2007 BCSECCOM 622

Hypo Alpe-Adria-Bank (Lichtenstein) AG

Sections 161(1), (2) and (3) of the *Securities Act*, RSB-C 1996, c 418

Hearing

Panel	Brent W. Aitken	Vice Chair
	Neil Alexander	Commissioner
	Robert J. Milbourne	Commissioner
Hearing date	September 14, 2007	
Decision date	September 14, 2007	
Date reasons issued	October 15, 2007	

Appearing

C. Paige Leggat	For the Executive Director
Gordon R. Johnson	For Hypo Alpe-Adria-Bank (Lichtenstein) AG

Reasons for Decision

I Introduction

¶ 1 This was an application under section 161(3) of the *Securities Act*, RSBC 1996, c. 418 for an order extending a temporary order issued by the executive director against Hypo Alpe-Adria-Bank (Lichtenstein) AG until a hearing is held and a decision is rendered. The hearing on the merits has been set for January 30 and 31, 2008.

¶ 2 On September 14, 2007 we heard the application and extended the temporary order (see *Hypo Alpe-Adria-Bank (Lichtenstein) AG* 2007 BCSECCOM 555). These are our reasons.

II Background

¶ 3 On August 28, 2007 the executive director issued a notice of hearing and temporary order under section 161(1) and (2) against Hypo Alpe-Adria-Bank (Lichtenstein) AG (see *Hypo Alpe-Adria-Bank (Lichtenstein) AG* 2007

BCSECCOM 511). The temporary order prohibited Hypo from trading or purchasing any securities or exchange contracts in British Columbia.

¶ 4 Hypo is a subsidiary of Hypo Alpe-Adria-Bank International AG, an Austrian bank.

¶ 5 Hypo says it "has operated trading accounts for clients in British Columbia for over three years." Hypo has accounts at six British Columbia investment dealers.

¶ 6 One of Hypo's accounts is with Gateway Securities Inc. Hypo acknowledges that its clients have a financial interest in the account. However, Hypo says that due to banking secrecy laws in Lichtenstein, it cannot "forward any information concerning the beneficial owners of the securities traded" through its accounts.

¶ 7 The evidence, which Hypo did not dispute, shows that between April 18 and May 31, 2007, Gateway executed trades through the Hypo account in securities listed on two over-the-counter markets in the United States: the Over-the-Counter Bulletin Board and the Pink Sheets LLC. Of the 51 securities traded, all but one were quoted on the OTCBB or the Pink Sheets. During that period, 12% of the issuers whose securities were bought or sold through Hypo's Gateway account were the subject of promotional email (spam), and 86% of the market transactions of spammed securities in the account were sales.

¶ 8 On May 16 and 17 Commission staff received spam identifying one of the OTCBB-quoted issuers, Compliance Systems Corporation, as an issuer whose shares were "getting ready to make a run for the top!" On May 16, the trading volume in Compliance Systems' shares was 34,250 shares; on the 17th it was 1,140,000 shares. About 28% of this volume was represented by trades made through Hypo's Gateway account; all those trades were sales.

¶ 9 In the course of investigating this trading activity, Commission staff sought to identify the beneficial owners of the shares being traded in Hypo's Gateway account. They have been unsuccessful. When Commission staff asked Hypo for information, Hypo responded as follows:

> "Following a careful consideration of the respective legal aspects, therefore we have to tell you, that we will not be able to provide you with any kind of information, related to our clients."

¶ 10 The executive director says that without this information, Commission staff are unable to investigate the trading by the beneficial owners.

¶ 11 Following discussions with Commission staff, Gateway voluntarily agreed to suspend trading in the Hypo account.

¶ 12 At the hearing on the merits, the executive director will be seeking an order prohibiting Hypo from trading or purchasing any securities or exchange contracts in British Columbia until the identities of all of the beneficial owners of Hypo accounts at dealers in British Columbia are known to Commission staff.

¶ 13 In the meantime, the executive director argued that it is necessary and in the public interest that the temporary order be extended until that hearing is held a decision rendered.

III Discussion and analysis

A The test for extending a temporary order

¶ 14 To extend a temporary order, the commission must find that it is necessary and in the public interest to do so.

¶ 15 Section 161(3) of the Act says:

> 161(3) If the commission . . . considers it necessary and in the public interest, the commission may . . . make an order extending a temporary order until a hearing is held and a decision rendered.

