2011 BCSECCOM 490

Blackmont Capital Inc., Dean Shannon Duke and Investment Industry Regulatory Organization of Canada

Section 28 of the *Securities Act*, RSBC 1996, c. 418

Hearing and Review

Panel	Brent W. Aitken	Vice Chair
	David J. Smith	Commissioner
	Shelley C. Williams	Commissioner
Dates of Hearing	September 12, 2011	
Date of Decision	October 27, 2011	
Appearing		
Nigel Campbell	For Blackmont Capital Inc.	
Ronald. N. Pelletier	For Dean Shannon Duke	
Barbara Lohman	For Investment Industry Regulatory Organization of Canada	

Decision

I Introduction

¶ 1 This is a hearing and review under section 28 of the *Securities Act*, RSBC 1996, c. 418 of a decision of a hearing panel of the Investment Industry Regulatory Organization of Canada (IIROC) that Blackmont Capital Inc. and Dean Shannon Duke contravened IIROC rules (September 1, 2010) and imposing penalties on them (December 20, 2010).

II Background

¶ 2 A notice of hearing issued by IIROC on October 29, 2009 contained three counts of alleged contraventions of IIROC rules by the respondents.

¶ 3 Count 1 alleged that between January 2003 and March 2007, Blackmont and Duke entered into and participated in an arrangement which involved the payment of commissions to a third party who placed orders in the accounts of seven clients, without disclosing the details and the existence of the arrangement to the clients, contrary to IIROC Rules 29.6 and 29.1.

¶ 4 Count 2 alleged that between January 2003 and October 2007, Blackmont and Duke effected trades in the accounts of clients based on the instructions of a third party without the existence of a duly executed trade authorization, contrary to IIROC Rule 200.1(i)(3).

¶ 5 Count 3 alleged that between January 2003 and October 2007, Blackmont failed to obtain documents and verify identities for some accounts as required under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* and in doing so contravened IIROC Rule 29.1.

¶ 6 The IIROC hearing panel found that Blackmont and Duke contravened IIROC rules under counts 1 and 2 and that Blackmont contravened IIROC rules under count 3.

¶ 7 Blackmont and Duke are asking us to set aside the panel's finding on Count 1, and in any event, to reduce the penalty the panel imposed related to that finding. Duke is also asking us to reduce the panel's penalty decision related to its finding on Count 2.

¶ 8 IIROC is asking us to vary the penalty decision by ordering Blackmont and Duke to disgorge the commissions earned by each of them in connection with the contraventions found by the panel.

III Analysis

A Standard of Review

¶ 9 Under section 28 of the Act the Commission may review a decision of a self regulatory body like IIROC. The Commission may confirm or vary the decision or make another decision it considers proper.

¶ 10 The Commission's standard for reviewing decisions under section 28 is set out in section 5.9(a) of BC Policy 15-601 *Hearings* as follows:

> **"5.9 Form and scope of reviews**
>
> **(a)** ***Where the review of an SRO decision proceeds as an appeal*** – The Commission does not provide parties with a second opinion on a matter decided by an SRO. If the decision under review is reasonable and was made in accordance with the law, the evidence, and the public interest, the Commission is generally reluctant to interfere simply because it might have made a different decision in the circumstances. For this reason, generally, the person requesting

the review presents a case for having the decision revoked or varied and the SRO responds to that case.

In these circumstances, the Commission generally confirms the decision of the SRO, unless

- the SRO has made an error of law
- the SRO has overlooked material evidence
- new and compelling evidence is presented to the Commission or
- the Commission's view of the public interest is different from the SRO's."

¶ 11 As stated in BCP 15-601, the Commission is reluctant to interfere in SRO decisions that, among other things, are reasonable. However, if the Commission finds that an SRO decision under review is not reasonable, it will consider whether to confirm or vary the decision, or make another decision it considers proper.

¶ 12 The respondents say that the IIROC hearing panel erred in law because it:

- confused the requirements of IIROC Rule 29.6 and section 53 of the *Securities Rules* BC Reg 194/97 made under the *Securities Act* RSBC 1996 c. 418, and
- found that the respondents contravened IIROC Rule 29.6, section 53 of the *Securities Rules,* and IIROC Rule 29.1 without sufficient evidence.

