2011 BCSECCOM 569

VerifySmart Corp. (formerly known as Verified Capital Corp.), Verified Transactions Corp., Daniel Scammell and Casper de Beer aka Casha de Beer

***Securities Act*, RSBC 1996, c. 418**

Hearing

Panel	Brent W. Aitken	Vice Chair
	Kenneth G. Hanna	Commissioner
	Don Rowlatt	Commissioner
Hearing Date	July 4, 2011	
Submissions Completed	September 29, 2011	
Date of Findings	December 21, 2011	

Appearing

Bronwyn M. Turner	For the Executive Director
Ronald N. Pelletier Owais Ahmed	For Daniel Scammell
Patricia A.A. Taylor	For Casper de Beer aka Casha de Beer

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 an amended notice of hearing issued July 4, 2011 (2011 BCSECCOM 310) the executive director alleges that VerifySmart Corp., Verified Transactions Corp., Daniel Scammell and Casper de Beer contravened the Act by trading and distributing securities without being registered and without filing a prospectus, contrary to sections 34 and 61 of the Act.

¶ 3 Scammell and de Beer were represented at the hearing by counsel. de Beer testified. Scammell entered no evidence. The corporate respondents did not appear through counsel or another representative.

II Background

A The Parties

¶ 4 Scammell formed Verified Transactions to develop technology to prevent credit card fraud. He owned patents which he licensed to Verified Transactions. At the relevant time Scammell was the sole director of Verified Transactions and the company had no named officers.

¶ 5 Scammell brought in de Beer to raise capital for the business. VerifySmart (then called Verified Capital Corp.) was formed.

B The Distributions

¶ 6 The executive director alleges that from September 2006 to December 2008, Verified Transactions and Scammell distributed common shares of that company to 49 investors in British Columbia, Alberta and Washington, raising a total of $641,309. The executive director alleges that Scammell, under section 168.2(1), also authorized, permitted or acquiesced in Verified Transactions' distribution of its shares.

¶ 7 The executive director alleges that from November 2008 to March 2009, VerifySmart and de Beer distributed common shares of that company to 50 investors in British Columbia, Alberta, Saskatchewan, Manitoba and Ontario, raising a total of $575,000. The executive director alleges that de Beer and Scammell, under section 168.2(1), also authorized, permitted or acquiesced in VerifySmart's distribution of its shares.

¶ 8 None of Scammell, de Beer, or the corporate respondents was registered under the Act, and no prospectus was filed in connection with the distributions.

¶ 9 Verified Transactions and VerifySmart purported to rely on exemptions from the registration and prospectus requirements. The executive director alleges they were not entitled to do so.

III Analysis and Findings

A The Issues

¶ 10 Section 34(1) of the Act says "a person must not . . . trade in a security . . . unless the person is registered in accordance with the regulations . . . ."

¶ 11 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.

¶ 12 Section 1(1) defines "trade" to include "(a) a disposition of a security for valuable consideration" and "(f) any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the activities specified in paragraphs (a) to (e)".

¶ 13 Section 1(1) defines "distribution" as "a trade in a security of an issuer that has not been previously issued".

¶ 14 It is not contested (in that none of the respondents made submissions on these points) that Verified Transactions and VerifySmart sold their shares to the investors, and for the amounts, alleged in the notice of hearing. It is not contested that the shares are securities, or that the sales of shares were trades and distributions under the Act.

¶ 15 We find that the distributions by Verified Transactions and VerifySmart contravened sections 34(1) and 61(1) unless exemptions from those sections applied.

¶ 16 The issues for us to decide are:

- Did Verified Transactions and VerifySmart contravene the Act because they were not entitled to rely on exemptions from sections 34(1) and 61(1)?
- Did Scammell and de Beer contravene sections 34(1) and 61(1), either because they distributed securities in contravention of those sections without an available exemption, or because, under section 168.2(1), they authorized, permitted, or acquiesced in contraventions by Verified Transactions and VerifySmart?

B Availability of the exemptions to Verified Transactions and VerifySmart

¶ 17 In making their respective distributions, Verified Transactions and VerifySmart purported to rely on the family, friends and business associates exemption in sections 2.5(1) and (2) of National Instrument 45-106 *Prospectus and Registration Exemptions.*

¶ 18 It is the responsibility of a person trading securities to ensure that the trade complies with the Act. This is so whether the person chooses to comply by filing a prospectus, or by using an available exemption: *Solara* 2010 BCSECCOM 163.

