2007 BCSECCOM 437

Edward Bernard Johnson

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

Hearing

Panel	Brent W. Aitken	Vice Chair
	David J. Smith	Commissioner
	Suzanne K. Wiltshire	Commissioner
Submissions completed	June 29, 2007	
Date of Decision	July 20, 2007	
Submissions filed by		
C. Paige Leggat Lisa Ridgedale	For the Executive Director	
John S. Forstrom	For Edward Bernard Johnson	

Decision

I. Introduction

¶ 1 This is a hearing under sections 161(1) and 162 of the *Securities Act*, RSBC 1996, c. 418. This decision should be read with our Findings made on May 11, 2007 (2007 BCSECCOM 257).

¶ 2 Edward Bernard Johnson was a registered representative for a brokerage account in the name of a Robert Taylor. Johnson knowingly accepted trading instructions, without proper authorization, from a third party for at least 400 of 450 trades in the Taylor account in a period spanning more than four years. The third party was Stanley Steven Ross, who at the time was prohibited from trading because of a 1999 order of the executive director.

¶ 3 Johnson gave answers under oath at two compelled interviews by commission staff investigators in late 2004 and early 2005. At the first interview, he appeared alone; at the second he was represented by counsel. At both interviews, when asked by staff investigators about the source of his trading instructions, Johnson

said that he did not know that Taylor had allowed Ross to trade in the account, and that to his knowledge, Ross did not do so. These answers were untrue.

¶ 4 The trades in the Taylor account earned Johnson's firm commissions of about $59,000. Johnson says his share of those commissions would have been "50% or less".

II. Summary of Findings

¶ 5 Based on Johnson's admissions and acknowledgements, we found that he contravened:

1. By-law 201.1(i)(3) of the Investment Dealers Association of Canada by permitting Ross to trade in the Taylor account without a duly signed authorization from Taylor;

2. IDA Regulation 1300.1(b) by failing to exercise due diligence to ensure that the acceptance of instructions from Ross with respect to trading in the Taylor account was within the bounds of good business practice;

3. IDA By-law 29.1 by failing to exercise due diligence, which constituted conduct unbecoming or detrimental to the public interest; and

4. section 168.1 of the Act by making misleading statements to an investigator appointed under the Act.

¶ 6 In the notice of hearing, the executive director alleged that Johnson's conduct was contrary to the public interest. Although in the Findings we did not make this specific finding, clearly Johnson's violation of IDA rules, and his making misleading statements to a commission investigator, is conduct contrary to the public interest.

¶ 7 In the hearing that led to our Findings, the executive director argued that Johnson knew that Ross was trading for his own account through the Taylor account in violation of the 1999 order. The executive director wanted us to make this finding because, she argued, it would be relevant now, when we are determining sanctions.

¶ 8 Although we found that Johnson ought to have known about the 1999 order, the evidence did not establish that he had actual knowledge of the order. Therefore, we did not find that Johnson knew that Ross was trading through the Taylor account in violation of that order. More fundamentally, we found that the notice

of hearing did not allege actual knowledge, and so that was not a part of the case that Johnson had to meet.

III. Discussion and Analysis

A. Positions of the parties

¶ 9 The executive director seeks a six-month suspension of Johnson's registration, followed by six months of close supervision. The executive director also seeks an administrative penalty of $20,000.

¶ 10 Johnson says the appropriate sanction is a reprimand followed by six months of close supervision. He says the administrative penalty should not exceed $10,000.

B. Factors to consider

¶ 11 In *Re Eron Mortgage Corporation* [2000] 7 BCSC Weekly Summary 22, the commission discussed the factors relevant to sanction as follows (at page 24):

> In making orders under sections 161 and 162 of the Act, the Commission must consider what is in the public interest in the context of its mandate to regulate trading in securities. The circumstances of each case are different, so it is not possible to produce an exhaustive list of all of the factors that the Commission considers in making orders under sections 161 and 162, but the following are usually relevant:
>
> - the seriousness of respondent's conduct,
> - the harm suffered by investors as a result of the respondent's conduct,
> - the damage done to the integrity of the capital markets in British Columbia by the respondent's conduct,
> - the extent to which the respondent was enriched,
> - factors that mitigate the respondent's conduct,
> - the respondent's past conduct,
> - the risk to investors and the capital markets posed by the respondent's continued participation in the capital markets of British Columbia,
> - the respondent'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.

