

2005 BCSECCOM 441

Nano World Projects Corporation and Robert Papalia

Sections 161 and 162 of the *Securities Act*, RSBC 1996, c. 418

Hearing

Panel	Robin E. Ford	Commissioner
	Marc A. Foreman	Commissioner
	John K. Graf	Commissioner

Dates of Hearing March 7 and 8, 2005

Date of Findings June 22, 2005

Appearing

Ralph H. Sahrman For the Executive Director

Findings

Introduction

¶ 1 On January 20, 2005, the executive director issued a notice of hearing alleging that:

1. while engaging in investor relations activities or with the intention of effecting a trade in a security, Nano World Projects Corporation and Robert Papalia each made statements in press releases that they knew, or ought reasonably to have known, were misrepresentations, contrary to section 50(1)(d) of the *Securities Act*, RSBC 1996, c. 418;
2. Nano World and Papalia each contravened sections 57 and 57.1 of the Act by issuing press releases containing misrepresentations and by selling shares, when they knew, or ought reasonably to have known, that the transactions:
 - (a) resulted in or contributed to a misleading appearance of trading activity in, or an artificial price for, the shares of Nano World; or
 - (b) were fraudulent;
3. by authorizing, permitting or acquiescing in Nano World's conduct, under section 168.2 of the Act, Papalia contravened sections 50(1)(d), 57 and 57.1 of the Act; and

2005 BCSECCOM 441

4. Nano World's and Papalia's conduct described in the notice of hearing was contrary to the public interest.

¶ 2 Neither Nano World nor Papalia appeared at the hearing on March 7, 2005. Since Commission staff counsel did not propose to call any witnesses, we directed that staff provide the affidavit evidence and file written submissions on liability. On March 8, we recalled staff counsel to answer our questions on the evidence and submissions.

Facts

¶ 3 From April 2000 to February 2001, Papalia was a resident of British Columbia. He has never been registered under the Act.

¶ 4 Nano World was a company incorporated in Delaware. In filings with the United States Securities and Exchange Commission (SEC), it listed its principal place of business as South Bothell, Washington until November 2000, then as New York, New York.

¶ 5 On November 8, 2002, the Delaware Secretary of State deemed Nano World to be an "inactive" corporation. We received no submissions on the effect under Delaware law of being deemed inactive. We assume that Nano World continues to be inactive, but that an inactive corporation remains a "person" under the Act for the purposes of these proceedings.

¶ 6 Nano World had significant connections with British Columbia. The company reported a BC business and mailing address in SEC filings and maintained a corporate office in Vancouver, BC with support staff. It used the services of a securities law firm in Vancouver.

¶ 7 Nano World has never been registered under the Act.

¶ 8 Papalia became a director of Nano World on April 17, 2000. He was chairman of the board from August 21, 2000. He became chief executive officer of Nano World in December 12, 2000. By September 2000, Papalia was fully aware of the financial condition of Nano World.

¶ 9 Nano World's stock was quoted publicly on the US Over-The-Counter Bulletin Board (the OTCBB). In April 2001, it was delisted for failing to file required periodic reports.

¶ 10 The business of Nano World involved the development and commercial exploitation of nanotechnology. While it was listed on the OTCBB, Nano World

2005 BCSECCOM 441

made and published press releases which became the subject of US SEC civil proceedings.

US SEC proceedings

- ¶ 11 On March 17, 2003, the SEC brought a civil enforcement case against Papalia that was heard by the United States Federal District Court on August 9, 2004 in Seattle (Case No. CV03-0683P).
- ¶ 12 On September 1, 2004, the Court issued Findings of Fact and Conclusions of Law against Papalia.
- ¶ 13 The Court found, under the laws of the US, that Papalia had committed securities fraud by, among other things, approving the issue by Nano World of four of the seven press releases which were before the Court. The Court found that the press release of September 25, 2000 was not materially misleading. The Court made no findings of law on the press releases of November 21, 2000 and January 22, 2001.
- ¶ 14 The Court found that:
- Papalia's conduct was knowing and reckless. He was fully aware of the financial condition of the company. Yet he repeatedly failed to give a balanced account outlining the company's financial obligations and difficulty in meeting these obligations. He repeatedly put a 'rosy' picture without balancing it with the reality based upon due diligence, demand for written commitments, or review of the company's financial worth and ability to fulfil oral promises. [para II.A.6 of the judgment]
- ¶ 15 The US Court also found that Papalia was "substantially unfit to serve as an officer or director of a publicly held company". He had failed "to recognize that his statements were misleading" and "that public companies must engage in business practices that reflect due diligence, caution, and documentation". "[His] lack of understanding of the heightened requirements for publicly traded companies ... makes it inappropriate to allow him to be an officer or director." [para II.B.18 of the judgment]
- ¶ 16 The Court ordered that Papalia:
1. pay a civil penalty of \$33,000 USD; and
 2. is prohibited from acting as a director and officer of any issuer that has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934.

