

2010 BCSECCOM 579

**Steven Peter Kylo
Mercury Capital S.A., Moenkopi Resources Inc.,
and Frey Mining Company Ltd.**

Section 161 of the *Securities Act*, RSBC 1996, c. 418

Hearing

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| Panel | Brent W. Aitken Don Rowlatt Suzanne K. Wiltshire | Vice Chair Commissioner Commissioner |
| Hearing dates | July 6 and 7, 2010 | |
| Submissions completed | July 22, 2010 | |
| Date of Findings | October 7, 2010 | |
| Appearing | Mila A. Pivnenko For the Executive Director | |

Findings

I Introduction

- ¶ 1 This is the liability portion of a hearing under sections 161(1) and 162 of the *Securities Act*, RSBC 1996, c. 418.
- ¶ 2 In a further amended notice of hearing issued February 11, 2010 the executive director alleges that, between 2002 and 2006, the respondents engaged in the following misconduct, all in contravention of the Act:
- Steven Peter Kylo, Frey Mining Company Ltd., Moenkopi Resources Inc. and Mercury Capital S.A. traded and distributed securities without being registered and without filing a prospectus,
 - Kylo, Moenkopi and Mercury made misrepresentations, and
 - Kylo perpetrated a fraud.
- ¶ 3 None of the respondents appeared or was represented by counsel at the hearing.
- ¶ 4 All dollar amounts are in US dollars.

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II Background

- ¶ 5 Kylo used the three corporate respondents, Frey, Moenkopi and Mercury, to raise \$1.14 million from 40 investors in British Columbia, Alberta, Ontario and the United States. In doing so, he misrepresented the nature of the so-called investments, and perpetrated a fraud by using investor's funds to enrich himself and members of his family, and for other purposes.
- ¶ 6 Kylo was the sole directing mind and will of all of the corporate respondents. He was the sole director and officer of Frey and Moenkopi, and was the sole representative of Mercury, a Turks and Caicos company. During the relevant period, he was resident in British Columbia and conducted much of the activity relevant to the notice of hearing here.
- ¶ 7 Kylo sold the investments in Frey, Moenkopi and Mercury directly and through individuals to whom he paid commissions. Kylo prepared the written materials that these individuals gave to investors, and provided information directly to investors and through these individuals. He alone controlled the flow of funds into and out of Frey, Moenkopi and Mercury, and he alone managed their affairs.

III Analysis and Findings

A Illegal trading and distribution

- ¶ 8 The executive director alleges that the respondents contravened sections 34(1) and 61(1).
- ¶ 9 Section 34(1) says "a person must not . . . trade in a security . . . unless the person is registered in accordance with the regulations"
- ¶ 10 Section 61(1) says ". . . a person must not distribute a security unless . . . a preliminary prospectus and a prospectus respecting the security have been filed with the executive director" and the executive director has issued receipts for them.
- ¶ 11 Section 1(1) defines trade:
- "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);

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- ¶ 12 Section 1(1) defines distribution as “a trade in a security of an issuer that has not been previously issued.”
- ¶ 13 Kylo used Frey to raise \$500,000 from 13 investors who received “Deeds of Beneficial Interests” that purportedly gave them a percentage in future sale proceeds of gold and other precious metals from a Utah mine.
- ¶ 14 Kylo used Moenkopi to raise \$75,000 from two investors, who purportedly participated in something styled “Private Placement Programs Bank Instrument Forfeiting.” They were promised returns of 10 times their initial investment in as little as two to four weeks.
- ¶ 15 Kylo used Mercury to raise \$565,000 from 25 investors, to whom he sold “Capital Contribution Agreements.” They were promised monthly returns of 25% for four months and the return of their principal at the end of the fourth month.
- ¶ 16 The Frey, Moenkopi and Mercury investments were investment contracts. An investment contract is an investment of money in a common enterprise with profits to come from the efforts of others. (See *SEC v. W. J. Howey Co.* 328 U.S. 293 (1946), *SEC v. Glen W. Turner Enterprises, Inc.* 474 F. 2d 476 (1973), *Pacific Coast Coin Exchange v. Ontario Securities Commission*, [1978] 2 S.C.R. 112.)
- ¶ 17 Participation in Frey, Moenkopi and Mercury required an investment of money. The investors’ profits were to come from the efforts of persons other than themselves – the evidence is clear that once they deposited their funds, investors were not required to do anything else to earn their returns. The commonality that is required by the cases cited above existed between the respondents and the investors.
- ¶ 18 We find that the Frey, Moenkopi and Mercury investments were securities.
- ¶ 19 Kylo created the Frey, Moenkopi and Mercury securities. He solicited sales of the securities, and sold the securities, directly and through others. His activities fell within paragraphs (a) and (f) of the definition of trade.
- ¶ 20 Frey, Moenkopi and Mercury issued the securities, a trade as defined in paragraph (a) of the definition.
- ¶ 21 We find that all of the respondents traded securities.
- ¶ 22 The Frey, Moenkopi and Mercury securities were not previously issued. We find that the trading by the respondents in those securities were distributions.