¶ 12 The parties also referred us to the IDA Disciplinary Sanction Guidelines. We are not bound by those guidelines, but they are relevant. The guidelines identify the factors that IDA disciplinary panels ought to consider in sanctioning contraventions of IDA Regulation 1300.1(b), IDA By-law 29.1, and IDA By-law 201.1(i)(3). Those factors are:

For contraventions of IDA Regulation 1300.1(b)

- why the order was not within the bounds of good business practice
- number of orders executed
- magnitude of losses directly attributable to the orders executed
- client's acceptance of the orders
- level of sophistication of the client

For contraventions of IDA By-law 29.1

- seriousness of the legislative breach
- client's knowledge or consent
- loss to the client
- respondent's intent
- respondent's enrichment or financial benefit
- whether respondent concealed or attempted to conceal the conduct from the member firm or the IDA

For contraventions of IDA By-law 201.1(i)(3)

- number of unauthorized instructions acted upon by the registrant
- whether the client provided verbal authority
- underlying reason for accepting unauthorized instructions
- nature of instructions and impact on the account
- magnitude of client losses

¶ 13 Johnson also says his contravention of section 168.1 of the Act is analogous to a contravention of IDA By-laws 19.5 or 19.6, which deal generally with the issue of co-operating with, or impeding, IDA investigations. For contraventions of those By-laws, the IDA guidelines cite these factors:

- disciplinary history of the respondent
- whether the contravention was intentional or inadvertent
- whether complete or only partial non-compliance
- impact of the non-compliance on the investigation
- refusal reasonably based on legal advice
- materiality of the misleading information to the pending investigation

C. Application of the factors to Johnson's conduct

¶ 14 We have considered all of the factors cited in *Eron* and those described above from the IDA guidelines in deciding the sanctions that ought to flow from Johnson's conduct. There is a high degree of overlap among the factors; for convenience, we have organized this discussion around the factors listed in *Eron*.

¶ 15 The parties agree that Johnson should be subject to a six-month period of close supervision, and that he should pay an administrative penalty. As to the amount, the executive director says $20,000, Johnson says $10,000. The main issue between the parties is whether Johnson's registration should be suspended. As is reflected in our orders, we have reached a different decision than the parties on the quantum of the administrative penalty.

¶ 16 Therefore, in applying the relevant factors to Johnson's conduct, we have considered in particular the impact of those factors on two issues – whether a suspension is appropriate, and what the quantum of the administrative penalty ought to be.

¶ 17 Although we found that Johnson contravened three IDA rules, all of those contraventions arose from the same conduct. It is not unusual that the same conduct can result in the contravention of more than one IDA rule. The IDA guidelines take the approach, in essence, that generally what matters is the imputed conduct, not the number of contraventions it generates.

¶ 18 We agree with this approach, although where, as in this case, various contraventions arise from the same conduct, the factors associated with each contravention should be considered in determining the appropriate sanction.

Seriousness of the conduct

¶ 19 In assessing the seriousness of Johnson's conduct, we considered the importance of the provisions he contravened. For Johnson's contraventions of IDA rules, we considered the number of orders he executed in contravention of those provisions, the reason his execution of the orders was not within the bounds of good business practice, the underlying reason for his acceptance of unauthorized instructions, and the nature of the instructions and the impact on the account.

¶ 20 A consideration of these factors show that Johnson's contravention of IDA rules was serious. The IDA rules that Johnson contravened are important ones. They are all designed to prevent, in one way or another, improper trading. They are designed to ensure, not only that trades are not executed against the will of the client (not an issue in this hearing), but also to ensure that there is a record of

which individuals trade. This is so that trades by those who, for whatever reason, ought not to be trading, can be prevented, or at least detected.

¶ 21 As a registrant, Johnson is a person the regulatory system depends upon to be familiar, and comply, with the rules of his self-regulatory organization, the IDA, to ensure that the integrity of the markets is not damaged. Had Johnson followed IDA rules, he would have discovered that Ross was subject to the 1999 order, and could have avoided executing the trades. By failing to comply with those rules, Johnson allowed Ross to make hundreds of trades in our markets that ought never to have taken place, all in violation of a trading ban imposed by this commission. That is the main reason Johnson's execution of the orders was outside the bounds of good business practice.