2005 BCSECCOM 441

- ¶ 17 Papalia filed a defence and, at the trial, he took the stand and gave evidence. He was represented by counsel. In evidence before us is the record of the US proceedings including a Pretrial Order. Also in the record is the sworn interview of Papalia in the SEC investigation dated November 14 and 15, 2001 (where he was not represented by counsel). In these documents, Papalia agreed to facts and made admissions.
- ¶ 18 Andrew Cochrane is a lawyer who was on the board of Nano World from February/March of 2000 to early February 2001. He acted as secretary and chief financial officer at Nano World. He too gave sworn evidence in the SEC investigation on January 17 and 18, 2002 and gave sworn deposition testimony for the SEC in the civil proceedings on April 5, 2004. Both documents were before the US Court.
- Press releases false or misleading?
Background
- ¶ 19 From September 2000 to January 2001, Nano World issued seven press releases over Business Wire from Seattle or New York. They concerned:
- business relationships with Centro Ricerche Fiat, the research and development arm of the Fiat Group, or other companies, or
 - stated or implied that Nano World had received or would receive financing from third parties,
- or both.
- ¶ 20 Papalia reviewed, and approved the issue of, each of the seven press releases. Papalia also directed or was fully involved in all the negotiations referred to in the press releases. He was well aware of the circumstances of each arrangement.
- ¶ 21 Nano World had no revenues in the year 2000. Cochrane said that he first became concerned about the solvency of Nano World around August 2000, and discussed those concerns with Papalia. By the time Cochrane left in February 2001, Nano World had not developed a marketable product or received any new financial support.
- ¶ 22 Cochrane expressed concerns to Papalia about inaccuracies in the November 22, 2000 and January 30, 2001 press releases. Although he expected to be consulted about all the press releases, he was given the opportunity to review only two of the seven press releases before they were issued. He resigned from Nano World when Papalia approved the issue of the press release of January 30, 2001 without (once again) following the procedure mandated by the board of Nano World. Cochrane

2005 BCSECCOM 441

attributed inaccuracies and omissions in the press releases to disorganization, sloppiness, and a desire to put out optimistic, premature versions of events in hopes of obtaining financing and investors for the company.

Fiat

- ¶ 23 The press release issued on September 12, 2000 contained this description of the business of Nano World:

Nanotechnology is a revolutionary new field involving engineering at the molecular level. 'Nano World's Dynamic Thin Laminar Flow ... process enables us to produce single- or multi-layer films for various applications,' said Giorgio Marioni, NWPC President.

- ¶ 24 The press release stated that Nano World had "just signed a long-term contract" with Fiat and "with financial backing from Venture Capital USA Inc, this ... alliance ... has the potential to generate fruitful synergies for both our organizations".
- ¶ 25 Nano World's contract with Fiat was contingent on the ability of Nano World to obtain at least \$3,000,000 USD in financing. Nano World did not have a signed agreement for financing with Venture Capital USA and never received financing from Venture Capital USA. These facts were not disclosed.
- ¶ 26 Cochrane viewed the press release claim that Venture Capital USA was providing financial backing as an attempt by Papalia to "announce an arrangement to crystallize a deal". He said that Papalia explained to him that a published statement of financial backing would push Venture Capital USA into providing financing for the company.
- ¶ 27 The September 25, 2000 press release stated that Nano World and Fiat announced a "strategic partnership" which was a "joint venture", the purpose of the "combined initiative" being to, among other things, "speed commercialization of an advanced new technology ...".
- ¶ 28 The agreement with Fiat was a research contract to develop technology, not a legal partnership or a joint venture. Cochrane said that the word partnership was used to describe a relationship, not a legal entity.
- ¶ 29 The statement in the press release of September 12, 2000 that Nano World had financial backing from Venture Capital USA was false. Any commitments were not binding.

2005 BCSECCOM 441

- ¶ 30 The statements about Nano World's contract with Fiat in the press releases of September 12 and 25, 2000 were misleading because they did not disclose that the contract was contingent on the ability of Nano World to obtain at least \$3,000,000 USD in financing.
- ¶ 31 Staff say that, in the press release of September 25, the description of the agreement with Fiat as a strategic partnership and joint venture was also misleading. The contract was simply a research contract to develop technology, not a legal partnership or joint venture. We do not think these descriptions were misleading. Both phrases can also mean a relationship that does not necessarily include the formation of a legal entity. We doubt that a reasonable investor would have read much into the use of those phrases in this context.

