BRITISH COLUMBIA SECURITIES COMMISSION
Securities Act, RSBC 1996, c. 418

Citation: Re Carnes, 2015 BCSECCOM 187 Date: 20150514

John Richard Carnes

Panel	Nigel P. Cave	Vice Chair
	Judith Downes	Commissioner
	Audrey T. Ho	Commissioner
Hearing Dates	November 24 to 28, 2014	
Submissions Completed	January 30, 2015	
Date of Decision	May 14, 2015	
Appearing		
Derek J. Chapman Jennifer L. Whately	For the Executive Director	
Shayne P. Strukoff Joanne Kuroyama	For Jon Richard Carnes	

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 October 27, 2014 (2014 BCSECCOM 448), the executive director alleges that Jon Richard Carnes:

a) perpetrated a fraud, contrary to section 57(b); and
b) engaged in conduct that is contrary to the public interest.

[3] During the hearing, the executive director called one witness, a Commission investigator, and tendered documentary evidence. The respondent testified at the hearing and tendered documentary evidence.

II Background

[4] Carnes was a resident of British Columbia at the time of the alleged misconduct. He has never been registered in any capacity under the Act.

[5] Carnes has a long and successful history of personal investing, which ultimately led him to start his own hedge fund in 2004 called Eos Holdings LLC. Eos is controlled by Carnes and is his personal investment vehicle. Eos also is the investment vehicle for a charitable foundation that Carnes established in 1995 called One Horizon Foundation. Carnes testified that approximately 80% of the Eos profits go to this foundation.

[6] Eos has never been registered in any capacity under the Act.

[7] After the formation of Eos, Carnes began to focus on Chinese companies for investment. Between 2005 and 2010 Carnes reviewed or conducted due diligence on over 100 companies based in China in a wide variety of industries. During this period, Carnes opened several offices in China and employed seven or eight employees. He also utilized outside professionals to assist with due diligence.

[8] While Carnes was initially looking in China for long investment opportunities (i.e. acquiring securities which would increase in value if the share price in the company increased in value), by 2009 he had determined that there were a number of North American listed Chinese companies that had exaggerated their earnings. He began to take short positions (i.e. acquiring securities that would increase in value if the share price of the company decreased in value) against some of these companies.

[9] At some point in 2010, Carnes began publishing reports on his blog, and some publicly available investing blogs, about Chinese-based companies listed on North American exchanges.

[10] Carnes wrote those reports under fake names. At some point in 2010 he began to use the name Alfred Little in connection with his published reports. The reports were published on a blog or a website that bore that name. Carnes gave Alfred Little a fake biography as follows:

> Mr. Little has over 35 years investing experience having begun his career as an accountant at Deloitte. He spent 10 years in China, from 1994 to 2004, representing various foreign investors including Coke, P&G, and Budweiser, as they established beacheads in the world's fastest growing economy. Today he lives in New York and spends his time researching Chinese and other high growth companies. Having built a very successful track record investing the last decade, he plans to share his investing ideas in a newsletter blog he will edit.

[11] None of the above is true, as it relates to Carnes. He acknowledged that the fake biography was intentionally crafted to be very different from his own.

[12] Carnes says that he did this out of concern for his and his employees' personal safety. He testified that he was threatened during one of his due diligence investigations and took that threat seriously.

[13] The executive director says that Carnes grossly inflated the Alfred Little biography, relative to Carnes' own biography, in order to lend credibility to his published reports. The parties' submissions on this point are not mutually exclusive.

[14] Carnes says that the Alfred Little persona was retired in June 2011.

[15] Carnes says that the Alfred Little website was changed in June 2011 to publicly invite others to contribute research and investment ideas to the website, provided that the contributions met the website's standards.

[16] However, the only content that was ever published on this website was prepared by Carnes and his research team.

[17] Carnes acknowledged that he authorized one or more individuals, using fake names, to represent the website in media interviews and to portray the site as having multiple contributors and a managing editor. This portrayal was not accurate.

[18] Carnes also created a fake research group, International Financial Research & Analysis Group (IFRA), to provide content for some of his reports.

[19] IFRA's website described itself as follows:

> Formed in 2009, the International Financial Research & Analysis Group (IFRA) is quickly becoming the world's premier independent provider of complex financial analysis, business research and investigative due diligence services. We have assembled expert analysts from a broad range of industries and regions and decades of experience helping clients protect their investments. For more than 25 years, IFRA's principals have provided companies and individuals with the analysis and intelligence required to reduce their exposures in funding new business opportunities and investments.