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¶ 23 We have found that the respondents traded and distributed the Frey, Moenkopi and Mercury securities. None of the respondents was registered under the Act. None has filed a prospectus. There is no evidence any exemption applies.

¶ 24 We find that the respondents contravened sections 34(1) and 61(1) when they traded and distributed the Frey, Moenkopi and Mercury securities.

B Misrepresentation

¶ 25 The executive director alleges that Kyлло, Moenkopi and Mercury contravened section 50(1)(d):

¶ 26 Section 50(1)(d) says:

50. (1) A person, . . . with the intention of effecting a trade in a security, must not

. . .

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

¶ 27 Section 1 defines “misrepresentation” as “an untrue statement of a material fact” or “an omission to state a material fact that is . . . necessary to prevent a statement that is made from being false or misleading in the circumstances in which it was made.”

¶ 28 Section 1 defines “material” fact as a fact about a security “that significantly affects, or could reasonably be expected to significantly affect, the market price or value” of a security.

¶ 29 Moenkopi and Mercury, at Kyлло’s direction, told investors that:

- their funds would be invested with traders dealing in large private high-yield trading programs
- their funds would not be put at risk
- investors in Moenkopi would receive returns of ten times their initial investment in a time period of as short as two to four weeks
- investors in Mercury would receive monthly returns of 25% for four months and the return of their principal at the end of the fourth month

¶ 30 These statements were false and misleading. Only 15% of the investors’ funds were placed with traders, but not in the high-yield trading programs described, which in fact do not exist. The investor funds placed with the traders generated no returns and were lost.

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- ¶ 31 Investors' funds were not preserved in bank accounts as Kylo promised, nor were the funds available to the investors on demand, as Kylo promised. None of the investors received returns anywhere near those promised, and indeed those returns were not possible.
- ¶ 32 The evidence included a report from Dr. Peter Klein. In addition to a law degree and a Masters in Business Administration from the University of Western Ontario, Dr. Klein has a doctorate in finance from the University of Toronto. He is a Chartered Financial Analyst, a Chartered Business Valuator, and a Certified General Accountant. He was an investment banker for nine years and is currently a full professor in the Faculty of Business Administration at Simon Fraser University where his research is focused primarily on investments and derivative securities. He is also a portfolio manager at an investment management firm in Vancouver. He has over 14 years of teaching and research in finance and has published extensively on finance and other subjects.
- ¶ 33 We accept Dr. Klein as an expert for the purpose of providing relevant opinion evidence in the hearing.
- ¶ 34 The following paraphrases relevant portions of Dr. Klein's report:
- The high yield programs Moenkopi and Mercury described to investors do not exist.
 - Risk-free investments do not exist.
 - In general there is a positive correlation between risk and return: if a given investment has higher risk then the expected return must be higher to compensate the investor for bearing that risk. This is well established through financial economic theory as well as extensive empirical study of capital market risks and returns.
 - In short, financial theory would say that as the return increases, the incidence of consistency of those returns decreases.
 - Dr. Klein concludes, "I am not aware of any legal risk-free trading or investment opportunity that could generate such high returns. As [my] empirical analysis of hedge fund managers . . . shows, even the most aggressive hedge fund managers following the most sophisticated trading strategy using the maximum amount of leverage have been unable to produce such high returns, and the returns they were able to produce were accompanied by extreme amounts of risk."
- ¶ 35 In other words, not only did Moenkopi and Mercury fail to pay the returns they promised investors, it is impossible to earn returns of that magnitude through legal means.