¶ 22 Furthermore, of the 450 or so trades in the Taylor account during the four-year period, at least 400 of them Johnson executed in contravention of IDA rules. It is hardly a stretch to characterize his conduct as serious when as a result, nearly 90% of the trading in the Taylor account was in violation of IDA rules and, ultimately, in violation of the 1999 order against Ross.

¶ 23 We have no evidence as to the underlying reason for Johnson's acceptance of unauthorized instructions, or the impact of the resulting trades on the account, so these factors did not contribute to our decision.

¶ 24 Turning to Johnson's contravention of section 168.1 of the Act, we considered the importance of that section and also considered whether his contravention was complete or partial, whether his contravention was intentional or inadvertent, the materiality of his statements to the investigation, and their impact on it.

¶ 25 Applying these considerations, Johnson's contravention of section 168.1 was very serious. Section 168.1 is important in preserving the integrity of the regulatory system by requiring those required to provide information to the commission to do so truthfully. While under oath, Johnson falsely told investigators, in two separate interviews (being represented by counsel in the second) that he did not know that Taylor had allowed Ross to trade in the account, and that to his knowledge, Ross did not do so.

¶ 26 Furthermore, Johnson's conduct was not inadvertent. The only reasonable inference to be drawn from the evidence is that he intentionally misled commission investigators. His misleading statements were the exact opposite of the actual facts, and went to the heart of the matter under investigation. That he misled investigators twice while under oath raises serious questions about his personal integrity.

¶ 27 Johnson acknowledges that his misleading statements were regrettable and a "significant aggravating factor", but says they are "considerably ameliorated" by his admissions in the Findings hearing.

¶ 28 We disagree that Johnson's admissions ameliorate his contravention of section 168.1. What is important is that at the crucial time of the investigation, he chose, under oath, to mislead commission investigators on the very matter that was under investigation. Our expectations of registrants are much higher.

¶ 29 The system of securities regulation in Canada depends heavily on high standards of integrity on the part of all those who are part of the registered industry. In *British Columbia Securities Commission v. Branch*, [1995] 2 SCR 3, the Supreme Court of Canada commented on the essential role of registrants in the system (at paragraph 9):

> [T]he *Securities Act* is essentially a scheme of economic regulation which is designed to discourage detrimental forms of commercial behaviour. . . . *the effective implementation of securities legislation depends on the willingness of those who choose to engage in the securities trade to comply with the defined standards of conduct.* [our emphasis]

¶ 30 This obligation falls on individual registrants, those who supervise them directly, and the managers, executives and directors of registered firms. We expect all of these persons to demonstrate integrity not just in day-to-day trading and advising, but also in candour and cooperation with securities regulatory authorities in connection with investigations into suspected wrongdoing. Any lesser standard invites contempt of the enforcement process by the very ones charged to a large degree with protecting the integrity of our markets. Johnson failed to meet that standard of integrity when he misled commission staff investigators.

Harm suffered by the client

¶ 31 We have no evidence of any losses or harm to Taylor as a result of Johnson's conduct. This factor did not contribute to our decision.

Damage to British Columbia's capital markets

¶ 32 We have no evidence of actual damage to British Columbia's capital markets as a result of Johnson's conduct. However, evidence of actual damage is not necessary to consider this as a factor. We know that as a result of Johnson's conduct, Ross was able to make hundreds of trades in our capital markets while being prohibited from trading by an order that the executive director issued in the public interest.

Allowing those prohibited from trading to do so is inherently damaging to our capital markets.

¶ 33 In *Research Capital Corp* 2004 BCSECCOM 128, this commission ruled that the contravention by a registrant of a cease trade order warranted sanction, even in the absence of evidence of any harm to investors or damage to market integrity. The commission noted (at paragraph 42) that a cease trade order "is one of the commission's most important tools for enforcing compliance" but is "effective only if registered dealers comply with it". Research Capital did not intentionally fail to comply with the order, but the commission went on to sanction the firm, saying it was important to do so "to induce future compliance by Research Capital with the defined conduct for registered dealers".

¶ 34 In our opinion, the same reasoning applies here. We did not find that Johnson knew about the 1999 order, so he is not burdened with the knowledge that his contraventions facilitated a breach of that order. However, the IDA rules require registrants to exercise due diligence just so they can discover things like outstanding cease trade orders. Johnson's failure to do so resulted in the damage to our markets described above.

