

# 2002 BCSECCOM 293

## Notice of Hearing

**George Melvin Grafton, Grafton Global Management Ltd.,  
Valley Mortgage and Investment Company Ltd.  
and TD Securities Inc.  
(the Respondents)**

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

[para 1]

A hearing will be held (the Hearing) to give George Melvin Grafton (Grafton), Grafton Global Management Ltd. (Grafton Global), Valley Mortgage and Investment Company Ltd. (Valley), and TD Securities Inc. (TD) an opportunity to be heard before the British Columbia Securities Commission (the Commission) considers whether it is in the public interest to make the following orders:

1. pursuant to section 161(1)(c) of the *Securities Act*, RSBC 1996, c. 418 (the Act) that any or all of the exemptions described in sections 44 to 47, 74, 75, 98 or 99 of the Act do not apply to Grafton, Grafton Global and Valley;
2. pursuant to section 161(1)(b) of the Act that Grafton, Grafton Global and Valley cease trading in or be prohibited from purchasing any securities;
3. pursuant to section 161(1)(d) of the Act that Grafton resign any position he holds as a director or officer of any issuer and be prohibited from becoming or acting as a director or officer of any issuer;
4. pursuant to section 161(1)(d) of the Act that Grafton, Grafton Global and Valley be prohibited from engaging in investor relations activities;
5. pursuant to section 161(1)(f) of the Act that TD be reprimanded and that its registration be suspended, cancelled or restricted or that conditions be imposed on its registration;
6. pursuant to section 162 of the Act that the Respondents pay an administrative penalty;
7. pursuant to section 174 of the Act that the Respondents pay the prescribed fees or charges for the costs of or related to the Hearing; and
8. any other orders the Commission may deem appropriate in the circumstances.

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[para 2]

The Commission will be asked to consider the following facts and allegations in making its determination:

### **The Parties**

1. Grafton is a resident of British Columbia and has been registered under the Act in various capacities from January 4, 1982. From November 30, 1994 to March 10, 1997 Grafton was registered as a trading partner/director/officer with Grafton Global and its predecessor, Grafton Asset Management Group Ltd. (Grafton Asset). From March 11, 1997 to July 7, 1997 Grafton was registered as an investment adviser with TD. Grafton is no longer registered in any capacity under the Act.
2. Grafton Global is a company incorporated in British Columbia. Grafton Global had a seat on the Vancouver Stock Exchange (the VSE) from October 17, 1994 until March 11, 1997.
3. Valley is a company incorporated in British Columbia on September 2, 1994. Valley is not a reporting issuer and has never been registered under the Act to trade in securities. At all material times Grafton has been the directing mind of Valley.
4. TD was registered as a broker with the VSE from January 1, 1996 to June 5, 1997 and has been registered as an investment dealer with the Investment Dealers Association from February 1, 1997 to the present.

### **The Relationship between Grafton, Grafton Global and TD**

5. Grafton Asset entered into an introducing/carrying broker agreement with Green Line Investor Services Inc. (Green Line) on or about October 13, 1994 (the Introducing/Carrying Broker Agreement).
6. Pursuant to the Introducing/Carrying Broker Agreement Green Line agreed to act as carrying broker for the clients of Grafton Asset and to provide the following services:
  - (a) to trade and clear securities;
  - (b) to issue confirmations and other documents in respect of such trades;
  - (c) to hold securities and cash of the clients in safekeeping;
  - (d) to keep proper records;

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- (e) to maintain all necessary records and in doing so to comply with all requirements of applicable law and the requirements of all Canadian self-regulatory organizations (“SROs”);
  - (f) except as provided in the Introducing/Carrying Broker Agreement, to act on behalf of Grafton Asset in relation to any of Grafton Asset’s clients in every respect as it would were the client a customer of Green Line;
  - (g) to administer the accounts of the clients in compliance with the rules of the TSE as if the clients were clients of Green Line; and
  - (h) to be responsible for obtaining and maintaining account opening documentation from the clients and be responsible for compliance with applicable law and the requirements of SROs including, without limitation, the “know your client” rules and for determining or supervising the suitability of trading activity, the nature of securities purchased, or the portfolio structure of the clients and to have the right and discretion to refuse to accept a particular account or client or to execute a particular trade.
7. Green Line amalgamated with TD on January 1, 1996 and Grafton Asset changed its name to Grafton Global on January 8, 1996. The Introducing/Carrying Broker Agreement remained in effect until March 11, 1997 when Grafton Global resigned its seat on the VSE and Grafton became an employee of TD.
8. Between March 11, 1997 and July 7, 1997, Grafton transferred his clients’ accounts to other brokers at TD. On July 7, 1997, Grafton left the employment of TD and ceased being registered under the Act.

