$3,500 related to investigation costs. Although settlements made by the Executive Director are not binding on the Commission, they are relevant to the issue of sanction, particularly when they arise from the same facts. Clearly, comparing the conduct of Barnscher with that of MacDonald, there is no basis to impose sanctions against MacDonald greater than those in Barnscher's settlement.
- ¶ 27 To the contrary, in considering orders against MacDonald, we have the following: his limited role in the distribution, no evidence of investor harm attributable to his conduct, no apparent enrichment as a result of his introducing investors to Barnscher, and no evidence of past misconduct. In light of this, it is difficult to conclude that MacDonald's conduct has done appreciable damage to the capital markets of British Columbia, or that MacDonald constitutes a threat to those markets.
- ¶ 28 We accordingly make no orders against MacDonald.

Callies

- ¶ 29 Callies contravened sections 34 and 61 of the Act (the importance of which we mentioned earlier) and committed fraud by stealing money from an elderly, unsophisticated investor. He also failed in his duties as a director and officer and acted contrary to the public interest. Applying the *Eron* criteria, his conduct is serious, he harmed investors, and his conduct damaged the integrity of the securities markets in British Columbia. He enriched himself through the perpetration of a fraud. Callies poses a risk to investors and markets in British Columbia. It is also important that we make orders which will serve to deter others from similar conduct.

Orders

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

601949

1. under section 161(1)(b) of the Act that all persons cease trading in, and be prohibited from purchasing, the securities or exchange contracts of 601949;
2. 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 601949;

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Callies

3. 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 Callies for a period of 25 years expiring on July 27, 2029, except that Callies may rely on the exemption in section 45(2)(7) of the Act to trade securities for his own account through a registrant, if he gives the registrant a copy of this decision;
4. under section 161(1)(d)(i), that Callies resign any position he holds as a director or officer of any issuer, except an issuer owned solely by himself or his family;
5. under section 161(1)(d)(ii), that Callies be prohibited from becoming or acting as a director or officer of any issuer for a period of 25 years expiring on July 27, 2029, except an issuer owned solely by himself or his family;
6. under section 161(1)(d)(iii), that Callies be prohibited from engaging in investor relations activities for a period of 25 years expiring on July 27, 2029;
7. under section 162, that Callies pay an administrative penalty of \$125,000; and
8. under section 174, that Callies pay costs of or related to the hearing in an amount of \$6,798.

¶ 31 July 28, 2004

¶ 32 **For the Commission**

Brent W. Aitken
Vice Chair

Neil Alexander
Commissioner

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John K. Graf
Commissioner