B Liability Decision

1. Factual background

¶ 13 During the relevant period, Blackmont (then under another name) carried on business as a registered dealer in British Columbia. Duke was employed by Blackmont as a registered representative.

¶ 14 Seven large banks based in Switzerland and Liechtenstein opened accounts for undisclosed bank customers with Blackmont and authorized Clarion Finanz AG, a Swiss-based asset management company, to give trading instructions in the accounts on behalf of the banks' customers. The principal of Clarion was Carlos Civelli.

¶ 15 The banks' customers entered into agreements with the banks authorizing Clarion to manage their portfolios, and entitling Clarion to commission rebates for doing so.

¶ 16 The banks' customers entered into separate agreements with Clarion setting out, among other things, investment strategy, fees and commissions. The banks are not a party to those agreements and do not know the terms of the agreements.

¶ 17 Duke did the trading in the accounts on Clarion's instructions. He agreed with Clarion to rebate to Clarion 30% of the commissions. Duke retained 20% of the commissions and the remaining 50% went to Blackmont.

¶ 18 IIROC Rule 29.6 requires a registrant to obtain prior written consent of the client before entering into any commission-sharing arrangement. Section 53 of the *Securities Rules* requires a registrant to disclose commission-sharing arrangements to the client. Following a sales compliance review by IIROC staff in 2007 neither Blackmont nor Duke were able to produce the European banks' consents to the commission-sharing arrangement with Clarion, nor were they able to produce any records showing that they had disclosed the arrangement to the banks. Blackmont and Duke asked Civelli to obtain the consents from the banks. When Civelli refused, Blackmont terminated the commission-sharing arrangement.

2. Contravention of IIROC Rule 29.6

¶ 19 The allegations in Count 1 of the IIROC notice of hearing arise from the commission-sharing arrangement. Count 1 alleges that Blackmont and Duke entered into the commission-sharing arrangement "without disclosing the details and the existence of the arrangements" with the clients "contrary to Rule 29.6 . . . and/or . . . Rule 29.1."

¶ 20 IIROC Rule 29.6 says:

> "29.6. No Dealer Member or any . . . employee . . . of a Dealer Member shall give, offer or agree to give or offer, directly or indirectly, to any . . . agent of a customer . . . a gratuity, advantage, benefit or any other consideration in relation to any business of the customer with the Dealer Member, unless the prior written consent of the customer has first been obtained."

¶ 21 In finding that the respondents contravened Rule 29.6, the IIROC hearing panel said:

> "Rule 29.6 is clear and unequivocal. Rule 29.6 requires that the Respondents obtained from the Banks prior to the payment of any of the commissions under the Commission Arrangement the Banks' written consent to such payment. Without this prior written consent, neither Blackmont nor Mr. Duke should have

> made or authorized any payments under the Commission Arrangement.
>
> Indeed, Rule 29.6 requires that [Blackmont] and Mr. Duke prior to agreeing to the Commission Arrangement should have obtained this prior written consent."

¶ 22 There is an obvious discrepancy between the language in Count 1 of the notice of hearing and the language in Rule 29.6. The allegation in the notice of hearing is that the respondents' failure to disclose to the banks the details and existence of the commission-sharing arrangement with Civelli was a contravention of Rules 29.6 and 29.1. Yet, as far as Rule 29.6 is concerned, that rule says nothing about disclosure. It requires nothing other than the obtaining of consent.

¶ 23 The allegation in Count 1 therefore is not and can not be an allegation that Blackmont and Duke contravened Rule 29.6 – Rule 29.6 contains no disclosure requirement. Count 1 does not allege any other misconduct that could be a contravention of Rule 29.6, and the particulars in the notice of hearing cite only the alleged failure to disclose as required under section 53 of the *Securities Rules* as a basis for the contravention of Rule 29.6. Therefore, the only allegation in Count 1 is that the respondents' failure to disclose the existence and details of the commission-sharing arrangement to the banks was a contravention of Rule 29.1

¶ 24 A notice of hearing is the foundation of hearings before IIROC panels and this Commission. It identifies the alleged misconduct that the respondent has to meet. It establishes the issues to be determined at the hearing. It follows that a panel does not have jurisdiction to determine matters not alleged in the notice of hearing. (Particulars need not be in the notice of hearing, but must relate to an allegation that is in the notice.)