Financial backing

- ¶ 32 In the September 27, 2000 press release, Nano World stated that:

With the backing of a strong and supportive group of shareholders, international partners and the financial community, Nano World expects to rapidly reach the critical mass to attract attention from investors globally. ... Our engagement of Ciris International reflects our readiness to target a more diverse group of shareholders, as well as to build our profile in the national and international financial, media, and scientific communities.

- ¶ 33 The only committed "international partner" was Fiat. There was no firm backing from the financial community. These facts were not disclosed.
- ¶ 34 The statement about the backing of international partners and the financial community was misleading because it failed to disclose that the only committed "international partner" was Fiat and that there was no firm backing from the financial community.

Oom Lab

- ¶ 35 The November 21, 2000 press release announced a "signed" "research agreement with the Orientationally Ordered Media (OOM) Lab" which was stated to be a joint creation of, among others, the Optics and Photonics departments of Fiat.
- ¶ 36 Cochrane said that on November 21, 2000, Nano World had a draft agreement with OOM Lab, but it had not yet been signed. The OOM Lab project was never completed. These facts were not disclosed.
- ¶ 37 The statement about the "signed" agreement in the press release of November 21, 2000 was false.

2005 BCSECCOM 441

Euroinks

- ¶ 38 On November 22, 2000, Nano World issued a press release, which it also filed with a Form 8-K with the SEC (signed by Papalia), announcing that it had “signed an agreement to acquire” a company named Euroinks srl. Euroinks was apparently an Italian company engaged in the production of high quality, thick film screen printing inks. The headline stated: “Nano World Acquires Euroinks, Adds Revenues, Significant Client Base, Strong Business Synergies”.
- ¶ 39 Cochrane said that on November 22, 2000, Nano World was not in a position to perform any agreement to acquire Euroinks since Nano World had no money or soon would have no money. On November 22, 2000, any prospective agreement for Nano World to acquire Euroinks had not been completed. Nano World did not disclose these facts.
- ¶ 40 The closing date of the Euroinks contract was April 30, 2001. Papalia knew that Nano World did not have money on the closing date to acquire Euroinks and did not acquire Euroinks. Nano World did not disclose this fact.
- ¶ 41 On November 29 and 30, 2000, a “spam” e-mail campaign further distributed Nano World’s press release concerning the Euroinks acquisition. This e-mail or “equity blast” resulted in the distribution of approximately 15,000,000 e-mails.
- ¶ 42 In his evidence in the US proceedings, Papalia denied that he approved the “equity blast” scheme. Whether he formally approved it or not, Papalia’s own testimony and a copy of a fax to him shows that he was aware of the proposed blast. There is no evidence that he tried to stop it. On his own evidence, Papalia contemplated reaching even more readers with Nano World’s November 22, 2000 press release than would usually be the case. Nano World issued 2000 shares to pay for the blast. This could not have been agreed without Papalia’s approval.
- ¶ 43 The statement about acquiring Euroinks in the press release of November 22 was false because Nano World had only a tentative agreement with Euroinks that was non-binding, and subject to further negotiation and formalization of terms. The statement was also misleading because it did not disclose that the agreement was contingent on Nano World finding \$1.75 million USD in financing within four months. Nano World had no financing arrangements in progress that would have allowed Nano World to meet that contingency.

Fiat

- ¶ 44 The January 22, 2001 press release quotes Papalia as saying:

2005 BCSECCOM 441

We have been quite pleased with CRF [Centro Ricerche Fiat] to date as each of the parties has fulfilled its obligations. We look forward to beginning the application phase with them shortly.

- ¶ 45 Nano World could not make its second payment of \$300,000 USD to Fiat, due on December 31, 2000, and had to ask for an extension. In 1999, Papalia had purchased 300,000 shares in his wife's name at 5 cents USD per share. In January 2001, Papalia was still attempting to save the company by obtaining financing. He sold shares held by his wife for \$120,000 to \$130,000 USD in January 2001 in order to make part of the \$300,000 payment to Fiat in January.
- ¶ 46 In February or March 2001, Nano World suspended its performance under the agreement with Fiat because, having made the first two payments, it could not make the next 10 payments under the contract. Nano World did not announce the suspension of the Fiat contract.
- ¶ 47 The statement about CRF in the press release of January 22, 2001 was misleading because the press release failed to disclose that Nano World was in serious financial difficulty and the contract with Fiat was at risk. Nano World had run out of money and further financing, although being negotiated with Frefax Inc, was subject to a number of contingencies.

