

Citation: 2013 BCSECCOM 310

**Canaco Resources Inc., Andrew Lee Smith,
Randy Smallwood, David Parsons, and Brian Lock**

Securities Act, RSBC 1996, c. 418

Hearing

Panel	Brent W. Aitken Kenneth G. Hanna Don Rowlatt	Vice Chair Commissioner Commissioner
Hearing dates	January 8, 11, 14-18, 21-23, 25, and March 6, 2013	
Date of Decision	August 7, 2013	
Appearing		
Jeremy Gellis Ryan Carrier	For the Executive Director	
Hein Poulus, QC Lisa Hiebert Matthew Nied Patricia A.A. Taylor	For Canaco Resources Inc. and Andrew Lee Smith	
H. Roderick Anderson Owais Ahmed	For Randy Smallwood, David Parsons and Brian Lock	

Decision

I Introduction

- ¶ 1 This is a hearing under sections 161(1) and 162 of the *Securities Act* RSBC 1996, c. 418.
- ¶ 2 On April 24, 2012 the executive director issued a notice of hearing alleging that Canaco Resources Inc., Andrew Lee Smith, Randy Smallwood, David Parsons, and Brian Lock failed to disclose drill results immediately as a material change, in contravention of section 85 of the Act. The notice of hearing also alleges that Smith, Smallwood, Parsons and Lock failed to act in the best interests of Canaco when they issued stock options with knowledge of the undisclosed drill results, and in so doing acted contrary to the public interest.

- ¶ 3 At the relevant time Canaco was a reporting issuer under the Act and its shares were listed on the TSX Venture Exchange. It had no revenue and its focus was mineral exploration.
- ¶ 4 Canaco's board consisted of the individual respondents and two others.
- ¶ 5 Smith was Canaco's president and chief executive officer and its "qualified person" under National Instrument 43-101 *Standards of Disclosure for Mineral Projects*. Smith is a professional geologist with over 25 years' experience in the mining industry. During his career he has been a director and officer of several Exchange-listed companies.
- ¶ 6 Smallwood, Parsons and Lock were independent directors of Canaco.
- ¶ 7 Smallwood is professional engineer with over 25 years' experience in the mining industry. He is the president, CEO, and a director of a Vancouver-based public company that purchases and resells precious metal production from operating mines. During his career he has acted as a director and officer of several Exchange-listed companies.
- ¶ 8 Parsons is a certified general accountant with experience in the mining industry.
- ¶ 9 Lock is an electrical engineer and during his career has been involved with the development of about 30 mining projects.

II The Hearing

- ¶ 10 In an 11-day hearing in January, six witnesses testified: the Commission staff investigator, Smith, Smallwood, and three experts called by Canaco: two mining geologists and a financial economist.
- ¶ 11 The executive director sought an adjournment in order to have more time for their own experts to review the Canaco expert reports and to prepare for cross-examination of the Canaco experts. We denied the application because Canaco had filed its reports within the time frame required by section 11 of the *Evidence Act*, RSBC 1996 c. 124, and because the adjournment would not have been in the public interest due to the delay in the hearing that would have resulted.
- ¶ 12 On March 6, 2013 the parties made oral submissions and answered questions put to them by the panel.

III Issues

A The Allegations; Onus of Proof

- ¶ 13 The notice of hearing alleges that:

- Canaco contravened section 85 of the Act when it failed to issue immediately a news release disclosing results from eight mining drillholes and failed to file a material change report describing those drill results;
- the individual respondents also contravened section 85 by the application of section 168.2(1) when they authorized, permitted or acquiesced in Canaco's contravention of section 85; and
- the individual respondents failed to act in the best interests of Canaco when they voted in favour of issuing Canaco stock options to themselves and others with the knowledge that the Canaco stock price did not take into account the undisclosed drill results.

¶ 14 The allegations fall into two sets:

- those relating to Canaco's alleged contravention of section 85, and
- those relating to the allegations that the individual respondents acted contrary to the public interest by failing to act in Canaco's best interests.

¶ 15 Both sets of allegations are about the materiality of the results of eight drillholes Canaco drilled in 2010 on a claim known as the Magambazi deposit. The eight drillholes were numbered 84, 87, 88, 90, 93, 96, 97 and 98. Canaco numbered drillholes in the order in which they were drilled.

¶ 16 By no later than Monday, November 29, 2010, Canaco and Smith knew the drill results for all eight holes, and Smallwood, Lock and Parsons knew the results for four of them. Canaco disclosed the drill results in news releases dated December 6 (Monday), December 9 (Thursday) and December 22 (Wednesday), 2010. The executive director says that by failing to immediately disclose the drill results (which the executive director says were a material change), the respondents contravened section 85.

¶ 17 The executive director also says that by issuing Canaco options to themselves and others with knowledge of the undisclosed drill results (which the executive director says were also a material fact), the individual respondents acted contrary to the public interest.

¶ 18 The onus is on the executive director to prove, on a balance of probabilities, that the allegations are true. The proof must be clear and convincing and based on cogent evidence. Cogent evidence is "convincing" and "compelling": *Hu* 2011 BCSECCOM 355 (para 13).