¶ 25 It follows that the IIROC hearing panel did not have the jurisdiction to make a finding that the respondents contravened Rule 29.6 because the notice of hearing did not allege misconduct that would constitute a contravention of that Rule. The panel therefore erred in law in finding that the respondents contravened Rule 29.6.

¶ 26 We set aside the IIROC hearing panel's finding that the respondents contravened IIROC Rule 29.6.

3. Contravention of IIROC Rule 29.1

¶ 27 Count 1 alleges that the respondents' failure to disclose the commission-sharing arrangement was a contravention of IIROC Rule 29.1.

¶ 28 The requirement to disclose was in section 53 of the *Securities Rules*. These are the relevant portions of section 53:

> "53 (2) . . . if a registrant . . . pays to . . . another person a commission or other compensation related to the purchase or sale of a security . . . on behalf of a client . . . the registrant must disclose the compensation to the client on whose behalf the purchase or sale is made.
>
> (3) . . . the disclosure required [under subsection (2)] must . . . be made . . . [at] the time the purchase or sale is made or as soon as practicable after that time."

¶ 29 IIROC Rule 29.1 says:

> "29.1. Dealer Members and each . . . Registered Representative . . . of a Dealer Member . . . shall not engage in any business conduct or practice which is unbecoming or detrimental to the public interest . . . ."

¶ 30 The panel found that the respondents contravened Rule 29.1 because they did not comply with the provisions of section 53 in relation to the commission-sharing arrangement.

Section 53 of the Securities Rules

¶ 31 This is how the panel describes the requirements in section 53:

> "Section 53 expands upon the provisions of Rule 29.6 by requiring that the written disclosure that the Respondents were to provide to their clients prior to the payment of any share of the commissions to [Clarion] under the Commission Arrangement should include details of the amount of commission that was paid to [Clarion] and the service for which this commission was to be paid."

¶ 32 This paragraph presents two problems. First, it is not clear what the panel means when it says that section 53 "expands upon the provisions of Rule 29.6." There is no suggestion in section 53 that it is related in any way to Rule 29.6, although it deals with the same general subject matter. Second, the panel implies that section 53 would have required disclosure of the commission-sharing arrangement "prior to the payment of any share of the commissions" to Clarion. This is a misinterpretation of section 53. Section 53 requires disclosure to the client of an arrangement related to the purchase or sale of a security only "at the time the purchase or sale is made or as soon as practicable thereafter."

¶ 33 This paragraph is one of several that show the confusion in the panel's reasoning in terms of the requirements of Rule 29.6 and section 53:

- The panel incorrectly described section 53 as an "expansion" of Rule 29.6.
- The panel misinterpreted section 53 as to the time frame in which disclosure must be made.
- In considering the respondents' attempts to rectify the records, the panel refers to the banks' signing "the necessary documentation to satisfy the provisions of Rule 29.6 and Section 53". The banks would have had to sign Rule 29.6 consents but would not have had to sign anything in connection with the requirements of section 53.
- In considering the onus of proof, the panel referred to "copies of the required prior written consents from the Banks as required by Rule 29.6 and Section 53". There is no requirement in section 53 to obtain consents.

Sufficiency of evidence - contravention of section 53

¶ 34 The panel found that, for IIROC to prove the respondents' contravention of section 53, it was sufficient for IIROC to prove only that there was no evidence in the respondents' files that they had disclosed the commission-sharing arrangement to the banks as required by that section.

¶ 35 The respondents say that because section 53 does not require any records to be kept in the registrant's files, it was not open to the panel to find a contravention of section 53 solely on that basis. They say that to prove a contravention of that section, IIROC must produce other evidence that the respondents did not make the required disclosure.