### **The Distributions**

9. In or about March, 1996, Valley solicited residents of British Columbia to invest in Valley by issuing securities with three and five year terms (the March 1996 Notes). Approximately 90 clients of Grafton, Grafton Global and TD invested \$4.11 million in the March 1996 Notes. Of the \$4.11 million raised \$2 million came from “roll-overs” of notes previously issued by Valley, while the remaining amount came from new investments.
10. In November, 1996, Valley raised a further \$550,000 from residents of British Columbia by issuing unsecured promissory notes with a two year term (the November 1996 Notes). Approximately 13 clients of Grafton, Grafton Global and TD invested in the November 1996 Notes.

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11. Between March and May 1997, an additional \$450,000 was raised by Valley by issuing unsecured promissory notes with a five year term (the 1997 Notes). Seven clients of Grafton and TD invested in the 1997 Notes.
12. The money raised from the March 1996 Notes, the November 1996 Notes and the 1997 Notes (together, the Valley Notes) was lent to developers who were developing property in the Kelowna area (the Developers).
13. The Valley Notes were not qualified for distribution to the public under section 42 of the *Securities Act*, SBC 1985, c. 83, as amended (the Former Act) and section 61 of the Act.
14. TD permitted Grafton, Grafton Global and Valley to issue the Valley Notes without a prospectus, an exemption from the prospectus requirements or an offering memorandum, contrary to section 42 of the Former Act and section 61 of the Act.
15. When Grafton, Grafton Global and TD sold the Valley Notes, they were under an obligation to determine under what exemption, if any, they were proceeding and to further ensure that each of the clients met the conditions of such exemption.

### **Misrepresentations regarding Valley**

16. In some cases Grafton made statements, with the intention of effecting a trade in the securities of Valley, that the investments were low risk, when he knew that the proceeds would be used to fund a risky real estate development, which was a misrepresentation, contrary to section 35(1)(d) of the Former Act and section 50(1)(d) of the Act.

### **Undisclosed Conflicts of Interest**

17. Grafton Global, Grafton and Valley were connected parties within the meaning of section 75 of the Securities Rules, which states, among other things, that a registrant and a person that has any relationship with the registrant are connected parties if such a relationship leads a reasonable prospective purchaser of securities to question whether the registrant and the person are independent of each other. In particular Grafton was the directing mind of Valley during the period when the Valley Notes were sold to investors.
18. Grafton and Grafton Global traded in the securities of Valley, a connected party, in the course of an initial distribution. Grafton and Grafton Global did not file a conflict of interest rules statement in the required form, contrary to section 77(1) of the Securities Rules.

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19. Grafton and Grafton Global did not provide to persons, upon them becoming clients, a copy of the current conflict of interest rules statement, contrary to section 77(2) of the Securities Rules.
20. Grafton and Grafton Global did not deliver a current conflict of interest rules statement or the equivalent information to their clients prior to distributing the Valley Notes, contrary to section 79(1)(c) of the Securities Rules.
21. Grafton and Grafton Global did not promptly send written confirmation to clients after their purchase of Valley Notes that Grafton, Grafton Global and Valley were connected parties, contrary to section 79(1)(d) of the Securities Rules.
22. Grafton and Grafton Global advised their clients with respect to the Valley Notes without first advising their clients of their relationship to Valley contrary to section 81(1)(a) of the Securities Rules.

### **Know Your Client and Suitability**

23. Grafton, Grafton Global and TD did not make reasonable inquiries of their clients to determine and understand their essential and current financial and personal circumstances, financial sophistication and investment experience, investment objectives and risk tolerance in order to determine whether the investments in the Valley Notes were suitable for them.
24. Grafton's and Grafton Global's failure to know their clients was contrary to sections 14 and 48 of the Securities Rules.
25. TD's failure to know their clients was contrary to section 14 of the Securities Rules and Rules F1.01 and F12.07 of the VSE (the VSE Rules).
26. The Valley Notes were risky, illiquid, and speculative. Grafton, Grafton Global and TD did not understand the nature and risks of the investment or if they did understand, they did not convey this information to their clients, contrary to sections 14 and 48 of the Securities Rules and the VSE Rules.
27. The Valley Notes were unsuitable for any investor unless that investor had a high tolerance for risk, no need for short-term income, and the securities represented only a reasonable percentage of his or her overall portfolio. Grafton, Grafton Global and TD knew or should have known this and failed to convey this information to their clients, contrary to sections 14 and 48 of the Securities Rules and the VSE Rules.