B The issues

¶ 19 The executive director says the allegations are supported by the facts, which he says go like this:

- Canaco learns about drill results from an infill drilling program. Some of these results it later describes in a news release as “spectacular new drill results”.
 - When the directors hear of the results, they exchange emails describing the results as “just beautiful”, “spectacular”, and “fantastic news”.
 - Canaco “kept stock prices high by staggering the disclosure of the drill results” and “Smith attempted to raise money at higher share prices by communicating drill results ‘to engage the investment community and interest them in [Canaco’s] product’”.
 - Analysts boost this effort through highly positive reports issued the same day as Canaco’s news releases. Canaco cultivated relationships with the analysts, Canaco and the analysts “did not work at arm’s length from each other” and in fact the analysts “worked closely with Canaco directors and officers to market Canaco’s securities”.
 - Meanwhile, before announcing any of the drill results, the directors issue themselves and Canaco management a significant number of options.
 - The Exchange orders Canaco to announce the remaining undisclosed drill results on December 22, 2010 and requires Canaco to re-price the options.
- ¶ 20 The respondents say that the drill results were not material, so there was no obligation to disclose them in accordance with the requirements of section 85, nor is there any question of Canaco or its directors or officers having knowledge of an undisclosed material fact when the options were issued.
- ¶ 21 The parties made submissions on several issues in connection with the section 85 allegations, including whether the drill results were a “change”; if so, whether they were a change “in the business, operations or capital” of Canaco; and if so, whether that change was material. They also made submissions on whether the individual respondents had the benefit of a due diligence defence under section 168.2.
- ¶ 22 The parties made submissions on several issues in connection with the public interest allegation, including the standard (under corporate law or otherwise) for determining whether the individual respondents failed to act in the best interests of Canaco, whether there was a legal foundation for finding their failure to do so to be conduct contrary to the public interest under the Act, and whether there was a due diligence defence.
- ¶ 23 It was not necessary for us to consider all of these issues. In our opinion, the crux of the matter in both sets of allegations was the materiality of the drill results and so we considered that issue first. Having concluded that the drill results were not material, it was not necessary to consider other issues.

IV Analysis

A The Allegations

- ¶ 24 The section 85 allegations are in subparagraphs 13 and 14 of paragraph 1 of the notice of hearing:

“13. By failing to immediately issue and file a news release disclosing the Drill Results, and by failing to file a material change report, Canaco breached section 85 of the Act.

14. Smith, Smallwood, Parsons, and Lock authorized, permitted or acquiesced in Canaco’s breach of the Act, and therefore contravened the same provision under section 168.2 of the Act.”

¶ 25 The public interest allegations, in subparagraphs 19 and 20 of paragraph 1 of the notice of hearing, read as follows:

“19. Smith failed to act in the best interests of Canaco by:

- (a) voting in favour of the Options with the knowledge that the market price upon which they were based did not take into account the Drill Results; and
- (b) voting in favour of a grant of stock options to himself whose exercise price was under-priced by \$0.32 per share, and by a total of \$320,000.

20. Smallwood, Parsons and Lock failed to act in the best interests of Canaco by:

- (a) voting in favour of the Options with the knowledge that the market price upon which they were based did not take into account four of the Drill Results; and
- (b) voting in favour of grants of stock options to themselves whose exercise price was under-priced by \$0.32 per share, and by a total of \$192,000 each.”

¶ 26 In argument, the executive director said that the individual respondents’ failure to act in Canaco’s best interests arises from their issuance of stock options with knowledge of an undisclosed material fact relating to Canaco, namely, the drill results. That failure, says the executive director, constitutes conduct contrary to the public interest.

¶ 27 The section 85 allegations can stand only if the executive director succeeds in proving that the drill results were a material change. The public interest allegations can stand only if the executive director succeeds in proving that the drill results were a material fact.

- ¶ 28 To prove either, the executive director must prove that the drill results would reasonably be expected to have had a significant effect on the market price or value of Canaco’s securities. If he cannot prove this, he cannot prove any of the allegations in the notice of hearing.

B The Facts

1 The Magambazi Property

- ¶ 29 Magambazi is a gold deposit that is part of a Canaco property in Tanzania called Handeni.
- ¶ 30 Canaco drilled the first hole, Hole 1, on Magambazi in September 2009. It turned out to be the discovery hole.
- ¶ 31 Canaco continued exploration drilling. By May 2010, it had drilled 45 holes. In a May 3, 2010 news release, Canaco said, “the Magambazi Lodes, containing high-grade gold intercepts on every section drilled to date, are now defined over a 440m strike (from 60,320N to 60,760N local grid).”
- ¶ 32 By July 2010, Canaco had drilled 66 holes. In a news release that month, Canaco announced the results of Hole 66. The news release included these statements:

“This compelling high grade intercept . . . confirms the presence of a core of thick, high grade gold mineralization as a component of the Magambazi Main Lodes . . .

. . .

The confirmation of continuity in structure and grade of a high-grade core and the recognition of the Magambazi Main Lodes and Magambazi North as separate parallel zones of near-surface gold mineralization has a dramatic, positive impact on the overall potential of the [project].”

- ¶ 33 By September 2010, Canaco had drilled 82 holes. In a news release that month, Canaco announced the results of Hole 79, saying, “The new results from Magambazi Central . . . prove the continuity of the Magambazi Main Lode to be over 860 metres of strike and still remaining open to the north.”