[20] In fact, Carnes created IFRA and directed all its research. When Carnes published research provided by IFRA in his reports, he intentionally did not disclose that there was any relationship between IFRA and Alfred Little; his reports referred to IFRA as an independent research organization.

[21] The IFRA website content was also not true in that the principals of IFRA did not have the 25 years of due diligence experience portrayed by the website.

[22] Carnes also testified that on several occasions he assisted US securities regulators with some of their investigations into Chinese companies that were the subject of an Alfred Little report. He said that this was evidence of the public benefit that his reports (and their underlying due diligence) provided the markets.

[23] In May 2011 Carnes received an anonymous tip that he should investigate Silvercorp, a TSX-listed mining company whose principal assets were operating silver mines in China.

[24] Carnes did not immediately commence an investigation on Silvercorp; however, later in the summer of 2011, when looking for a new investigation target, he noticed that Silvercorp shared a number of traits with some of his previous investigative targets. In particular, Silvercorp had gone public through a reverse takeover of a listed shell (i.e. a transaction in which a private entity is vended into an existing listed entity (often one with few or no assets) and the principals of the private entity acquire a controlling interest in the publicly listed entity). In late June or early July 2011, Carnes and his research group commenced research on Silvercorp with a view to taking a short position in its shares.

[25] One element of Carnes' investigation was to conduct due diligence on the published mining technical reports (and related continuous disclosure) of Silvercorp. Carnes says that although he had a good working knowledge of geological information from a past investment in a feldspar mine in China, he wanted to retain a geological consultant with some experience in Chinese mining matters to review the Silvercorp geological disclosure.

[26] Carnes' team retained a Vancouver-based geological consultant. They did so through the use of a fake investment company as the purported party engaging the consultant. The fake investment company created by Carnes happened to have an e-mail address that was very similar to that used by a real investment company in the US.

[27] This geological consultant was sent some translations of filings that Silvercorp had made with the Heenan Provincial Land & Resource Bureau in China (the Chinese Reports). The consultant was given these instructions by Carnes' team:

> We are focused on whether the company deserves the valuation it has right now based on the results published. So we will only need some analysis and opinions on their public numbers, to see if they are reasonable, make sense or match.

[28] The response from this consultant was as follows:

> I reviewed the data that you sent to me. I also downloaded and spent perhaps 20 minutes reviewing the May 20, 2011 NI 43-101 report that is filed on SEDAR.
>
> My comments on the data that you provided are as follows:
>
> - I did not see any "fatal flaws" in that data
> - There were no apparent discrepancies in the data, although perhaps some of the titles could have benefitted from being more descriptive.

[29] There were differences between the resource numbers in the Chinese Reports and Silvercorp's NI 43-101 reports. However, the consultant advised Carnes that the Chinese numbers and the published numbers should not match because the reports were prepared under different conditions and used different reporting criteria. The consultant wished to see other, more detailed Chinese reports (called DR reports) before commenting further on the discrepancies.

[30] After this initial opinion from the consultant, Carnes was contacted by a Hong Kong-based hedge fund interested in research on Silvercorp similar to what Carnes' research team was conducting. The two hedge funds agreed to cooperate on their research. The Hong Kong based fund had identified their own geological consultant. Carnes says that, as a consequence, they did not carry on with their retainer of the first consultant. The Hong Kong hedge fund hired a second geological consultant to review Silvercorp's Chinese mining reports and its published reports.

[31] Notwithstanding Carnes' explanation for retaining a second consultant, the following e-mail to Carnes from one of his research team suggests another motive for finding a new geological consultant:

> His [the first consultant] comments do not help with our thesis. What should [i] do with him?

[32] Carnes and his research team continued to carry out due diligence on Silvercorp and Carnes was confident that he was going to write a negative report on Silvercorp by the middle of August, 2011.

[33] On August 15, 2011, Eos purchased $4.1 million of Silvercorp put options that would expire on September 17, 2011. On August 15, 2011 the Silvercorp shares opened the day trading at $9.20 on the New York Stock Exchange. Carnes structured his short trade with a model that considered $7 to be a reasonable target for the Silvercorp share price.

[34] Before the second geological consultant had completed his report, Silvercorp issued a press release on September 2, 2011 saying that it had received an anonymous letter that contained a number of allegations against Silvercorp, including disclosure problems and a non-arm's length transaction involving the CEO of Silvercorp that was not properly disclosed. This announcement caused the price of Silvercorp's shares to go down significantly.