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28. Some of the clients of Grafton, Grafton Global and TD were unsophisticated investors who relied heavily on the professional advice and judgment of Grafton. In some instances the clients, encouraged by Grafton, transferred funds from money markets or T-bill accounts, and redeemed mutual funds, in order to complete purchases of the Valley Notes, as recommended by Grafton. Many of these clients had low risk tolerance, a need for short-term income and an unsuitably high percentage of such holdings in their portfolio. Grafton, Grafton Global and TD knew or should have known these investments were unsuitable and failed to convey this information to their clients, contrary to sections 14 and 48 of the Securities Rules and the VSE Rules.
29. Grafton, Grafton Global and TD allowed some of their clients to purchase Valley Notes for the registered retirement savings (RSP) accounts when it was unclear whether the Valley Notes were RSP eligible.

### **Discretionary trading without registration**

30. In some cases, Grafton directed trades on behalf of clients with full discretion without registration as a portfolio manager or investment counsel, contrary to section 20(1)(c) of the Former Act and section 34(1)(c) of the Act. In some cases Grafton would inform the clients of the trade after the trade had been made and in other cases, he would not inform the clients of the trade unless they called to enquire. A number of clients did not become aware of their investment position in Valley until two years after the investment.

### **Misleading Account Statements**

31. The statements provided by TD referred to the March 1996 Notes as “mortgages” and for a period of over a year as “TD mortgages”. These statements are misleading as the March 1996 Notes do not appear to be mortgages and the reference to TD mortgages gave investors a false sense of security regarding the safety of their investments.
32. In June, 1999, Valley brought a petition of foreclosure against the Developers. Despite the fact that the mortgages underlying the March 1996 Notes and the 1997 Notes were in default, TD continued to list the value of the Valley Notes at their purchase price. This was especially burdensome to the investors who now carried the Valley Notes in their registered income funds, as the amount of their minimum allowable withdrawals were based on inflated values.

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### **Failure of TD to comply with a production order**

33. By Order for Production under section 141 of the Act, dated February 23, 2001 the Commission ordered TD to provide a list of Grafton client accounts who held or traded in any of the March 1996 Notes or November 1996 Notes. In response to this order, TD provided a list that appeared to include only the original investors in the March 1996 Notes.
34. As a result of TD's failure to comply with the original Order for Production numerous subsequent requests had to be made, and staff had to spend considerable time determining who had traded in the Notes so that the back up documentation could be requested.

### **Breaches of the Act**

35. As a result of the foregoing, Grafton and Grafton Global breached:
  - (a) section 42 of the Former Act and section 61 of the Act by trading in the Valley Notes without a prospectus or a prospectus exemption;
  - (b) sections 14 and 48 of the Securities Rules by failing to properly advise clients about the risks involved in the Valley Notes and by allowing clients to invest in the Valley Notes which were unsuitable for them;
  - (c) section 35(1)(d) of the Former Act and section 50(1)(d) of the Act by advising that the investments in the Valley Notes were low risk when they were not;
  - (d) section 20(1)(c) of the Former Act and section 34(1)(c) of the Act by acting as a portfolio manager or investment counsel without being registered to do so; and
  - (e) sections 77, 79 and 81 of the Securities Rules by failing to comply with the conflict of interest requirements.
36. As a result of the foregoing, TD:
  - (a) breached section 42 of the Former Act and section 61 of the Act by trading in the Valley Notes without a prospectus or a prospectus exemption;
  - (b) breached section 14 of the Securities Rules by failing to properly advise clients about the risks involved in the Valley Notes and by allowing clients to invest in the Valley Notes which were unsuitable for them;

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- (c) breached section 38 of the Securities Rules by providing misleading monthly account statements to their clients; and
- (d) acted contrary to the public interest by:
  - (i) breaching the VSE Rules, by failing to properly advise clients about the risks involved in the Valley Notes and by allowing clients to invest in the Valley Notes which were unsuitable for them,
  - (ii) failing to comply with the Agreement, and
  - (iii) failing to reply fully and timely to an Order for Production of the Commission.

37. As a result of the foregoing, Valley breached section 42 of the Former Act and section 61 of the Act by issuing the Valley Notes without a prospectus or a prospectus exemption.

[para 3]

The Respondents may be represented by counsel at the Hearing, and may make representations and lead evidence. The Respondents are requested to advise the Commission of their intention to attend the Hearing by informing the Commission Secretary at PO Box 10142, Pacific Centre, 701 West Georgia Street, Vancouver, BC V7Y 1L2 phone: (604) 899-6500; email: commsec@bcsc.bc.ca.

[para 4]

The Respondents or their counsel are required to attend at the 12<sup>th</sup> Floor Hearing Room, 701 West Georgia Street, Vancouver, British Columbia, on Tuesday, April 23, 2002, at 9:30 am if they wish to be heard before the Commission sets a date for the Hearing.

[para 5]

Determinations may be made in this matter if the Respondents or their counsel, do not appear at the Hearing.

March 15, 2002

Martin Eady, C.A.  
A/Executive Director