2 The Holes in Issue

- ¶ 34 The drilling results in issue come from holes drilled within the then-known boundaries of the deposit that Canaco had announced in its May 2010 news release. All of these holes were “infill” holes – that is, holes drilled in the spacing between previous drillholes, or otherwise nearby to previous drillholes. The following paragraphs summarize the location and geological context of each of the holes in issue.

Holes 84, 88, 90 and 93

- ¶ 35 Holes 84, 88, 90 and 93 were drilled between a series of previously-drilled holes (44, 66 and 79), all of which encountered mineralization. Holes 44, 66 and 79 were the subject of news releases issued by Canaco.
- A May 3, 2010 news release mentioned Hole 44 as follows: “Other significant intercepts have been returned for extensional drilling and infill drilling at Magambazi, including . . . [Hole 44].”
 - A July 12, 2010 news release said that Hole 66 “confirms the presence of a core of thick, high grade gold mineralization.” The release went on to say that “The confirmation of continuity in structure and grade of a high-grade core and the recognition of the Magambazi Main Lodes and Magambazi North as separate parallel zones of near-surface gold mineralization has a dramatic, positive impact on the overall potential of the Handeni Project.”
 - A September 17, 2010 news release said this about Hole 79: “The new results . . . prove the continuity of the Magambazi Main Lode”
- ¶ 36 Holes 84, 88, 90 and 93 did not extend the boundaries of mineralization established by Holes 44, 66 and 79, and the grades were consistent with those from the nearby holes. One exception was one metre of Hole 84, which encountered very high grade mineralization (173 g/t). However, Smith considered that an anomalous result that would be eliminated through top-cutting (also called grade cutting), a process explained below in the excerpts from one of the expert geologist reports.

Hole 87

- ¶ 37 Hole 87 was drilled between Holes 10 and 38. Hole 38 encountered mineralization; hole 10 did not.
- ¶ 38 A May 3, 2010 Canaco news release disclosed the mineralization in Hole 38 as 1.87 g/t Au over 15.3 metres, including 2.64 g/t over 6.7 metres and 4.07 g/t over 2.1 metres.
- ¶ 39 Canaco believed that the mineralization ended somewhere between Holes 38 and 10, and Hole 87 merely confirmed that. The Hole 87 grades were consistent with nearby holes.

Hole 96

- ¶ 40 Hole 96 was drilled between Holes 11 and 12, both of which encountered mineralization. A September 16, 2009 Canaco news release said this about Holes 11 and 12:

“On the project to date, [Hole 12] has produced the best diamond drill intercept of 56m at 6.43 g/t, topping the previous best intercept in discovery [Hole 1] Other significant new results include 23.8m at 3.86 g/t in [Hole 11].”

- ¶ 41 Hole 96 did not extend the boundaries of mineralization established by Holes 11 and 12. The Hole 96 grades were consistent with those from the nearby holes.

Hole 97

- ¶ 42 Hole 97 was drilled near Holes 43 and 45, both of which encountered mineralization. A May 3, 2010 Canaco news release said this about Holes 43 and 45:

“Canaco is extremely pleased to announce exciting new intercepts from [Magambazi] Extensional drilling 240m north of previously reported drilling conducted at Magambazi has intersected high-grade gold grades over large widths, including . . . [Hole 43] and . . . [Hole 45].”

- ¶ 43 Hole 97 did not extend the boundaries of mineralization established by Holes 43 and 45. The Hole 97 grades were consistent with those from the nearby holes.

Hole 98

- ¶ 44 Hole 98 was drilled between Holes 35 and 36, both of which encountered mineralization. A March 8, 2010 Canaco news release said this about Holes 35 and 36:

“New results . . . include intercepts from holes 35 and 36 which were drilled to extend the zone of high-grade gold mineralization to the north and down plunge Drilling intersected both the Upper and Lower lodes in both holes with excellent widths and grades.”

- ¶ 45 Hole 98 did not extend the boundaries of mineralization established by Holes 35 and 36. Although Hole 98 contained a 0.7 metre interval of a very high grade (280 g/t), its average grade was consistent with holes 35 and 36. As with Hole 84, Smith considered that result anomalous and likely to be eliminated when top-cutting was applied.

3 Canaco’s Receipt of Assay Results for the Holes in Issue

- ¶ 46 Canaco did not necessarily receive assay results for holes in the same order in which they were drilled. Assay results for a given hole also did not come all at once. The assay lab provided Canaco with initial assay results, which were then tested through a quality assurance and quality control (QA/QC) process. The results were then considered final and reported to Canaco.
- ¶ 47 The QA/QC process could, and sometimes did, result in significant changes between the preliminary and final results for a hole, so Canaco did not disclose drill results for any hole until its final results were known.