Frefax

- ¶ 48 On January 30, 2001, Nano World issued a press release announcing a financing "agreement in principle" with Frefax. It also announced that, in consideration for Nano World's execution of the agreement, Frefax had "committed itself to providing Nano World with an immediate loan of \$500,000".
- ¶ 49 The January 30 press release summarized the agreement between Nano World and Frefax, indicating Nano World would retain a 15% interest in the business ventures being financed by Frefax, as well as "ownership of its technology, and any technology which may be developed pursuant to its collaborations, and 100% of any profits which may result from activities not mentioned above [in the press release]".
- ¶ 50 The letter of intent also gave Frefax a 12-month option to purchase Nano World's remaining 15% interest in profits as well as "all technology at 200% of cash contribution by Nano World".
- ¶ 51 On January 30, 2001, Frefax had \$85 USD in the bank and no discernable assets or prospects. There was not an immediate loan of \$500,000 to Nano World from Frefax. It appears that about \$160,000 USD may have been advanced by individuals involved with Frefax, but the full loan was never made. It appears that

2005 BCSECCOM 441

Frefax itself was unable to make the immediate loan without obtaining outside financing. None of these facts was disclosed. Papalia said that he had rushed this release and realized his failure to make proper disclosure later. The information was not, however, corrected.

- ¶ 52 The statements in the press release of January 30, 2002 about the letter of intent and immediate loan were misleading because the press release failed to disclose all the important terms of the letter of intent including Frefax's 12-month option to purchase Nano World's remaining 15% interest in profits as well as "all technology at 200% of cash contribution by Nano World". It also failed to disclose that Frefax had \$85 USD in the bank and no obvious assets or prospects, and that Frefax was unable to make the immediate loan without obtaining outside financing.

Role of Papalia and the board of Nano World

- ¶ 53 The board of directors of Nano World seems not to have exercised any effective oversight of Papalia or the issue of press releases. Although some directors may have been involved in the drafting and approval of some of the press releases, the board itself was not involved and had not set up any procedure to ensure that Nano World's disclosure was appropriate and compliant with the law. Even when the board resolved that Cochrane should review the press releases, Papalia did not comply with the resolution. The board appears to have had no mechanism in place to ensure that he did comply. Papalia released the Euroinks, Frefax and OOM Lab press releases without following Nano World's press release policy.
- ¶ 54 None of the failures to disclose was later corrected by Nano World or Papalia or anyone.

Investors at risk

- ¶ 55 Nano World announced the contract with Fiat on September 12, 2000. The closing price of Nano World on that day rose by approximately 13% to \$11.50 USD, from \$10.19 on September 11, 2000, with the volume of trading increasing approximately 310% from 34,900 on September 11 to 108,200 shares per day.
- ¶ 56 When Nano World announced the purported acquisition of Euroinks on November 22, 2000, the price of its stock increased approximately 6% from \$8.00 USD on November 21 to \$8.47 on November 22, 2000 and trading volume per day increased from 600 shares on November 22, 2000 to 28,900 shares within two days.
- ¶ 57 From November 28 to November 30, 2000, the dates the Euroinks press release was republished by the e-mail blast, the trading volume per day of Nano World increased from 13,900 shares to 115,600 shares.

2005 BCSECCOM 441

- ¶ 58 When Nano World announced the purported agreement with Frefax on January 30, 2001, the volume of shares traded per day increased from 126,800 shares to 275,000 shares on January 31, 2001, the day after the announcement.
- ¶ 59 By January 2001, the price of the shares had dropped below \$1 USD.

Benefits to Papalia

- ¶ 60 In January 2000, Papalia's wife owned 300,000 shares of Nano World. Papalia had purchased the shares for 5 cents USD. In January and February 2001, Papalia sold shares of Nano World held by his wife for proceeds of between \$120,000 and \$130,000 USD. We know that Papalia sold 37,000 shares on January 26 and sold 2500 shares on January 31, for prices ranging from approximately 39 to 63 cents USD. He testified that he sold the shares through his wife's broker in Vancouver. He purchased 22,500 shares for 48 or 61 cents USD on January 30.
- ¶ 61 We cannot determine with accuracy the profit made by Papalia on his sales of shares in January 2001. We accept his evidence that any profit was ploughed back into Nano World to keep the company going. It became a debt to him which Nano World has apparently not repaid. It appears that any profit has been lost.