Enrichment

¶ 35 Johnson's firm earned commissions of about $59,000 from his trading in the Taylor account, of which Johnson's share was "50% or less". Johnson says that the commissions he earned in the account should not enter in to our considerations, because they represent merely his compensation for servicing his client's account.

¶ 36 We disagree. Both *Eron* and the IDA guidelines identify the respondent's enrichment or financial benefit as a factor, and appropriately so. The fact remains that 90% of the trades Johnson executed in the Taylor account were in contravention of IDA rules, and the public interest demands that he cannot profit, or be seen to do so, from this misconduct.

Mitigating factors

¶ 37 The IDA guidelines suggest that the client's knowledge and consent is a relevant factor. This is appropriate when a registrant executes orders in a client's account, on the instructions of another, that are against the client's will or are contrary to the client's interests in some way. That is not what this case is about. It is about trading that allowed a cease trade order to be avoided. Taylor's awareness that Ross was giving Johnson trading instructions is therefore not a mitigating factor.

¶ 38 Johnson says that we should consider the fact that he made admissions as a mitigating factor, and that we should also consider the embarrassment and cost he has borne in connection with the hearing.

¶ 39 We disagree. Johnson's admissions came too late to be considered a mitigating factor. Two business days before the hearing began, he admitted that he took instructions on 400 of the 450 trades in the account from Ross. He did not make his remaining admissions (his contraventions of IDA rules and section 168.1) until his closing submissions, after the evidentiary portion of the hearing was over. Johnson says that this was because there is no mechanism for a respondent to make admissions without accepting a settlement with the executive director.

¶ 40 That is not so. It is open to a respondent to admit facts at any time during a hearing. The respondent can enter into an agreed statement of facts with the executive director to be put before the panel so it can make a sanction decision based on those facts. Alternatively, if the party and the executive director cannot agree on the facts, the respondent can enter admissions into evidence unilaterally.

¶ 41 Nor do we regard embarrassment and cost to be mitigating factors. Those are commonly associated with the hearing process. We do not find anything unique about Johnson's circumstances as they relate to these factors.

¶ 42 Aggravating factors can offset mitigating factors. The executive director says that even though we did not find that Johnson had actual knowledge of the 1999 order, the damage to the integrity of the market is the same. That is so, but had we found Johnson had actual knowledge of the 1999 order, his conduct would have involved knowingly assisting the breach of a commission order – much more serious conduct than what we found.

Past conduct

¶ 43 Johnson has been a registrant actively working in the industry for 17 years, with no prior disciplinary history.

Johnson's fitness as a registrant

¶ 44 Two aspects of Johnson's conduct raise questions as to his fitness to be a registrant. First, his contraventions of IDA rules were serious. Had he complied with them, he would not have enabled Ross to make hundreds of trades in violation of the 1999 order.

¶ 45 Second, when questioned by commission staff investigators, he misled them in a deliberate attempt to conceal his misconduct.

¶ 46 Although these factors bear on Johnson's fitness for registration, they do not rise to the level of requiring his removal from the industry. They are, however, relevant to whether a period of suspension is appropriate.

Previous orders and other authorities

¶ 47 We have considered the cases submitted by the parties. In none of them does the conduct under consideration correspond precisely to Johnson's conduct in this case. We note, however, the factors listed in section 4.3.1 of the IDA guidelines as to when a suspension may be appropriate:

> 4.3.1 Suspension
> A suspension may be appropriate where:
> - there have been numerous serious transgressions
> - there has been a pattern of misconduct
> - the respondent has a disciplinary history
> - the misconduct has an element of criminal or quasi-criminal activity; or
> - the misconduct in question has caused some measure of harm to the integrity of the securities industry as a whole.

¶ 48 We note the word "or" at the end of the penultimate factor, suggesting that any one or more of these factors could be enough, depending on the circumstances, to warrant a suspension.

¶ 49 Johnson has no disciplinary history. However, all of the other factors on the list are present. We have found Johnson's misconduct serious. There were numerous transgressions of IDA rules, and a pattern of misconduct that allowed over 400 improper trades to go through over a period of more than four years. We have described the damage to our markets that resulted.