- ¶ 48 When Canaco received drill results, Smith would see them immediately. The results would be disclosed to the board in monthly reports prepared in arrears. In the monthly reports, the directors saw final results for some holes and expected results for holes that were assayed but still going through QA/QC testing.
- ¶ 49 The September 2010 monthly report (delivered to the directors no later than October 27) reported on final results for Hole 84, and expected results for Holes 87, 88, 90, and 93.
- ¶ 50 The October 2010 monthly report (delivered to the directors no later than November 25) reported on final results for Holes 87, 88 and 90.
- ¶ 51 Accordingly, by November 25 the individual respondents, other than Smith, had final results only for Holes 84, 87, 88 and 90. They had only expected results for Hole 93, and no results for Holes 96, 97 or 98.
- ¶ 52 By November 29 Smith had final results for all eight holes.

4 The Sonora Property Claim Dispute

- ¶ 53 Shortly after Canaco's first strike in Magambazi, one Dr. Abdullah Kigoda (a former Minister of Mines of Tanzania) asserted he had a mining licence in the heart of the Magambazi property and approached Canaco to buy it. Canaco refused, believing the licence was bogus, and asked the Tanzania Commissioner of Mines to investigate.
- ¶ 54 In July 2010, Sonora Gold & Silver Corp., an Exchange-listed BC mining company, told Canaco it had acquired an option to purchase the Kigoda claim and offered to relinquish its claim for \$105 million, later reduced to \$35 million.
- ¶ 55 Canaco decided not to disclose the Sonora option and offer on the basis that the Sonora claim was devoid of merit and therefore could not succeed. The Exchange's manager of compliance and disclosure agreed with that approach.
- ¶ 56 On October 15, 2010 (a Friday) Sonora issued a news release about the Kigoda claim. At the request of the Exchange, Canaco issued a news release on the following Monday, detailing the views of the authorities in Tanzania, which appeared to support Canaco's position on the Sonora claim.
- ¶ 57 The Tanzanian Commissioner of Mines called a meeting of the parties for October 28, which Canaco announced on October 21. The outcome of the October 28 meeting was an adjournment of the matter to November 29.
- ¶ 58 When Canaco arrived for the meeting on November 29, the Commissioner did not appear. Canaco tracked him down in another town and met with him.

- ¶ 59 On December 2, the Commissioner issued his decision, the effect of which was to extinguish the Sonora claim. On Thursday, December 2, Canaco issued a news release announcing the Commissioner's decision.

5 Events from November 29 to December 22, 2010

- ¶ 60 Junior mining exploration companies rely heavily on stock options to compensate employees and directors in order to maximize the allocation of available cash to exploration activities, and to minimize the allocation of cash to overhead.
- ¶ 61 On August 4, 2010 Canaco completed an underwritten \$25 million private placement of 17.9 million shares. The underwriters also received warrants to purchase 17.9 million shares at the offering price, exercisable until August 4, 2012.
- ¶ 62 The underwriting agreement prohibited Canaco from issuing securities until December 2, 2010. The securities issued under the private placement were subject to a regulatory hold period that expired on December 5, 2010.
- ¶ 63 As a result, Canaco was unable to issue any stock options from August 4 until December 2 at the earliest. Canaco also expected to receive drilling results from due diligence drilling at another property in early December, which, if material, would have resulted in a self-imposed blackout for issuing stock.
- ¶ 64 With this in mind, Smith saw that the early days of December presented a very narrow window to issue stock options. So on November 23, Smith sent the board a list of proposed optionees showing a proposed allocation of options to each optionee. The optionees included employees and management of Canaco and the individual respondents.
- ¶ 65 A conference call was arranged for November 29, the day that a resolution of the Sonora claim was expected. All but one of the directors participated in the call. Once it became clear that the Sonora dispute was not to be settled that day, the conversation turned to Smith's list of proposed option grants. The participants in the call reached consensus on the aggregate number of options to be granted, but did not grant the options, nor did they set an exercise price.
- ¶ 66 During the call, Parsons asked Smith whether Canaco had any undisclosed information. Smith replied that there were undisclosed drill results, but that they were not material.
- ¶ 67 On December 2, the restriction on Canaco's ability to issue securities under the private placement underwriting agreement expired, and it announced the resolution of the Sonora dispute. Canaco was then in a position to issue options and proceeded to do so.

- ¶ 68 The Compensation Committee apparently met to approve the details of the option allocations and the exercise price, and on December 3, Canaco issued a news release announcing the option grants.
- ¶ 69 On December 5, Canaco's counsel circulated a consent resolution to the board granting options at an exercise price of \$4.56, the closing price on December 3, and with an effective date of December 3. The resolution provided that each director receiving options abstain from voting on the options to be granted to him.
- ¶ 70 On December 4, Smith sent to the board the draft news release disclosing the drill results for the eight drill holes. On that day and December 5, discussions ensued by email among board members and management about whether to disclose all the results at once, or to space them out, especially since Smith was scheduled for an investor road show in Europe after Christmas. Reasons to space out the disclosure identified in these discussions included:
- the desirability of maintaining a stream of news about the company, keeping in mind Smith's upcoming investor road show in January,
 - a concern, expressed by Smallwood, that a release of the drill results all at once (some of which were for holes drilled on parts of Magambazi that were part of the Sonora claim) might motivate Sonora to re-open that fight, and
 - as a reason to time the first release for December 6, to provide investors in the private placement with some good news about Canaco's prospects as a means of encouraging them to continue to hold at least a portion of the Canaco stock they acquired in the private placement, which would be free trading that day.
- ¶ 71 There was no concern that Canaco need disclose the drill results immediately because Smith had concluded that the drill results were not material. That made sense to Smallwood, an experienced mining man, and he had no reason to challenge Smith's conclusion. Parsons and Lock accepted Smith's assessment, Smith being Canaco's QP under NP41-101.
- ¶ 72 The outcome of the discussions was that the results would be disclosed in separate news releases, starting on December 6 and finishing a short time before the scheduled European investor road show.
- ¶ 73 Meanwhile, the Exchange became concerned about the timing of Canaco's disclosure of the drill results and about the option grant and made its concerns known to Canaco during the week of December 20. At the Exchange's insistence, Canaco disclosed the remaining undisclosed drill results on December 22, and re-priced the options (Canaco offered to cancel the options, but the Exchange was satisfied with their re-pricing).
- ¶ 74 Smith had left for a holiday on December 17 and between December 19 and 23 he was out of contact.