Analysis and findings

Admissibility of US investigation and deposition evidence and admissions

- ¶ 62 In the Pretrial Order in the US civil proceedings, Papalia made admissions as to facts and as to the authenticity and admissibility of documents.
- ¶ 63 Those admissions constitute judicial admissions, which are, under the laws of British Columbia, admissible against Papalia in British Columbia proceedings. The weight to be given them is a matter for the trier of fact. In this case, since there is no evidence to refute them, those admissions should stand as conclusive. See for example *Bank of Montreal v. Quality Feeds Alberta Ltd*, [1995] BCJ No. 167 (BCSC).
- ¶ 64 We have adopted relevant findings of fact of the US Court. We have also taken into account Papalia's and Cochrane's investigation and deposition evidence.

Misrepresentation

- ¶ 65 Staff allege that "while engaging in investor relations activities or with the intention of effecting a trade in a security, Nano World and Papalia each made statements that they knew, or ought reasonably to have known, were misrepresentations, contrary to section 50(1)(d) of the Act".
- ¶ 66 Under section 1(1) of the Act:

2005 BCSECCOM 441

“investor relations activities” means

any activities or oral or written communications, by or on behalf of an issuer or security holder of the issuer, that promote or reasonably could be expected to promote the purchase or sale of securities of the issuer ...;

“issuer” means

a person who

- (a) has a security outstanding,
- (b) is issuing a security, or
- (c) proposes to issue a security;

“security” includes

...
(d) a bond, debenture, note or other evidence of indebtedness, share, stock, unit, ... certificate of share or interest, ... or subscription...;

“trade” includes

(a) a disposition of a security for valuable consideration whether the terms of payment be on margin, installment or otherwise ...,

...
(f) any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the activities specified in paragraphs (a) to (e);

“material fact” means

where used in relation to securities issued or proposed to be issued, a fact that significantly affects, or could reasonably be expected to significantly affect, the market price or value of those securities;

“misrepresentation” means

- (a) an untrue statement of a material fact, or
- (b) an omission to state a material fact that is
 - (i) required to be stated, or
 - (ii) necessary to prevent a statement that is made from being false or misleading in the circumstances in which it was made.

2005 BCSECCOM 441

¶ 67 Section 50(1)(d) of the Act provides:

A person, while engaging in investor relations activities or with the intention of effecting a trade in a security, must not do any of the following:

...
(d) make a statement that the person knows, or ought reasonably to know, is a misrepresentation
...

¶ 68 Papalia and Nano World engaged in “investor relations activities” by issuing the press releases. These were “activities or ... written communications, by or on behalf of an issuer or security holder of the issuer, that promote or reasonably could be expected to promote the purchase or sale of securities of the issuer”.

¶ 69 Papalia was from September 2000 onward acting with the authority and on behalf of Nano World, an issuer. He controlled the issue of the press releases which clearly could reasonably be expected to promote the purchase or sale of Nano World shares. The press releases were issued to attract new financing for Nano World, whether by way of a purchase of securities in Nano World or otherwise. They were intended to make Nano World more enticing to prospective investors and financiers.

¶ 70 As we have found, in all the press releases, Nano World and Papalia made false statements of facts or omitted to state facts that were necessary to prevent a statement that was made from being misleading in the circumstances in which it was made. We also find that the facts in the false statements or omissions could reasonably be expected to significantly affect the market price or value of Nano World shares.

¶ 71 The disclosure of the fact that:

- announced financing or financial backing was not binding (September 12 and 27, 2000 press releases) or was subject to important contingencies (January 30, 2001 press release),
- the only committed “international partner” was Fiat (September 27, 2000 press release),
- the contract with Fiat was contingent on the ability of Nano World to obtain \$3,000,000 USD in financing (a significant amount for the company) (September 12 and 25, 2000 press releases),

2005 BCSECCOM 441

- the OOM Lab contract was not signed (November 21, 2000 press release),
- by November 2000, Nano World was in serious financial difficulty (all press releases from November 21, 2000),
- the agreement with Euroinks was non-binding, subject to further negotiation and formalization of terms, and contingent upon Nano World procuring \$1.75 million USD in financing for the deal within four months (November 22, 2000 press release), and
- Prefax had no obvious assets or prospects and was unable to make the immediate loan without obtaining outside financing (January 30, 2001 press release),

would in each case have removed the rosy glow painted by the related press release and could reasonably be expected to significantly affect the market price or value of the shares. The facts in the false statements or omissions were therefore “material”.