[35] Following this September 2, 2011 press release, a member of Carnes' research team sent this note to the Hong Kong hedge fund asking about the status of the second technical report on September 3, 2011:

> Is your geologist report ready? Company's pr [press release] yesterday is really affecting this trade. We need to have a strong report if we want to get the stock much lower. Now the company is alerted and prepared.

[36] The second geological consultant prepared an initial report. Although dated September 1, 2011 it was sent to Carnes' research team on September 5, 2011. Carnes' research team did not like this initial report, as evidenced by their e-mail to the Hong Kong hedge fund:

> I think the tone of the geological report is too soft. He gives too much benefit of the doubt to the company. He needs to more strong [sic] and critical of the document prepared by management. If he things [sic] the persons who worked on 43-101 reports are not independent he needs to point out why. Otherwise his conclusion is too vague and not damaging enough.

[37] On September 8, 2011 the second consultant prepared an updated report and on September 9, 2011 he added an addendum to his updated report.

[38] Like the first consultant, the second consultant also identified that there were differences in the resource numbers contained in the Chinese Reports and the NI 43-101 reports. The NI 43-101 reports showed Silvercorp having considerably larger resources and higher grades than those found in the Chinese Reports. Again, however, this second consultant also set out in his report that the two sets of numbers should not match as they were prepared on a different basis and for different purposes.

[39] The second consultant did identify other problems in the NI 43-101 reports including an over reliance on internal management prepared data and a lack of independent site visits to the Silvercorp properties that were the subjects of the reports.

[40] Carnes says that the second consultant gave a verbal opinion, not contained in his original or updated reports, that the discrepancies between the Chinese Reports and the reports filed in North America were simply too large to be explained by the differences in the basis of preparation and different reporting circumstances.

[41] We do not believe this evidence. While Carnes was generally credible as a witness, this evidence does not withstand review in light of all the circumstances. It is clear from the e-mail set out in paragraph 36 that Carnes' team wanted the second geological consultant to produce a more damaging report. This "verbal opinion" would be very damaging indeed. If the second geological consultant actually was of this opinion, it does not make sense that this would not have found its way into his report.

[42] Further, Carnes said that no notes were made of a conversation in which this verbal opinion was given, yet Carnes testified that in doing due diligence in China his research team's practice was to take notes of conversations as information had a tendency to change over time. This verbal opinion would have been very significant, yet there are no notes of this conversation. Finally, Carnes attended a two day interview with SEC and BCSC staff in 2012. Carnes never mentioned the existence of the "verbal opinion" notwithstanding considerable questioning on the topic of the second geological consultant's report.

[43] Carnes also says that in his experience the numbers found in Chinese-filed reports and those published in North America often do not match but that they are usually much closer than those found in the Silvercorp reports. Secondly, he says that Chinese reports usually contain greater resource numbers than those found in North American published reports. The reverse was true in this case. While these points were not contradicted by the executive director, we note that Carnes has no formal geological training and we place little if any weight on his evidence on these two points.

[44] On September 13, 2011, four days before the expiry of his Eos' options on September 17, 2011, Carnes posted his report on Silvercorp on his website, Alfredlittle.com. The Silvercorp report did not have attached to it the biography of Alfred Little set out in paragraph 10 above.

[45] The Alfred Little report covers eight pages and raises five main concerns regarding Silvercorp. We note that much of the content, including four of the five concerns, is not in contention in this hearing.

[46] At issue are the following portions of the Alfred Little report:

> This report shows that:
>
> - Heenan Provincial Land & Resource Bureau mining reports [the Chinese Reports] contradict the production, quality and resource estimates of SVM's [Silvercorp] key SGX (Ying) mine as shown in its 40-F and independent NI 43-101 reports that rely heavily upon data provided by management. No independent geologists have visited SVM's SGX mine since 2008.

…

Note: The contributors to this report believe all the information is accurate and the sources quoted are reliable…. Contributors to this report are short SVM.

- Heenan Provincial Land & Resource Bureau mining reports contradict the production, quality and resource estimates of SVM's [Silvercorp] key SGX (Ying) mine as shown in its 40-F and independent NI 43-101 reports that rely heavily upon data provided by management. No independent geologists have visited SVM's SGX mine since 2008.

The authors of SVM's independent 43-101 reports are geologists Chris Broili [Age 63] and Mel Klohn [Age 68], operating together as "BK Exploration Associates", a two man consulting outfit that has no employees, no office and no business license. While both Chris and Mel have strong credentials, their experience is primarily in South America and neither read Chinese thus making them heavily dependent on SVM to assist them in preparing their reports. We have no idea why SVM has not engaged a major international geological consulting firm with offices and staff in China who are already familiar with the SVM's projects to prepare its 43-101 reports. The cost of hiring a reputable firm is negligible compared to the market cap of the company.