C Applicable Law

1 Disclosure of Material Change

¶ 75 Section 85(b) of the Act says that a reporting issuer “must, in accordance with the regulations . . . provide disclosure of a material change.” Canaco is a reporting issuer under the Act.

¶ 76 The applicable regulation is National Instrument 51-102 Continuous Disclosure. Section 7.1(a) of NI 51-102 is the relevant section and says,

“(1) Subject to subsection (2), if a material change occurs in the affairs of a reporting issuer, the reporting issuer must

(a) immediately issue and file a news release authorized by an executive officer disclosing the nature and substance of the change; and

(b) as soon as practicable, and in any event within 10 days of the date on which the change occurs, file a Form 51-102F3 Material Change Report with respect to the material change.”

2 "Material change"; "material fact"

¶ 77 The term “material change” is defined in section 1(1) of the Act:

“ ‘material change’ means . . . if used in relation to an issuer . . . a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer . . . ”

¶ 78 Section 1(1) also defines “material fact”:

“ ‘material fact’ means, when used in relation to securities issued or proposed to be issued, a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.”

3 Individual liability for corporate contraventions

¶ 79 The allegations against the individual respondents in connection with section 85 are through the operation of section 168.2(1). That section says:

“168.2 (1) If a person, other than an individual, contravenes a provision of this Act or of the regulations . . . an . . . officer [or] director . . . of the person who authorizes, permits or acquiesces in the contravention . . . also contravenes the provision”

¶ 80 In other words, the individual respondents can be liable for a contravention of section 85 only if, through the operation of section 168.2(1), they authorized, permitted, or acquiesced in Canaco's contravention of that section. If there is no contravention of section 85 by Canaco, there can be no contravention of section 85 by the individual respondents under section 168.2(1).

4 The test for materiality

¶ 81 The section 85 allegations can stand only if the executive director succeeds in proving that the drill results were a material change. The public interest allegations can stand only if the executive director succeeds in proving that the drill results were a material fact.

¶ 82 The definitions of material fact and material change measure the materiality of a fact or event solely by the expected effect that fact or event would have on the market price or value of the issuer's securities. A fact or event is material only if it would reasonably be expected to have a significant effect on the market price or value of the issuer's securities.

¶ 83 It follows that to prove either set of allegations, the executive director must prove that the drill results would reasonably be expected to have a significant effect on the market price or value of Canaco's securities.

¶ 84 In *Cornish v. Ontario (Securities Commission)* 2013 ONSC 1310, the Ontario Superior Court of Justice (Divisional Court) summarized the current case law relevant to determinations of material fact and material change, including *YBM Magnex International Inc.* (2003) OSCB 5285; *AiT Advanced Information Technologies Corp.* (2008) 31 OSCB 712; *Kerr v. Danier Leather* [2007] 3 SCR 331; *Rex Diamond Mining Corp.* (2008) 31 OSCB 8337 (OSC); 2010 ONSC 3926 (Ont. Div. Ct); and *Biovail Corporation* (2010) 33 OSCB 8914. These are the principles that follow from these cases:

1. The test for materiality is objective – would the fact or event reasonably be expected to significantly affect the market price or value of the securities?
2. The test for materiality is a market impact test. As stated in *YBM*, “The investor is an economic being and materiality must be viewed from the perspective of the trading markets, that is, the buying, selling or holding of securities.”
3. The reasonableness of market impact is assessed from the point of view of the reasonable investor, that is, would a reasonable investor expect that the market price or value of the securities would be affected by the fact or event? (*Cornish*)

4. It is noteworthy that in some jurisdictions, the test for materiality is whether the fact or event is something that a reasonable investor would want to know. This is not the test under the Act. Information can be important to a reasonable investor without being “material”. As stated in *Biovail*:

“If a statement would be reasonably expected to have a significant effect on the market price or value of a security, then that statement would clearly be important to an investor in making an investment decision. However, it does not necessarily follow that a statement that is important to an investor in making an investment decision would reasonably be expected to have a significant effect on the market price or value of a security.”

5. Materiality is assessed in the context of the issuer’s industry and the market. (*Cornish*).
6. Issuers are not held to perfection nor is the expectation of the market impact assessed with the benefit of hindsight. As stated in *AiT*:

“Instead we must objectively assess the facts that were available to the AiT board during the relevant period, to determine in all the circumstances whether the three events constituted a material change It is important, therefore, to recognize the dangers of hindsight in coming to this conclusion and to be careful not to look at the situation based on what subsequently happened.”