¶ 72 The false and misleading statements in the press releases of September 12, 25 and 27, November 21 and 22, and January 22 and 30 were therefore “misrepresentations”.

¶ 73 Papalia (and through Papalia) Nano World knew, or were wilfully blind or reckless to the fact, that the statements were misrepresentations. Where Papalia has not given direct evidence that he knew that the statements were false or misleading, we infer that he knew, or was wilfully blind or reckless, about the misrepresentations because he was fully involved in the negotiations announced by the press releases. Nano World had the same knowledge as Papalia because the board had delegated the authority to issue press releases to Papalia. He controlled the issue of the press releases on behalf of Nano World.

¶ 74 **Accordingly we find that Nano World and Papalia breached section 50(1)(d) of the Act.**

Fraud

¶ 75 Staff alleged in the notice of hearing that “Nano World and Papalia each contravened sections 57 and 57.1 of the Act by, directly or indirectly, engaging in or participating in transactions relating to a trade in or acquisition of a security, namely [misrepresentations in press releases] and [share sales], when they knew, or ought to have known, that the transactions:

1. resulted in or contributed to a misleading appearance of trading activity in, or an artificial price for, any security anywhere; or
2. perpetrated a fraud on any person in British Columbia, or anywhere”.

2005 BCSECCOM 441

¶ 76 Section 57 of the Act states:

A person in or outside 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 transaction or series of transactions

- (a) results in or contributes to a misleading appearance of trading activity in, or an artificial price for, any security ... traded in British Columbia,
- (b) perpetrates a fraud on any person in British Columbia, or
- (c) perpetrates a fraud on any person anywhere in connection with trading in or acquiring securities ... in British Columbia.

¶ 77 Section 57.1 states:

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 transaction or series of transactions

- (a) results in or contributes to a misleading appearance of trading activity in, or an artificial price for, any security ... anywhere, or
- (b) perpetrates a fraud on any person anywhere.

¶ 78 We have, however, no evidence of trading in BC (other than Papalia's sale of Nano World shares in January 2001) and no evidence of fraud on persons in BC. In addition, although the notice of hearing alleged breach of sections 57(a) and 57.1(a), staff did not pursue these allegations in argument. (The notice of hearing also alleged that Papalia perpetrated fraud in his sale of shares in January 2001. Staff did not pursue this allegation in their written argument, but made submissions orally during the hearing.)

¶ 79 Accordingly, and to make the issues more manageable, we have reduced the alleged breaches to breach by Papalia of section 57.1(b) in his sale of shares of Nano World in January 2001, and breach by Nano World and Papalia of section 57.1(b) in their issue of the press releases.

¶ 80 Nano World was a person in British Columbia. It had a business and mailing address in BC and an office in Vancouver where it employed staff and contracted for services. Papalia was also in British Columbia. He had a residential address in BC and worked out of the corporate office in Vancouver.

2005 BCSECCOM 441

Meaning of transaction

- ¶ 81 Staff made no submissions on the meaning of "transaction" in section 57.1, and whether it includes the issue of a press release. A "transaction", as broadly defined in the Shorter Oxford English Dictionary, includes an arrangement, an agreement ...; a piece of business; doings, proceedings, dealings". In *R v White*, [1999] BCJ No. 1543, the Provincial Court said:

In the sense in which it appears to have been used in s. 41.1 [the predecessor of section 57 and 57.1], 'transaction' is defined in The Concise Oxford Dictionary (8th ed.) as meaning 'a piece of esp.[ecially] commercial business done'.

In *R v Goldstein* (1988), 42 CCC(3d) 548 at 554 (Ont CA), in considering section 510(2) of the Criminal Code, Houlden JA said:

In its ordinary sense it is understood to mean the doing or performing of some matter of business between two or more persons. 'Transaction' in its broadest sense expresses the concept of driving, doing, or acting as is denoted by the Latin word *transagere* from which it is derived. In *Bendir et al v Anson*, [1936] 3 All ER 326 [UK CA] at p. 330, it was suggested that 'transaction' would seem to mean an act the effect of which extends beyond the agent to other persons.

A 'transaction' may and frequently does include a series of occurrences extending over a length of time.

...

In my opinion, a series of acts or occurrences must be connected or related in order to constitute a transaction. For the purposes of this case, I would define 'transaction' as a series of connected acts extending over a period of time.

- ¶ 82 Section 8 of the *Interpretation Act*, RSBC 1996, c. 238 states:

Every enactment must be construed as being remedial, and must be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects.