…

The L&R Bureau reports show dramatically different production, quality and resource estimates for SVM's key SGX mine compared to the 40-F and 43-101 reports. The following table shows SVM produced **35% less ore and 75% less silver and lead in 2010 compared to its 40-F fiscal year end filing:** [bold reproduced from the original]

…

The measured average quality of the ore mined at SGX varies sharply between L&R Bureau records and SVM's 43-101 report. The records show silver quality (g/t) is 75% to 85% less than reported in the 43-101 for 2009 and 2010. [bold reproduced from the original]

…

According to L&R Bureau records the combined mineral resources (measured + indicated + inferred) of the SGX mine have been declining, in sharp contrast to the 43-101 reports, as shown in the following table:

…

After discovering these disturbing variances, an international geological consulting firm with significant experience evaluating Chinese mines was engaged to review and compare the data in the 43-101 reports to the L&R Bureau's geological reports. After a thorough review the consultant had serious concerns about the reliability of the 43-101 reports, citing:

"Silvercorp has done recent 43-101 reports that are built upon earlier reports rather than significant new information. Check assays are not provided, independent reporting is not complete, and the technical information was not reviewed by the independent qualified person going to site. **The 43-101 reports have deferred to employees from the company to do the reporting on the mine and resource work rather than being independent." [Emphasis added]** The consultant was perplexed by the lack of independent reviews and explained it could indicate conflicts of interest.

Even SVM's investor presentation appears to be misleading, as the consultant found "… the numbers in the corporate PowerPoint do not match the 43-101 reports because of different criteria and neither match the Chinese information." Even if the 43-101 reports are true:

"The SGX mine has calculated reserves that are only 68M Oz of equivalent silver. This is worrisome for a 100M market cap company let alone a $1,000M market cap company. **They should have more resources.**" Even assuming the 43-101 reports are accurate, the consultant believes the geology does not support a market cap of even 1/3 of the current valuation.

The consultant went on to explain that the SGX mine suffers from its very narrow veins that are too narrow to be mined efficiently. SVM is forced to extract a large amount of waste material along with the ore from the narrow veins. The geology requires expensive tunneling and large amounts of labor both underground and at the surface where the materials must be hand sorted…

…

Regarding SVM's business model, the consultant explained that:

> "Integrating a lot of small uneconomic mines as Silvercorp is doing is generally not a way to make a giant low cost economic producer. The business model Silvercorp is doing does not scale up easily. Small resources and expensive to prove up further, low confidence of ability to grow long term and to push for faster production makes the problem worse and typically collapses as a business. High cost producers that are barely economic and rely a lot of low cost manpower and old techniques like hand selection, hand mining, high work force approaches which the Chinese government very well likes but as wage demands increase will not necessarily be a sustainable business.
>
> The consultant concludes: "**Geologically the information found for Silvercorp projects suggests varied reporting, inconsistent reserve numbers, high labour, numerous challenges and not easy to build a large resource.**"
>
> …

[47] The Alfred Little report was posted at 10:30 am on September 13, immediately prior to a presentation by Silvercorp at an investment conference. Carnes intended to have copies of the report handed out at the conference. The release was timed to create the most possible damage for Silvercorp.

[48] Six minutes following the release of the Alfred Little report, another short seller, who had a considerable public following, posted on his website a link to the Alfred Little report. Subsequent media reports also quoted this short seller as supportive of some of the concerns raised by the Alfred Little report.

[49] Silvercorp's shares fell 20% on September 13. The shares opened at $7.95 on the NYSE and closed at $6.30. The market capitalization of the company fell by $288 million on the day.

[50] On September 14, Carnes closed his short position and made a total profit of $2.8 million.

[51] As part of their investigation, the Commission interviewed the second geological consultant. He was asked if he had any serious concerns about the reliability of Silvercorp's NI 43-101 reports. He answered in the negative.

III Law

[52] Section 57(b) of the Act says:

> "A person must not, directly or indirectly, engage in or participate in conduct relating to securities . . . if the person knows, or reasonably should know, that the conduct
> . . .
> (b) perpetrates a fraud on any person."