¶ 16 In *Terry James Minnie and Raymond Patrick Shaw* 2004 BCSECCOM 677, the commission said this about the standard of proof required to establish that an extension of a temporary order is necessary and in the public interest:

> As stated in *Fairtide*, there is no bright line test. The commission considers evidence using its expertise and specialized understanding of the markets . . . to determine what is in the public interest . . .
>
> Staff must produce evidence for the commission independently to assess whether there is *prima facie* evidence of the misconduct alleged and whether, in the circumstances, the extension is necessary and in the public interest. The evidence must be more than staff's opinion or belief . . .
> . . .
> . . . where there is *prima facie* evidence of egregious behaviour, our main aim must be to protect the public.

¶ 17 This enunciation of the standard of proof for extending a temporary order is useful in cases like *Fairtide* and *Minnie*, where the circumstances involve a known respondent and clearly defined alleged misconduct.

¶ 18 However, there is another category of cases, involving conduct that appears could be in contravention of the Act or otherwise be contrary to the public interest by persons unknown and, because they are unknown, it is not possible to gather the information necessary to meet the *prima facie* evidence standard described in *Fairtide* and *Minnie.*

¶ 19 For that category of cases, *LOM (Holdings) Limited et al* 2005 BCSECCOM 144 is instructive. In that case, the commission noted that it could be in the public interest to issue a cease trade order absent evidence of inappropriate trading activity. The commission said, "There is also no evidence of any inappropriate trading activity. Even without such evidence, it could still be in the public interest to make a cease trade order."

¶ 20 The commission has a broad public interest mandate to protect investors and maintain confidence in our capital markets, a mandate that has found strong support in the courts. (See, for example: *Brosseau v Alberta Securities Commission*, [1989] 1 SCR 301; *Pezim v British Columbia (Superintendent of Brokers)*, [1994] 2 SCR 557 at 589; *British Columbia Securities Commission v Branch*, [1995] 2 SCR 3 at 26; *Global Securities Corp v British Columbia (Securities Commission)*, [2000] 1 SCR 494; *Re Cartaway Resources Corp*, [2004] 1 SCR 672.)

¶ 21 In considering whether it is necessary and in the public interest to extend a temporary order, the commission must assess the risk to the capital markets. If that risk assessment is hampered because commission staff cannot obtain information on a timely basis about the trading of individuals whose identities are protected by foreign banking secrecy laws, the balance of interests must be tilted in favour of protecting our capital markets. Otherwise, persons intent on engaging in activities that would damage our capital markets could have a free pass simply by conducting their activities through the offices of a financial institution located in a jurisdiction with banking secrecy laws that suited their purposes. That would be an outcome inconsistent with the public interest.

B The executive director's arguments

¶ 22 The executive director says it is a reasonable inference that some or all of the beneficial owners of the shares traded in the Hypo account at Gateway directly or indirectly participated in the spam campaign related to Compliance Systems.

¶ 23 The executive director says that Hypo's continued trading on behalf of unknown beneficial owners through British Columbia dealers poses an ongoing risk and a threat to the public interest in the form of investor losses and damage to the integrity of the market.

C Hypo's arguments

¶ 24 Hypo does not dispute that it is in the public interest that the commission have policies and procedures to combat market manipulations effected through spam campaigns and other means.

¶ 25 However, Hypo argued that we ought not to extend the temporary order for these reasons:

1. There is no evidence of a manipulation having occurred in connection with the spam, although it admits that there is evidence that (i) an improper spam campaign has taken place, and (ii) a Hypo client at least knew of the spam campaign and may have participated in it by trading through the bank's accounts in British Columbia.

2. The commission should recognize that some trading in British Columbia is directed from off-shore, in some cases from countries that have banking secrecy laws. Although banking secrecy laws may appear odd and even suspicious to those in British Columbia, the jurisdictions that have such laws, such as Switzerland and Liechtenstein, have properly functioning capital markets.

3. It has made representations and undertakings to the commission, which in practical terms represent the maximum extent to which the Bank can cooperate while complying with Liechtenstein law.

4. There is no evidence of any "spamming" or suspect trading since May of 2007.

5. There is no suggestion that the Bank itself was involved in any improper conduct or activity. There is no evidence to suggest, and it is not suggested, that the Bank had advance notice that one or more of its clients would come under suspicion of conducting an improper spam campaign.

D Analysis

¶ 26 Spam is simply a new tool in an old game. It takes advantage of modern technology, the internet, to disseminate false, misleading and promotional information about an issuer in order to facilitate a classic "pump and dump" manipulation. Its sinister aspect is that the speed of communication over the

internet dramatically shortens the time necessary to profit from the manipulation. That same speed reduces the risk of detection while the manipulation is underway.