¶ 36 In its liability decision, the IIROC hearing panel said this about the importance of keeping proper records:

> "Disclosure of the identity of these market participants, their trading authority and their means of compensation is achieved through the creation and retention of various forms of records. . . . Dealer Members and registered representatives as gatekeepers of Canadian capital markets are required to keep such records. The contents of such records and how there [*sic*] are to be kept is spelled out in the rules and regulations governing all parties who so participate as gatekeepers."

¶ 37 Blackmont and Duke, as participants in a regulated industry, are expected to keep proper records. Among those records a registrant would be expected to keep are records showing compliance with regulatory requirements.

¶ 38 Here, the registrants ought to have retained records of having made disclosure to the clients, but they are unable to produce those records and they concede that they do not exist. Neither is there any evidence to explain why the records do not exist. In these circumstances, the panel was entitled to infer from the absence of the records that the respondents did not make the disclosure required by section 53.

¶ 39 We confirm the IIROC hearing panel's finding that the respondents contravened section 53 of the *Securities Rules*.

Contravention of IIROC Rule 29.1

¶ 40 The panel found that the respondents, in contravening section 53 of the *Securities Rules*, engaged in business conduct or practice which is unbecoming or detrimental to the public interest, contrary to IIROC Rule 29.1.

¶ 41 The panel's finding is based on its view that the matter before it "involves more than merely a case of missing paperwork or mere administrative error." Implicit in its finding is that the contravention of section 53 would not amount to a contravention of Rule 29.1 if the respondents' contravention of section 53 was through inadvertence or error.

¶ 42 In *Octagon*, [2007] IDACD No. 16, the Ontario Securities Commission, considered whether the negligent contravention of IIROC rules would constitute a contravention of Rule 29.1. The OSC panel cited *Gareau*, [2005] IDACC No. 25:

> "A majority of the Hearing Panel found that there was no breach in this case. By-Law 29.1 is intended to focus primarily on quasi-criminal and unethical conduct rather than negligent conduct. There was no evidence that Gareau acted unethically in the sense that he acted for an improper purpose. If anything, this was a case of negligence rather than one of personal gain or conflict of interest."

¶ 43 The OSC went on to say:

> "There is no evidence Octagon acted unethically or for an improper purpose. There is no evidence that Octagon had a conflict of interest. There is no evidence of dishonest motive or blameworthy conduct by Octagon . . . .

> Octagon was under a regulatory duty which required it to exercise reasonable care. Breach of a duty of care is negligence, but it does not follow that mere negligence constitutes a disciplinary offence. . . . It could be said that Octagon was negligent but that finding, if made, is not sufficient to constitute conduct unbecoming or detrimental to the public interest contrary to By-Law 29.1. Only aggravated negligence could lead to that conclusion."

¶ 44 The OSC also cited *JC Dickson Davidson Partners Ltd.*, [1989] TSEDD No. 10:

> "The respondent was not actuated by dishonest or improper motives, and we are unable to say that, in the particular circumstances, his negligence was of such a character as to fall within the description of 'conduct that is unbecoming' . . . ."

¶ 45 In *David Moffat Little,* a 2007 decision of an Ontario District Council IDA panel, said this:

> "It was argued, on behalf of Mr. Little, that every transgression by an employee of a Member does not, of itself, amount to conduct unbecoming or to conduct detrimental to the public interest. As a general proposition, that is probably a sound contention. However, we have difficulty accepting the generality of the statement found in *IDA v. Bahcheli,* [2004] IDACD No. 12, that:
>
> > . . . Implicit in the charge [of conduct unbecoming] is a degree of moral turpitude or, at the very least, bad faith on the part of the Respondent.
>
> Moral turpitude or bad faith could certainly turn, what otherwise might be a minor transgression, into conduct unbecoming. However, we are unable to accept that they are an essential ingredient of all charges of conduct unbecoming. . . .
>
> It is our view that transgressions must be looked at in the light of the reputation which the investment industry must maintain in the eyes of the public and the effect which the transgression could have upon that reputation. The public interest demands that Members of the industry, and their employees, be held to a very high standard of financial probity. They must be trusted because they handle other people's money. They must be seen to be trustworthy. If conduct could even appear to cast doubt upon that

> probity, then it could be detrimental to the public interest and constitute conduct unbecoming."