¶ 50 When questioned by commission staff investigators, Johnson misled them in a deliberate attempt to conceal his misconduct, in contravention of section 168.1. That conduct is also quasi-criminal, a contravention of section 168.1 being an offence under section 155.

¶ 51 We also considered the comments of an IDA panel in *Toban* [2005] IDACD No. 28. That panel noted that a suspension was more serious to a person still employed in the industry than to one who had left to work in another industry. One would be hard pressed to reach a different conclusion, but we are unsure how helpful that is when deciding whether or not to impose a suspension. A suspension applied to someone who has left the industry would have essentially

no impact. The difficult situations are always going to be those in which the registrant intends to remain employed in the industry.

¶ 52 On that point, the panel noted the time and hard work required for a registrant to build up his or her business. We recognize that suspension is a serious sanction, and we considered this factor carefully, as we did Johnson's submissions about the consequences to him of a suspension.

¶ 53 The panel in *Toban* also suggested that, in determining whether to impose a suspension or a period of supervision, a panel ought to consider the impact on the registrant's clients, "who are denied his or her services during the period of suspension, or whose ability to trade is affected by the respondent's supervision." We did not consider this factor. In our opinion, where a suspension or period of supervision is otherwise warranted, the client concerns articulated in *Toban* ought not to result in a different outcome. Those concerns can be addressed in how the suspension or period of supervision is implemented.

¶ 54 *Toban* also suggested that a relevant factor is the impact of a period of supervision on the registrant's employer firm. The panel said (at page 4):

> No matter how the reporting provisions for this period of supervision are structured, the imposition of such a penalty on a respondent will also impose additional administrative burdens upon the respondent's employer for the duration of the supervision period.

¶ 55 We did not consider this factor in making our orders. First, we have no evidence of the impact of the supervision on Johnson's employer. Second, the parties are agreed on the nature and duration of the supervision. However, we think it is worthwhile to comment on this aspect of the *Toban* decision. Had it been necessary for us to consider the issue of supervision in more detail, we would not have considered the impact on the employer a relevant factor. The purpose of a supervision order is to promote future compliance by the respondent (and indirectly by others in the industry) and to protect the integrity of the markets and the investing public. Those are the factors that determine the appropriateness of a supervision order. In our opinion, the convenience of the firm has no place in those considerations.

IV. Decision

¶ 56 Through the orders we are making, we intend to demonstrate the consequences of Johnson's conduct, to deter him from future misconduct, and to create an appropriate general deterrent.

¶ 57 We are therefore suspending Johnson's registration for a period. We do not do so lightly, but in our opinion a suspension is necessary to achieve the appropriate outcome in this matter.

¶ 58 Johnson asked that if we were to order a suspension, that it be effective no earlier than September 30. Although he provided no reasons for his request, we assume that at least one reason would be to provide time for him and his firm to make arrangements to service his clients during the period of his suspension. We have framed the order to accommodate that.

¶ 59 As noted above, Johnson cannot be seen to have profited from his wrongdoing, and any penalty we order ought to act as disincentive, both to Johnson and to others in future, to attempt to do so. The penalty therefore must exceed the commissions Johnson earned.

¶ 60 We do not have precise evidence as to the commissions Johnson earned through his trades in the Taylor account. However we do know that his commissions were "50% or less" of the $59,000 that his firm earned on his trades. For the purposes of ordering an administrative penalty, we have set his share arbitrarily at 45%, and have taken into account that he executed about 10% of the trades without violating IDA rules. We then doubled that figure. This accounts for $48,000 of the administrative penalty we are ordering.

¶ 61 In addition, an administrative penalty is appropriate in light of his intentional misleading of commission investigators. That accounts for the balance of the administrative penalty we are ordering.

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

1. under section 161(1)(f) of the Act, that Johnson's registration is suspended beginning September 1, 2007 until the later of
   a. November 1, 2007, and
   b. the date he pays the administrative penalty ordered under item 3 of this paragraph;

2. under section 161(1)(f), that for the first six months of his employment with a registered firm after his suspension, Johnson be subject to close supervision; and

3. under section 162, that Johnson pay an administrative penalty of $68,000.

¶ 63 July 20, 2007

¶ 64 **For the Commission**

Brent W. Aitken
Vice Chair

David J. Smith
Commissioner

Suzanne K. Wiltshire
Commissioner