7. The test, being objective, neither defers to the business judgement of management” (*Danier Leather*) nor depends “on the subjective assessment or optimistic personal views of company executives.” (*Cornish*, citing *Rex Diamond*)

¶ 85 The respondents argue that the test depends on an efficient market for the issuer’s shares – that is, the share price reflects all known information about the issuer.

¶ 86 Here, the respondents entered a report of a financial economist that included statistical analysis of the market in Canaco shares over a period of time prior to December 2010. The thrust of the report was that the market in Canaco’s shares was not, in fact, efficient, and so there was no basis for the respondents to believe that the drill results would have a significant effect on market price.

¶ 87 The report was not relevant. In determining whether a fact or event could reasonably be expected to significantly affect market price, the person making the determination must do so on the assumption that the market in the issuer's shares is generally efficient. To suggest otherwise opens the door to an approach where, for some companies, no information could be material because their stock does not trade efficiently, in our opinion an absurd interpretation.

D Applying the Test for Materiality to the Facts

1 Evidence

¶ 88 The evidence included expert reports and the testimony of the experts about their reports.

¶ 89 Two of the reports were from professional geologists. Based on the geologists' respective credentials and experience, both were unquestionably qualified to give professional opinion evidence on the drill results. The geologists' reports corroborated Smith's view, at the time he received the drill results for Holes 84 to 98, that they did not affect the value of the Magambazi deposit. We summarize their reports below.

¶ 90 The third report was from a financial economist. As explained above, we did not find his report or testimony useful.

¶ 91 We also heard testimony from Smith and Smallwood. We found both to be credible witnesses.

2 Discussion

¶ 92 The definitions of material fact and material change measure the impact on the "market price or value" of the issuer's securities. The implication is that "market price" and "value" can be affected differently by a given fact or event.

¶ 93 In determining whether the drill results were material, we first considered the drill results' effect on the value of the Magambazi deposit. For the reasons explained below, we concluded that the drilling results did not affect its value.

¶ 94 We then considered whether there was any evidence to prove that the drilling results would reasonably be expected to affect the market price of the Canaco shares for reasons other than a change in the value of the Magambazi deposit.

Value

¶ 95 The evidence included expert reports from two geologists: P. R. Stephenson, P. Geo., of AMC Mining Consultants (Canada) Ltd. and B. Terrence Hennessey, P. Geo., of Micon International Limited.

¶ 96 These are relevant excerpts from Stephenson's report:

“2.1 Magambazi Geology

...

The Magambazi gold deposit . . . is interpreted to be an Archaean, orogenic, vein-related deposit in volcanic and volcanoclastic rocks (often referred to as ‘greenstones’) . . .

...

2.2 Some Characteristics of Archaean, Greenstone-Hosted Gold Deposits

...

One of the characteristics of such deposits is that gold grades can be somewhat erratically distributed, and can contain ‘spiky’ high grades.

...

3.6 Treatment of High Grades in Mineral Resource Estimation

It is common in the exploration of gold deposits, and Archaean, greenstone-hosted deposits are no exception, to encounter a number of high to very high gold values in drillholes. These values can range up to several hundred or even several thousand grams per tonne. The problem that such grades can create when estimating Mineral Resources is that surrounding Resource blocks will tend to be assigned high grades because of the high values, and, if the lateral extent of the vein or other structure which hosts the high to very high values is limited (and it often is), the grades of the surrounding blocks may be overstated. . . .

There are various ways of dealing with high values depending on whether or not they are considered to be representative of the true distribution of such grades in the deposit. If they are considered not to be representative, and are interpreted as ‘outliers’, it is common practice to reduce the values (referred to as grade cutting or grade capping) prior to estimating Mineral Resource grades. There is no universally accepted technique for applying grade cutting / capping. Whether it should be applied, by what method and by how much is usually a subjective judgement made by the geologist supported by statistical analysis of assays.

...

3.7 Treatment of High Gold Grades at Magambazi

No Mineral Resource estimate had been prepared for Magambazi as of December 2010, so no information was available as to how Canaco intended to treat the high gold grades for Mineral Resource estimation purposes. I have, therefore, used my judgement based on my experience in the industry.

In my experience, given the range of individual gold values encountered in Magambazi drilling to December 2010, high grade cutting would have been applied in Mineral Resource estimation and could have been in the range of 50 g/t to 100 g/t. I emphasize that these are arbitrary cutting levels that would have to be confirmed during the Mineral Resource estimation process by undertaking various statistical and geological studies.

...

3.9 Opinion on Impact of [Holes 84 to 98] on Mineral Resources Estimates

Table 8 summarizes the weighted average grades of intersections including and excluding [Holes 84 to 98], and applying high grade cuts at 100 g/t and 50 g/t Au.