¶ 19 The companion policy to NI45-106 provides guidance as to the steps an issuer can take to determine whether an exemption is available. The policy says:

> "1.10 Responsibility for compliance
> A person trading securities is responsible for determining when an exemption is available. In determining whether an exemption is available, a person may rely on factual representations by a purchaser, provided that the person has no reasonable grounds to believe that those representations are false. However, the person trading securities is responsible for determining whether, given the facts available, the exemption is available. Generally a person trading securities under an exemption should retain all necessary documents that show the person properly relied upon the exemption.
>
> For example, an issuer distributing securities to a close personal friend of a director could require that the purchaser provide a signed statement describing the purchaser's relationship with the director. On the basis of that factual information, the issuer could determine whether the purchaser is a close personal friend of the director for the purposes of the exemption. The issuer should not rely merely on a representation: 'I am a close personal friend of a director'. Likewise, under the accredited investor exemption, the seller must have a reasonable belief that the purchaser understands the meaning of the definition of "accredited investor". Prior to discussing the particulars of the investment with the purchaser, the seller should discuss with the purchaser the various criteria for qualifying as an accredited investor and whether the purchaser meets any of the criteria.
>
> It is not appropriate for a person to assume an exemption is available. For instance a seller should not accept a form of subscription agreement that only states that the purchaser is an accredited investor. Rather the seller should request that the purchaser provide the details on how they fit within the accredited investor definition."

¶ 20 In *Solara*, the Commission said this about how to determine whether an exemption applies:

> "37 The determination of whether an exemption applies is a question of mixed law and fact. Many of the exemptions are not available unless certain facts exist, often known only to the investor. To rely on those facts to ensure that the exemption is available, the issuer must have a reasonable belief that the facts are true.

> 38 To form that reasonable belief, the issuer must have evidence. For example, if the issuer wishes to rely on the friends exemption, it will need representations from the investor about the nature of the relationship that make it a "close personal friendship" within the meaning of the exemption. If the issuer wishes to rely on the accredited investor exemption, it will need evidence about the details of the investor's financial circumstances that make the investor an "accredited investor".
>
> 39 Accordingly, a representation that merely asserts, with nothing else, that the investor is a close personal friend, or an accredited investor, is not sufficient to determine whether the exemption is available.
>
> 40 A representation by a representative of the issuer may not be sufficient evidence of compliance, even if that representation is informed by knowledge of the requirements of the exemption (for example, the criteria for close personal friendship). A representative of the issuer is not necessarily a disinterested party – it is in the issuer's interest that the exemptions be available to as many trades as possible. Corroborating evidence may be necessary to confirm the representative's assessment of the relationship.
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> 41 The companion policies note the value of the issuer's retaining all necessary documents that show that the exemption was available to the issuer. Here, Solara either never had documents of that nature, or failed to retain them. In any event, the respondents did not produce them."

¶ 21 Under sections 2.5(1) and (2) of NI45-106 the registration and prospectus requirements do not apply to a trade if the purchaser is a family member, close personal friend, or close business associate of a director, executive officer, or founder of the issuer.

¶ 22 The companion policy to NI45-106 states the regulators' views of the meaning of "close personal friend" and "close business associate" of a person who is a director, officer or founder. These policies say that the relationship must, at the time of the trade, be of a nature that the investor can assess the person's capabilities and trustworthiness. An investor purportedly a close personal friend must have known that person well enough, and have known them for a sufficient period of time, to make that assessment. An investor purportedly a close business

associate must have had sufficient prior business dealings with the person to make the assessment.

¶ 23 The companion policies say "the relationship . . . must be direct. For example, the exemption is not available to a close personal friend of a close personal friend of a director of the issuer."

¶ 24 The Commission panel in *Solara* said (at para. 53), "In our opinion, these are correct guidelines for the availability of the exemptions." We agree.

¶ 25 For the corporate respondents to be able to rely on this exemption for the trades that are the subject of the notice of hearing, those investors would have to be family, close personal friends, or close business associates of Scammell, de Beer, or of another director, officer, or founder.