¶ 27 The commission has stated that trading abuses in the US over-the-counter markets conducted through British Columbia securities dealers damage the reputation of our capital markets (see BC Notice 2007/24 *BCSC Response to Abusive Practices in British Columbia Involving US Over-the-Counter Markets* published June 25, 2007). Damage to the reputation of our markets puts their integrity at risk.

¶ 28 We disagree with Hypo's submission that there is no evidence of a manipulation having occurred in connection with the spam campaign. The high volume of sales of spammed securities from Hypo's Gateway account reveals a trading pattern that on its face appears consistent with patterns present in abusive trading schemes in the US over-the-counter markets. That the trading was contemporaneous with a spam campaign raises suspicion even further.

¶ 29 It is a fact, as Hypo says, that some trading in British Columbia is directed from off-shore, in some cases from countries that have banking secrecy laws. However, the secrecy laws of foreign jurisdictions are not relevant to the Commission's exercise of its public interest responsibility. The secrecy laws in another jurisdiction cannot serve as a shield against the legitimate exercise by the commission of its powers to enforce securities regulation in British Columbia, as stated by the commission in *Stephen C. Sayre et al* [2000] 21 BCSC Weekly Summary 75 in language approved by the British Columbia Court of Appeal (see *Exchange Bank & Trust Inc. v. British Columbia Securities Commission*, 2000 BCCA 389 (QL) at paras. 14, 15; *Exchange Bank & Trust Inc. v. British Columbia Securities Commission*, 2000 BCCA 549 (QL)):

> [T]he property subject to the Orders is in British Columbia and it is the securities laws of British Columbia . . . that are alleged to have been contravened. [Exchange Bank and Trust] chose to locate assets outside the jurisdiction of Nevis and must accept that those assets are subject to laws of the jurisdiction in which they are located, in this case British Columbia. It would be an utter abandonment of the public interest if we were to conclude that a party subject to secrecy laws in another jurisdiction could use those laws to shield themselves from the legitimate exercise of powers to enforce securities regulation in British Columbia. In short, the Nevis privacy laws are not relevant.

¶ 30 Hypo says that jurisdictions that have banking secrecy laws have properly functioning capital markets, naming Switzerland and Lichtenstein specifically.

That is not relevant to this application. The question before us is the impact those laws have on the ability of the commission to regulate our markets.

¶ 31 Hypo promises to take steps to stop the suspicious trading, including refusing any trading orders involving stocks identified on the commission's SpamWatch database. That is fine as far as it goes, but ultimately it is beside the point. It is not an answer to circumstances that impair the commission's obligation regulate its own markets in the public interest.

¶ 32 We considered it necessary and in the public interest that Hypo be prohibited from trading in British Columbia until the hearing is held and a decision rendered, for these reasons:

1. We find that there is evidence of suspicious trading that could be an attempt to manipulate the market in Compliance Systems shares through the Hypo account at Gateway.

2. There appears to have been conduct that contravenes the Act or is otherwise contrary to the public interest by persons unknown. That presents a risk to our markets. Because commission staff cannot establish on a timely basis the identities of those making the suspicious trades, they cannot investigate those trades, never mind gather the information necessary to meet the *prima facie* evidence standard described in *Fairtide* and *Minnie*.

3. Persons unknown that appear to be associated with suspicious trading chose to use Hypo as a conduit to make their trades. The trading is suspicious because it appears consistent with manipulative activity.

   Gateway has stopped trading Hypo's account, but Hypo has accounts at other dealers. We have no way of knowing whether the beneficial owners involved in the trading in the Gateway account have any connection with the beneficial owners at the other accounts. There is also nothing to stop Hypo from opening new accounts at other dealers on the instructions of these same clients. Without an extension of the temporary order, Hypo would be free, on the instructions of those clients, to continue to trade through any number of accounts at British Columbia dealers. That presents a risk to our markets.

4. Extending the temporary order is the only way to be sure that Hypo's clients do not continue to trade through dealers in British Columbia until the hearing is held and a decision rendered.

E Other arguments

¶ 33 The parties made further arguments that are more relevant to the issue of whether Hypo ought to be subject to a permanent cease-trade order than to our consideration of whether the temporary order ought to be extended. Although those arguments will be of interest to the panel that hears the matter on its merits, they were not relevant to this application.

IV Decision

¶ 34 We therefore decided to extend the temporary order until a hearing is held and a decision rendered.

¶ 35 October 15, 2007

¶ 36 **For the Commission**

Brent W. Aitken, Vice Chair

Neil Alexander, Commissioner

Robert J. Milbourne, Commissioner