Observations from Table 8:

- On raw, uncut data, the inclusion of [Holes 84 to 98] makes an appreciable difference, increasing the average grade of all mineralized intersections by 16%.
- When cuts of 100 g/t and 50 g/t Au are applied, the increase in average grade of all mineralized intersections arising from the inclusion of [Holes 84 to 98] is reduced to 7% and 4% respectively. In my opinion, an increase within this range is not appreciable in the context of the value of the Magambazi deposit.
- It is interesting to note that, with the application of high grade cuts, the inclusion of [Holes 84 to 98] actually reduces the average grade of the high grade core.

...

4 CONCLUSIONS

In my opinion, the results of [Holes 84 to 98] would not, as of 3 December 2010, have appreciably affected a Mineral Resource estimate for the Magambazi deposit. Since the value of the deposit depends on the Mineral Resource estimate, I believe that [Holes 84 to 98] would not, as of 3 December 2010, have appreciably affected the value of the Magambazi deposit.”

¶ 97 These are relevant excerpts from Hennessey's report:

“ . . .

The commencement of drilling at the Magambazi gold deposit was first announced by Canaco on September 8, 2009 and the first drill results were announced on September 28 of that year. Since that time drilling is reported to have continued and regular releases of drill hole assay results and initial metallurgical test results have been made summarizing the progress at Magambazi. As of the beginning of December, 2010 results for holes up to, and including [Hole 82] had been released.

Micon has reviewed the sections containing [Holes 84 to 98] and the older drilling on those and adjacent sections

A review of [Holes 84 to 98] shows them clearly to be infill drilling within the strike extents of the mineralization shown to occur at Magambazi by the previous drilling. The usual purpose of such a drill program is to better define and confirm shorter range continuity of mineralization prior to the preparation of a mineral resource estimate rather than the discovery of new mineralization.

Many of [Holes 84 to 98] such as [Holes 87, 96 and 98] . . . are on sections which had already been drilled and are located in between holes already completed. . . .

[Holes 84, 96 and 98] contain intersections of somewhat higher grade than the typical results reported prior to December 6, 2010. Two of these ([Holes 96 and 98]) are also some of the widest intersections, although not the widest, seen to that date. A review of the underlying assays for the intersection composites reveals that the grades shown ([Hole 84] = 13.54 g/t Au over 13.4 m, [Hole 96] = 14.81 g/t Au over 48.6 m and [Hole 98] = 9.51 g/t Au over 13.4 m) are all the result of single assays which are the largest, third largest and seventh largest assays in the database. Removal, or top-cutting, of these single high grade assays would make the intersections similar to those nearby.

Conclusions

Micon has concluded that the drill results released by Canaco in December of 2010 are infill drill results from an ongoing drill program which have generally confirmed the results of previous drilling and which will contribute to a database which could eventually be used for a mineral resource estimate. [Holes 84 to 98] have not substantially increased the size or extent of the previously known mineralization and a thorough examination of the assay results indicates that they would not likely have a substantial effect, one way or the other, on the results of a mineral resource estimate. These results combined with further drilling will contribute to confidence in the continuity of mineralization. Micon

concludes that the drill results for [Holes 84 to 98] disclosed in three press releases in December of 2010 do not represent a substantial change in tonnage, grade or value of the Magambazi deposit.”

- ¶ 98 It is clear the evidence of these experts corroborates Smith’s opinion about the drill results: that the eight holes in question would not affect the value of the Canaco shares from a geological perspective. The holes were infill drilling. They did not alter the known boundaries of the deposit. They did nothing more than add to the understanding of the continuity of the deposit. To the extent the results contained high grades, these would not affect a mineral resource estimate because their impact would have been neutralized through top-cutting.
- ¶ 99 We find that a reasonable investor with this information would not conclude that the drill results would reasonably be expected to have a significant effect on the value of the Canaco shares.

Market price

- ¶ 100 The analysis of the impact of a fact or event on market price requires the issuer to consider whether the information will change existing investor perception to an extent sufficient to significantly affect market price. The questions the issuer needs to consider are: What is current investor perception of our business and prospects now? Would this information reasonably be expected to change that perception? If so, would the information reasonably be expected to change the perception to an extent sufficient to significantly affect market price?
- ¶ 101 Canaco was a junior exploration issuer with no revenue and the Magambazi property was its main exploration focus. For an issuer with this profile, information associated with drill results is more likely to be material than for a larger issuer with more properties and more diversity to its business.
- ¶ 102 However, Canaco’s drilling program was well advanced before Holes 84 to 98 were drilled. Canaco had been issuing news releases steadily since its first release in September 2009 and, as of December 2010, had disclosed the results of 82 drillholes. Holes 84 to 98 merely confirmed what management and the market already knew about the property. These holes were all drilled in close proximity to previous drillholes and, as we have cited above, the drill results for Holes 84 to 98 were all consistent with the information that Canaco disclosed in the news releases relating to the previous drillholes.
- ¶ 103 In our opinion, the perception of a reasonable investor who was acquainted with Canaco’s periodic and continuous disclosure in December 2010 would not be significantly altered by the drill results from Holes 84 to 98. The results were consistent with the existing “story” about the company and, as the geologist experts found, would not “appreciably” or “significantly” affect a mineral resource estimate.

¶ 104 It is worth noting that there will not, in the course of a drilling program leading up to the point of a resource estimate, always be a point in time where it could be said that a “material change” occurs. Rather, the cumulative results may form a part of the material facts about the issuer that is disclosed over time through periodic and continuous disclosure to establish a complete picture of progress of the drilling program.