- ¶ 83 Keeping in mind the primary purpose of securities legislation, which is the protection of the investing public, we think it is open to us to interpret "transaction" broadly to include a communication (or press release) that is intended to inform the capital market. It is "a piece of business done". Therefore

2005 BCSECCOM 441

we find that Nano World and Papalia were directly engaging in or participating in a transaction or series of transactions relating to a trade in or acquisition of a security when they issued press releases to attract capital in return for the issue of securities in Nano World.

¶ 84 Alternatively, we find that the issue of press releases was in each case one act in a series of acts that together were a transaction or a series of transactions, namely the attempts by Papalia and Nano World to secure new financing. These transactions, although they did not succeed, were nevertheless "relating to a trade in or acquisition of a security", namely the issue of Nano World shares.

¶ 85 There is a third approach which is to say that the press releases were themselves "trades" as defined in section 1(1)(f) of the Act because they were acts in furtherance of a trade. This is so even if no actual trade takes place. So the activities of Nano World and Papalia leading up to the issue of the press releases were to "participate in a transaction or series of transactions relating to a trade", that is, the issue of the press release.

¶ 86 In addition, while in BC, Papalia sold Nano World shares in January 2001. In doing so, he engaged in a series of transactions relating to a trade in a security.

Law on fraud

¶ 87 As set out in *Anderson v. BCSC*, 2004 BCJ 8 (BCCA), the elements of fraud under section 57(b) of the Act were summarized in *R v. Théroux*, [1993] 2 SCR 5 at 20 by Madam Justice McLachlin (as she then was):

... the *actus reus* of the offence of fraud will be established by proof of:

1. the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and
2. deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim's pecuniary interests at risk.

Correspondingly, the *mens rea* of fraud is established by proof of:

1. subjective knowledge of the prohibited act; and
2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim's pecuniary interests are put at risk).

2005 BCSECCOM 441

¶ 88 McLachlin J also quoted with approval (at 23) the words of Taggart JA who stated in *R v. Long* (1990), 61 CCC (3d) 156 at 174:

... the mental element of the offence of fraud must not be based on what the accused thought about the honesty or otherwise of his conduct and its consequences. Rather, it must be based on what the accused knew were the facts of the transaction, the circumstances in which it was undertaken and what the consequences might be of carrying it to a conclusion.

¶ 89 The Court of Appeal also said in *Anderson* that, in determining whether a person has the required *mens rea*, evidence of that person's conduct and state of mind after the commission of the prohibited act(s) may be relevant.

¶ 90 The BC Court of Appeal in *Anderson* went on to say:

Fraud is a very serious allegation which carries a stigma and requires a high standard of proof. While proof in a civil or regulatory case does not have to meet the criminal law standard of proof beyond a reasonable doubt, it does require evidence that is clear and convincing proof of the elements of fraud, including the mental element.

Press releases

¶ 91 Did Nano World and Papalia breach section 57.1(b) by committing fraud on any person when they issued the press releases? The *actus reus* of fraud is clear. The first element is an act of falsehood or deceit. Nano World and Papalia issued false or misleading statements in the press releases.

¶ 92 The second element is the placing of investors' pecuniary or economic interests at risk. We have no evidence to allow us to come to any conclusions about whether prospective new financiers' or contractors' pecuniary or economic interests were put at risk by the misleading press releases.

¶ 93 However, we find that the pecuniary interests of purchasers of shares on the open market were put at risk. Although Nano World and Papalia intended that the press releases paint a rosy picture to attract new financing, it is common sense that the rosy picture would also have a positive effect on the market price of the shares of Nano World already trading. The misrepresentations therefore put investors' pecuniary interests at risk.

¶ 94 We must base our finding of the mental elements of fraud on our findings as to what Papalia actually knew. The evidence must be clear and convincing. Clearly the first element of subjective knowledge is established. Papalia (and through

2005 BCSECCOM 441

him) Nano World knew, or were wilfully blind or reckless to the fact, of the deceit, namely the misrepresentations in the press releases.