¶ 26 The parties made submissions about whether Stewart Goodin, someone Scammell hired to develop the technology was an "officer" of the respondent companies for the purposes of the exemption. This is because many of the investors, if they were in the category of "family, close personal friends, or close business associates", were in that category only because of their relationship with Goodin.

¶ 27 It is, however, unnecessary for us to determine whether Goodin was an officer. None of the respondents produced any documents showing that they properly relied on the exemptions, as described in the companion policy to NI45-106. There is no other evidence that meets the standard set by *Solara* to show that Verified Transactions or VerifySmart had a reasonable belief that their investors had the requisite relationship with Goodin (even if he was an officer) or any other director, officer or founder of the companies.

¶ 28 In the absence of that evidence, we find that the friends, family and business associates exemption was not available to Verified Transactions and VerifySmart.

¶ 29 We therefore find that Verified Transactions and VerifySmart contravened sections 34(1) and 61(1) when they distributed their securities as alleged in the notice of hearing.

C Contraventions by Scammell and de Beer

1 Scammell

¶ 30 The evidence includes the transcript of a March 30, 2010 compelled interview of Scammell by Commission staff. Scammell was under oath and represented by counsel.

¶ 31 In his interview, Scammell said he founded Verified Transactions and that it was "his company". During the relevant period he was its sole director and there were no named officers. He hired individuals to develop the technology and he otherwise ran its affairs.

¶ 32 Asked who was raising capital for Verified Transactions, Scammell said, "In the early stage, it was basically myself. He said that he raised about "half a million dollars" from about 15 to 20 "family and friends".

¶ 33 In addition to this money, Scammell says he contributed through shareholder loans about $900,000 of his own money, financed by mortgaging his house. He said that at the time of his interview, the company had paid him about $350,000 through a combination of salary and loan repayment.

¶ 34 The documentary evidence confirms Scammell's role in the distribution of Verified Transactions securities. By his own admission, he solicited investment in the company. As sole director, he approved the issuance of the shares. He signed the subscription agreements on behalf of the company. All of these activities were acts in furtherance of trades, and therefore trades, in securities of Verified Transactions. We have found that those trades were a distribution. Scammell therefore distributed securities of Verified Transactions contrary to sections 34(1) and 61(1).

¶ 35 Scammell says that he is entitled to rely on the company's purported use of the friends, family and business associates exemption. He also says that the *Solara* standard applies only to the issuer of the securities, not to a seller in his position.

¶ 36 We disagree. It would be a strange interpretation of the exemption regime that would result in exemptions being held not available to the issuer of the securities, and yet somehow available to a person selling those securities in identical circumstances on behalf of the issuer. That outcome would be contrary to the public interest, not to mention a violation of common sense. That is doubly so in circumstances like these, where the issuer is essentially the alter ego of the person selling the securities.

¶ 37 The only interpretation that makes sense and is consistent with the public interest is that if the exemption is not available, neither the issuer nor anyone selling securities on behalf of the issuer, can rely on it. Conversely, if the exemption is available, the issuer and anyone selling securities on behalf of the issuer can rely on it.

¶ 38 Scammell also contravened sections 34(1) and 61(1) under section 168.2(1) of the Act. That section says:

> "168.2 (1) If a person, other than an individual, contravenes a provision of this Act or of the regulations, or fails to comply with a decision, an employee, officer, director or agent of the person who authorizes, permits or acquiesces in the contravention or non-compliance also contravenes the provision or fails to comply with the decision, as the case may be."

¶ 39 We have found that Verified Transactions contravened sections 34(1) and 61(1) when it made its distributions. Scammell was its sole director and directed its affairs – there were no named officers. Clearly, he authorized, permitted and acquiesced in Verified Transactions' illegal distributions of securities and thereby committed the same contraventions under section 168.2(1).

¶ 40 The executive director alleges that Scammell was also a director of VerifySmart and that he also contravened sections 34(1) and 61(1) under section 168.2(1) in connection with the distribution of securities by VerifySmart.

¶ 41 Scammell denies that he is a director, saying that the only evidence of that is Scammell's name on a register of directors. Scammell says that there is no evidence of who prepared that document, and it is not cogent evidence that he was a director of VerifySmart.