¶ 46 The only evidence the panel relies on to support its finding that the respondents' failure to make disclosure was not inadvertent was the reaction of Civelli when asked to obtain the banks' consents. The panel says:

> "This is not a case of 'inadvertence [*sic*] documentary deficiencies'. If such were the case, surely Mr. Civelli and the Banks would have signed the necessary documentation to satisfy the provisions of Rule 29.6 and Section 53 and continue trading in the Accounts.
> . . .
> One would have thought that the payment of $682,725.62 to [Clarion] on Mr. Civelli's instructions over the Relevant Period, an expanse of a little over 4 years, would have encouraged Mr. Civelli to remedy the claimed inadvertent documentary deficiency in order for the parties to continue what would appear to have been a rather lucrative financial arrangement for [Clarion]."

¶ 47 The panel's reasoning in these paragraphs is obscure. It may be that the panel is inferring that if the commission-sharing arrangements were known to the banks, remedying the paperwork would have been a non-issue. Under that line of reasoning, it would follow that Civelli's refusal to cooperate is evidence that the commission-sharing arrangement was viable only for so long as the banks were kept in the dark.

¶ 48 In the absence of any other evidence to corroborate that theory, that line of reasoning is mere speculation. In any event, it is not a sufficient basis to conclude that the respondents' failure to make disclosure was not inadvertent. On top of that, the respondents' efforts to regularize the paperwork through Civelli had nothing to do with section 53. The intent was to obtain the banks' consent as required under Rule 29.6. The respondents did not need Civelli's cooperation to disclose the arrangements to the banks.

¶ 49 Neither did the panel identify any other evidence to demonstrate that the respondents' contravention of section 53 amounted to a contravention of Rule 29.1. After commenting at length on the importance of disclosure, both generally and in the context of the registrant-client relationship, it simply concluded that the respondents "failed in their duties as gatekeepers ensure that this disclosure principle was met with respect to trading in the accounts." It cited no evidence, for example, as to what the clients may have done had they been aware of the

commission-sharing arrangement, or as to what harm, if any, the clients suffered as a result of the non-disclosure.

¶ 50 The IIROC hearing panel noted in its decision a number of factors that in our opinion are relevant to the issue of whether the respondents' contravention of section 53 amount to a contravention of Rule 29.1:

- the commission-sharing arrangement was not illegal
- there was no loss to clients
- there was no evidence of unjust enrichment
- there were no complaints from the banks
- there was no attempt to conceal the commission-sharing arrangement from the regulators
- all parties to the commission-sharing arrangement "were fully aware of what was happening with respect to trading" in the accounts; "If there was not written authorization for this trading activity, there was certainly verbal authority."

¶ 51 To this we would add that the commissions paid by the banks were not higher as a result of the commission-sharing arrangement than would otherwise be the case, and in any event the beneficial owners of the accounts authorized the commissions.

¶ 52 Of all of these factors, the most significant by far is that the banks were mere intermediaries and had no financial interest in the commission-sharing arrangement. That was a matter between Clarion and the beneficial owners of the accounts, who agreed to and authorized the arrangement.

¶ 53 In considering its finding on Rule 29.6 (which we have set aside), the panel said,

> " . . . In the matter at hand, the question is begged as to whether the customer is each of the Banks in whose names the Accounts were registered, or the Banks' customers, the acknowledged beneficial owners of the securities in the Accounts and the parties who bore the cost of the commission payments to [Clarion]."

¶ 54 The same can be said about the requirements of section 53, and in considering whether the respondents' conduct is a contravention of Rule 29.1, it is central to the issue. The beneficial owners were the only ones affected by the commission-sharing arrangement and they knew about it and agreed to it. Any contravention of section 53 that is based only on the respondents' failure to make disclosure to the banks is purely technical.