- ¶ 95 In our view, the second element is also established - subjective knowledge that the deceit could have as a consequence the deprivation of another in that the victim's pecuniary interests are put at risk. We do not know what Papalia actually knew about the potential effect of the press releases on the market price and trading volumes of Nano World shares. Clearly, however, Papalia (and through him) Nano World knew, or were wilfully blind or reckless, about the effect of the misrepresentations on the market.
- ¶ 96 Under ever increasing pressure to obtain financing for the company, Papalia took big risks, repeatedly. For example, he announced contracts that were not agreed or for which the necessary financing had not been found. He did so even after Cochrane had raised with him his concerns that he was not following the board mandated procedure in issuing the press releases.
- ¶ 97 Papalia hoped and perhaps expected that the information in the press releases would come true, or the omissions would not matter in future. That is not a defence. What matters is that he intended that the rosy picture painted by the press releases would attract new financing and that the market would act on the information in the press releases. It follows that the market would act and investors in shares already trading would also be affected by the misleading information in the press releases, even if the investors were not specifically aware of it.
- ¶ 98 Papalia decided to increase the risk to all investors (or was wilfully blind or reckless to it) by making the company look more valuable than it was. He knew that the market did not have material facts about Nano World. We infer that Nano World (through Papalia) and Papalia had subjective knowledge of the risk to the pecuniary interests of investors.
- ¶ 99 **Accordingly, we find that Nano World and Papalia breached section 57.1(b) of the Act when Papalia and (through Papalia) Nano World knowingly or recklessly made false or misleading statements that put investors' pecuniary interests at risk.**

Sale of shares

- ¶ 100 Did Papalia breach section 57.1(b) by committing fraud on any person when he sold Nano World shares in January 2001? To find an act of deceit we would need to find that Papalia sold the shares on January 26 and 31 for a price that was artificially elevated by one or more of the press releases.

2005 BCSECCOM 441

- ¶ 101 This we infer because the correction of the misleading information in the January 22 and 30 press releases would, in our view, have caused the share price to drop. We have taken into account the fact that when Nano World announced the agreement in principle with Frefax, the volume of shares traded per day increased from 126,800 shares on January 30, 2001 to 275,000 shares on January 31, 2001, the day after the announcement, when Papalia sold one block of shares.
- ¶ 102 It follows that Papalia's sale of the shares during a period when the market was not informed of all material facts would have put the pecuniary interests of prospective purchasers of those shares at risk. We find that the *actus reas* of fraud is established.
- ¶ 103 We have already found that Papalia knew, or was wilfully blind or reckless to the fact, that the January press releases contained misrepresentations. It follows that he knew, or was wilfully blind or reckless to the fact, that he sold the shares into a market in which the material facts necessary to correct the misrepresentations had not generally been disclosed. We find that Papalia had subjective knowledge of the deceit.
- ¶ 104 Did Papalia have subjective knowledge that the deceit could have as a consequence the deprivation of another, in that the victim's pecuniary or economic interests are put at risk? We do not know what Papalia actually knew about the effect of the misleading press releases on the market price and trading volumes of Nano World shares. However, as we have already found, Papalia knew, or was wilfully blind or reckless, about the potential effect of the misrepresentations on the market.
- ¶ 105 Papalia hoped and perhaps expected that the false information in the press releases would come true, or the omissions would not matter in future. He also gave evidence that his motive in selling the shares was to obtain the money needed to pay Fiat. That is not a defence.
- ¶ 106 What matters is whether he knew, or was wilfully blind or reckless to the fact, that the press releases might contribute to an artificial price for the shares. He intended that the rosy picture painted by the press releases would attract new financing. He knew that the market was not aware that the company had no money and any prospective financing was subject to some important contingencies. It follows that the market price would reflect the misleading information in the press releases. We infer that Papalia had subjective knowledge of the risk to the pecuniary interests of investors when he sold the shares.

2005 BCSECCOM 441

¶ 107 **Accordingly, we find that Papalia breached section 57.1(b) of the Act when he knowingly or recklessly sold Nano World shares and so put investors' pecuniary interests at risk.**

Section 168.2

¶ 108 Staff also alleged that Papalia authorized, permitted or acquiesced in Nano World's contraventions and so, under section 168.2 of the Act, also contravened those provisions. As a result of our findings above, we do not need to make findings under section 168.2.

Conduct contrary to the public interest

¶ 109 We find that Nano World's and Papalia's conduct which breached sections 50 and 57.1 of the Act was contrary to the public interest.

Sanctions

¶ 110 We now await written submissions from staff on the orders to be made under sections 161, 162 and 174 of the Act. The submissions must be sent to the Secretary to the Commission within four weeks and served on Nano World and Papalia. Nano World and Papalia may make submissions in reply which must reach us and staff within four weeks of their receipt of staff's submissions. If they decide to make submissions, then they should inform the Secretary to the Commission as soon as practicable. If Nano World and Papalia make submissions, then staff must provide to us any submissions in reply within seven days of receipt of their submissions.

¶ 111 June 22, 2005

¶ 112 **For the Commission**

Robin E. Ford
Commissioner

Marc A. Foreman
Commissioner

2005 BCSECCOM 441

John K. Graf
Commissioner