¶ 42 The register of directors in question was provided to a Commission staff investigator by the corporate respondents' then counsel in response to the investigator's inquiry as to the identity of the directors and officers of VerifySmart. The company's response was that the register provided was a list of the directors and officers and the timeframes in which they held those positions. The register shows that Scammell was a director of VerifySmart from February 1, 2008. There is no entry in the space provided to enter the date he ceased to be a director.

¶ 43 In his testimony, de Beer reviewed the register and confirmed that it accurately listed the directors of VerifySmart at the relevant time. This evidence was not challenged on cross examination by Scammell's counsel and is otherwise uncontroverted.

¶ 44 We find that Scammell was a director of VerifySmart.

¶ 45 Scammell would have us believe that Verified Transactions and VerifySmart were distinct entities and once VerifySmart was formed and de Beer took over capital raising, he was out of that aspect of the business.

¶ 46 That is a form over substance argument. It was Scammell who brought de Beer in to run the capital raising side of the business, and VerifySmart was created for that purpose. However, the fact remains that, as a practical matter, the two companies were in the same enterprise, which involved two major activities: the development of the technology and the financing to support it. We have found that Scammell was a director of VerifySmart. In the circumstances, one would be surprised if he were not. (In fact, he signed the subscription agreements on behalf of the company.)

¶ 47 We find that Scammell authorized, permitted and acquiesced in VerifySmart's illegal distribution and so contravened sections 34(1) and 61(1) under section 168.2(1).

2 de Beer

¶ 48 Scammell brought de Beer in to raise capital for the business. In his submissions, de Beer does not dispute his role in capital raising. His defence is that he was entitled to rely on the exemptions that VerifySmart purportedly relied on, and that he relied on legal advice.

¶ 49 de Beer solicited investors to buy shares of VerifySmart in connection with VerifySmart's illegal distribution. These solicitations were acts in furtherance of trades, and therefore trades, in securities of VerifySmart. We have found that those trades were a distribution. de Beer therefore distributed securities of VerifySmart contrary to sections 34(1) and 61(1).

¶ 50 We have found that Scammell was not entitled to rely on exemptions if Verified Transactions could not, and the same argument applies to de Beer's distribution of VerifySmart shares.

¶ 51 de Beer also contravened sections 34(1) and 61(1) under section 168.2(1) of the Act. He was a director of VerifySmart, and his role was to raise capital for the company. Clearly, he authorized, permitted and acquiesced in VerifySmart's illegal distributions of securities and thereby committed the same contraventions under section 168.2(1).

3 Significance of legal advice

¶ 52 Both Scammell and de Beer say they relied on legal advice that the exemptions were available to the companies, and that their reliance on that advice was reasonable.

¶ 53 That is not relevant to whether they contravened sections 34(1) and 61(1). The onus is on those selling securities in reliance on an exemption to ensure that the exemption is available.

¶ 54 Reliance on legal advice is, however, a factor relevant to sanctions, which we will consider at the appropriate time.

III Summary of Findings

¶ 55 We find that:

1. Verified Transactions and Scammell 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 when they distributed securities of Verified Transactions to 49 investors for proceeds of $641,309 in purported reliance on exemptions from the registration and prospectus requirements that were not available;

2. Scammell contravened sections 34(1) and 61(1) of the Act under section 168.2(1) when he authorized, permitted and acquiesced in Verified Transactions' illegal distributions of securities;

3. VerifySmart and de Beer 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 when they distributed securities of VerifySmart to 50 investors for proceeds of $575,000 in purported reliance on exemptions from the registration and prospectus requirements that were not available; and

4. de Beer and Scammell contravened sections 34(1) and 61(1) of the Act under section 168.2(1) when they authorized, permitted and acquiesced in VerifySmart's illegal distributions of securities.

IV Submissions on sanction

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

By January 17	The executive director delivers submissions to the respondents and to the secretary to the Commission
By January 31	The respondents deliver response submissions to the executive director, to each other, 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

By February 7	The executive director delivers reply submissions (if any) to the respondents and to the secretary to the Commission

¶ 57 December 21, 2011

¶ 58 For the Commission

Brent W. Aitken
Vice Chair

Kenneth G. Hanna
Commissioner

Don Rowlatt
Commissioner