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- ¶ 36 A statement that a security exists when it does not obviously significantly affects its value. A statement that there is little or no risk associated with investment in a security, when in fact the risk is substantial, significantly affects its value. A statement that significantly overstates a security's expected return significantly affects its value. We find the false and misleading statements related to material facts. We find the statements were misrepresentations.
- ¶ 37 All of the misrepresentations were made for the sole purpose of inducing investors to invest in Moenkopi or Mercury, and therefore were made with the intention of effecting a trade in those securities, and we so find.
- ¶ 38 We find that Kylo, Moenkopi and Mercury contravened section 50(1)(d).

C Fraud

- ¶ 39 The notice of hearing alleges that Kylo engaged in transactions, or a series of transactions, that perpetrated a fraud, contrary to sections 57(b) and 57.1(b) of the Act.
- ¶ 40 Sections 57(b) and 57.1(b) say:
57. A person . . . 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
...
(b) perpetrates a fraud on any person in British Columbia.
- 57.1 A person . . . 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
...
(b) perpetrates a fraud on any person anywhere.

- ¶ 41 The language describing fraud in sections 57(b) and 57.1(b) is identical. Section 57(b) was considered by the British Columbia Court of Appeal in *Anderson v. British Columbia (Securities Commission)*, 2004 BCCA 7. The Court said:

29 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 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.

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¶ 42 The Court cited the elements of fraud from *R. v Théroux*, [1993] 2 SCR 5 (at p. 20):

. . . 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).

¶ 43 The evidence provides clear and convincing proof that Kylo committed what *Théroux* describes as a "prohibited act" and that it caused deprivation. He made misrepresentations with the intention of effecting a trade in Mercury securities. He did not use the investors' funds in the manner he told investors the funds would be used.

¶ 44 Mercury raised \$565,000 from 25 investors. All of them lost their capital and 18 of them received no return on their investment. The remaining seven received some modest payments (\$50,000 in the aggregate), well short of the promised 25% returns. Those payments were funded, not from investment returns, but from the investments of subsequent investors.

¶ 45 None of the funds was used to purchase any of the investments Kylo described to investors. Instead, the money went primarily to Kylo, his family members, his associates, and others. Expenditures to Kylo (\$252,000), his wife (\$21,000) and daughter-in-law (\$16,000) accounted for over half.

¶ 46 The evidence provides clear and convincing proof that Kylo had subjective knowledge of the deceit, and that it could have as a consequence the deprivation of others.

¶ 47 Kylo created the Mercury securities. He alone controlled the flow of the investor funds. He had to have known that the funds he was taking from investors could not be invested in the high yield investment programs he described to investors because those programs do not exist. In any event, he placed no money with

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traders purporting to trade in those programs (he could not – they do not exist). He knew he was distributing investor funds to himself, his family members, and others. He knew this is not what he told investors would happen to their money.

¶ 48 We find that Kylo committed prohibited acts, had subjective knowledge of the prohibited acts, and that those acts would result, not merely in the investors' pecuniary interests being put at risk, but in their actual deprivation.

¶ 49 We find that Kylo perpetrated a fraud on persons in British Columbia and elsewhere, and in so doing contravened sections 57(b) and 57.1(b).

IV Summary of Findings

¶ 50 We find that:

1. all of the respondents traded in securities without being registered to do so, contrary to section 34(1) of the Act, and distributed those securities without filing a prospectus, contrary to section 61(1) of the Act;
2. Kylo, Moenkopi and Mercury made misrepresentations, contrary to section 50(1)(d), when they lied to investors about how investors' funds would be invested, the returns offered, and the risk associated with the investments; and
3. Kylo perpetrated a fraud, contrary to sections 57(b) and 57.1(b), when he lied to investors, and used investors' funds to enrich himself and his family members, and for other purposes.

V Submissions on sanction

¶ 51 We direct the parties to make their submissions on sanctions as follows:

By October 22 The executive director delivers submissions to the respondents and to the secretary to the Commission

By November 5 The respondents deliver response submissions to the executive director and to the secretary to the commission; any party seeking an oral hearing on the issue of sanctions so advises the secretary to the Commission

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By November 15 The executive director delivers reply submissions (if any) to the respondents and to the secretary to the Commission

¶ 52 October 7, 2010

¶ 53 **For the Commission**

Brent W. Aitken
Vice Chair

Don Rowlatt
Commissioner

Suzanne K. Wiltshire
Commissioner