¶ 55 In addition, there was no evidence that the respondents' conduct in contravening section 53 was intentional, was motivated by dishonest intent or for an improper purpose, or was otherwise unethical. Neither, in our opinion, was the respondents' conduct likely to impair the public's trust of the industry.

¶ 56 In these circumstances, the IIROC hearing panel erred in law in finding that the respondents' contravention of section 53 of the *Securities Rules* amounted to a contravention of IIROC Rule 29.1.

¶ 57 We set aside the panel's finding that the respondents contravened IIROC Rule 29.1.

C Penalty Decision

Penalties related to Count 1

¶ 58 In its December 20, 2010 penalty decision, the IIROC hearing panel fined Blackmont $612,500 and Duke $245,000 for its findings against them under Count 1.

¶ 59 We have set aside the findings of the IIROC hearing panel that the respondents contravened IIROC Rules 29.6 and 29.1. It follows that the penalties related to those findings must also be set aside, and that IIROC's application to order disgorgement is moot.

¶ 60 We set aside the penalties imposed by the hearing panel related to Count 1.

Penalties related to Count 2

¶ 61 That leaves Duke's submission that the penalty the panel imposed for his contravention under Count 2 of the notice of hearing should be reduced.

¶ 62 In its December 20, 2010 penalty decision the IIROC hearing panel fined Duke $20,000 for its findings against him under Count 2.

¶ 63 The panel also ordered that Duke, because he was a repeat offender:

- be prohibited from approval in any capacity in the investment industry for a period of six months ending June 30, 2011, and
- if he applies for readmission to the industry after June 30, 2011, a term of his re-approval include a six month period of strict supervision and the requirement that he must have first successfully completed IIROC's Code and Practices Handbook examination.

¶ 64 Duke acknowledges the prohibition is now moot. He says the fine for Count 2 should be only $5,000 and that we should set aside the conditions imposed in connection with any application he may make for readmission.

¶ 65 These are the factors the panel considered in imposing the $20,000 fine on Duke for his contravention of Count 2 and for his status as a repeat offender:

- there was no loss to clients
- in contrast to Blackmont, whose conduct the panel described as "benign neglect", Duke "was concerned about the necessary paperwork being extant" and was "actively attempting" to obtain necessary documentation
- there was no evidence of unjust enrichment
- there were no complaints from the banks
- there was no attempt to conceal the commission-sharing arrangement from the regulators
- after the 2007 sales compliance review, he fully cooperated with IIROC staff
- all parties to the commission-sharing arrangement "were fully aware of what was happening with respect to trading" in the accounts; "If there was not written authorization for this trading activity, there was certainly verbal authority"
- this is Duke's third disciplinary matter - he entered into settlements with the TSX Venture Exchange and its predecessor in 1997 (in which he admitted, among other things, to discretionary trading without authorization) and 2003 (in which he admitted to effecting trades for a client who did not have the intention to settle and to failing to discharge his obligation as a gatekeeper).

¶ 66 For his contraventions under Count 2, the panel imposed a penalty of $20,000 - the minimum penalty under IIROC guidelines of $5,000 for each of the four accounts in connection with which it found Duke contravened Rule 200.1(i)(3).

¶ 67 In our opinion, the panel did not err in law in imposing these penalties on Duke in connection with its findings on Count 2, nor do we find its decision otherwise unreasonable. We confirm the panel's penalty decision against Duke under Count 2.

V Decision

¶ 68 We set aside the IIROC hearing panel's decision that the respondents contravened IIROC Rule 29.6.

¶ 69 We set aside the panel's decision that the respondents contravened IIROC Rule 29.1.

¶ 70 We set aside the penalties imposed by the panel related to its findings against Blackmont and Duke under Count 1.

¶ 71 We confirm the panel's penalty decision against Duke related to its findings against him under Count 2.

¶ 72 October 27, 2011

¶ 73 **For the Commission**

Brent W. Aitken
Vice Chair

David J. Smith
Commissioner

Shelley C. Williams
Commissioner