¶ 105 In our opinion, there is no evidence that the facts available to Canaco and its board in early December 2010 would have led them to believe that a reasonable investor would expect the drill results to have a significant effect on Canaco’s market price.

3 Findings

¶ 106 Above we summarized the executive director’s theory of the case, which we revisit.

¶ 107 *Canaco learns about drill results from an infill drilling program. Some of these results it later describes in a news release as “spectacular new drill results”.*

¶ 108 The language in the news releases is not relevant to an assessment of materiality in connection with section 85. The test for materiality is objective, and whatever an issuer might say in a news release, the language it chooses cannot make a fact or event material when otherwise it would not be.

¶ 109 *When the directors hear of the results, they exchange emails describing the results as “just beautiful”, “spectacular”, and “fantastic news”.*

¶ 110 These responses are not relevant.

¶ 111 First, there is no evidence that the directors believed the drill results were material. In fact what evidence there is on that subject suggests that they believed the contrary. When the directors discussed the issuance of stock options on November 29, Parsons asked Smith if there was any undisclosed information. Smith told the directors that the yet-undisclosed drill results were not material. Had the directors, upon reviewing the news release, formed a view that the drill results were material, one would have expected that they would ask Smith about materiality again in light of the new disclosure. There is no evidence they did so.

¶ 112 Second, and more important, even if the directors did believe the drill results were material, their opinions are not determinative. The test is an objective assessment of the likely impact on market price from the point of view of a reasonable investor. The directors’ subjective opinions are not relevant.

- ¶ 113 *Canaco “kept stock prices high by staggering the disclosure of the drill results” and “Smith attempted to raise money at higher share prices by communicating drill results ‘to engage the investment community and interest them in [Canaco’s] product’”.*
- ¶ 114 *Analysts boost this effort through highly positive reports issued the same day as Canaco’s news releases. Canaco cultivated relationships with the analysts. Canaco and the analysts “did not work at arm’s length from each other” and in fact the analysts “worked closely with Canaco directors and officers to market Canaco’s securities”.*
- ¶ 115 It is a trite observation that sequence does not prove causation, an axiom worth considering before concluding that a change in the market price has been caused by an item of disclosure. Market prices are affected by a wide range of factors, many of which are unknowable from day to day. A host of factors can cause price changes and a combination of even minor factors can combine to move the price. It is also difficult to measure the time it takes for a disclosure about a given issuer to be absorbed by the market and reflected in the share price.
- ¶ 116 This is one of the reasons that the principles of interpretation we cite above mention the dangers of considering actual changes in market price when assessing whether the objective test for materiality was met.
- ¶ 117 In any event, the test for materiality is measured before the decision to disclose is made. So it makes no difference whether one is confident of the correlation between a given fact or event and a subsequent change in market price. What matters, as stated in *AiT Technologies*, is an objective assessment of the facts that were available to the issuer’s board at the time the decision to disclose, or not, is being made. What happens to the price afterwards is not relevant.
- ¶ 118 The executive director produced no evidence that Canaco “kept stock prices high by staggering the disclosure of the drill results”. Even if there were such evidence, this assertion is not relevant to whether the drill results were material.
- ¶ 119 Neither is there any evidence that Canaco and the analysts “did not work at arm’s length from each other”, but, again, even if there were such evidence, it would not be relevant to whether the drill results were material.
- ¶ 120 Neither of these assertions, nor the statement that “Smith attempted to raise money at higher share prices by communicating drill results ‘to engage the investment community and interest them in [Canaco’s] product’”, have any relevance to materiality or to any of the allegations in the notice of hearing. If anything, they seem to imply some sort of market manipulation activity, of which there is no allegation and no evidence.

¶ 121 *Meanwhile, before announcing any of the drill results, the directors issue themselves and Canaco management a significant number of options.*

¶ 122 That the directors issued stock options is not evidence of any wrongdoing. We have found that they did not do so while in possession of undisclosed material facts. The executive director did not tender any evidence of any other basis for concluding that the option grants were contrary to the public interest.

¶ 123 *The Exchange orders Canaco to announce the remaining undisclosed drill results on December 22, 2010 and requires Canaco to re-price the options.*

¶ 124 The Exchange's decision to require Canaco to announce the remaining undisclosed drill results on December 22, 2010 is a decision it was entitled to make in its judgement in the circumstances. There was no evidence before us that it was the Exchange's opinion that the results were material, and in any event, the Exchange's opinion is no more relevant to the objective test under the Act than the opinions of Canaco's management. We note, however, that as a measure of the depth of the Exchange's concern, it required Canaco only to re-price the options, not cancel them, even though Canaco offered to do so.

¶ 125 We find that the evidence does not prove that the drill results would reasonably be expected to significantly affect the market price or value of the Canaco shares. Accordingly, we find that the drill results were not a material change or a material fact relating to Canaco.

V Decision

¶ 126 We dismiss the allegations in the notice of hearing.

¶ 127 August 7, 2013

¶ 128 **For the Commission**

Brent W. Aitken
Vice Chair

Kenneth G. Hanna
Commissioner

Don Rowlatt
Commissioner