[53] In *Anderson v. British Columbia (Securities Commission),* 2004 BCCA 7, the British Columbia Court of Appeal stated the following regarding fraud under the Act (at page 29):

> While proof in a civil or regulatory case does not have to meet the criminal law standard of proof beyond a reasonable doubt, it does require evidence that is clear and convincing proof of the elements of fraud, including the mental element.

[54] The *Anderson* decision cited the elements of fraud from *R. v. Theroux,* [1993] 2 SCR 5 (at page 20):

> … the actus reus of the offence of fraud will be established by proof of:
>
> 1. the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and
> 2. deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim's pecuniary interests at risk.
>
> Correspondingly, the mens rea of fraud is established by proof of:
>
> 1. subjective knowledge of the prohibited act; and
> 2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim's pecuniary interests are put at risk).

[55] The Supreme Court of Canada decision in *F.H. v. McDougall,* [2008] 3 SCR 41, makes clear that in civil cases, including cases of fraud, there is only one standard of proof (para. 49):

> In the result, I would reaffirm that in civil cases there is only one standard of proof and that is proof on a balance of probabilities. In all civil cases, the trial judge must scrutinize the relevant evidence with care to determine whether it is more likely than not that an alleged event occurred.

[56] This is the standard that the Commission applies to allegations: see *David Michael Michaels and 509802 BC Ltd. doing business as Michaels Wealth Management Group*, 2014 BCSECCOM 327, para. 35.

IV Positions of the Parties

a) Fraud

[57] The executive director says that the respondent committed fraud contrary to section 57(b) by:

a) knowingly misrepresenting the second mining expert's opinions in the Alfred Little report, which he knew would lead to a drop or risk of a drop in Silvercorp's share price; and

b) knowingly leaving out important facts about the second mining expert and the second mining expert's opinions in the Alfred Little report, which he knew would lead to a drop or risk of a drop in Silvercorp's share price.

[58] In particular, the executive director says that Carnes falsely claimed that the Chinese Reports contradicted the NI 43-101 reports because the Chinese Reports had lower production, quality and resource estimates, and that the second geological consultant supported this claim.

[59] Further, the executive director says that Carnes falsely claimed that the second geological consultant:

a) was an "international geological consulting firm";
b) carried out a "thorough review" of the Chinese filings and the North American filings;
c) had "serious concerns" about the reliability of Silvercorp's NI 43-101 reports;
d) found Silvercorp's investor presentation to be misleading;
e) was of the opinion that the geology of the SGX mine required "expensive tunneling" and large amounts of labour.

[60] The respondent says that the Alfred Little report does not quote the second geological consultant as saying that the Chinese filings contradicted the North American filings and there is therefore no misrepresentation of that expert's opinion. However, the respondent says that if we find that the Alfred Little report does suggest that to be the opinion of the second geological consultant, then the statement is both objectively true and that Carnes had a subjective belief that that statement was true.

[61] With respect to the absence in the Alfred Little report of the second geological consultant's view that the Chinese Reports should not match the NI 43-101 reports, the respondent says:

a) he and the two geological consultants were all in agreement that the differences between the Chinese filings and the North American filings were too large to be explained by the differences in reporting methods between China and North America;
b) he was under no obligation to include all the information contained in the second geological consultant's report and the failure to include this opinion in the Alfred Little report does not constitute fraud.

[62] The respondent says that the second geological consultant that the Hong Kong hedge fund hired to review Silvercorp geological reports was an "international geological consulting firm". Even though the second geological consultant was an individual whose primary occupation was in senior management of a publicly-listed mining company, the respondent says that that individual ran a consulting business as well and that he had considerable expertise in mining projects located around the world. On this basis it was reasonable to say that an "international geological consulting firm" was retained to review the geological information.

[63] The respondent says that whether the second geological consultant carried out a "thorough review" is a subjective assessment and that it would be impossible to conclude that that was an incorrect statement in the circumstances. Secondly, he says that the second geological consultant did an amount of work which justified the description of his efforts as a "thorough review".

[64] With respect to the allegation that the second geological consultant had serious concerns about the NI 43-101 reports, the respondent says that a close review of the Alfred Little report shows that this was Carnes' opinion or interpretation of the expert's views. In addition, Carnes says that he did not have the mens rea for fraud in writing this opinion as he honestly believed that the expert had serious concerns about the reliability of the NI 43-101 reports.

[65] The respondent says that the Alfred Little report does not say that the second geological consultant found the Silvercorp corporate presentation to be misleading but rather this was Carnes' opinion based upon the expert's opinion that the numbers used in that presentation were different from both the Chinese reports and the NI 43-101 reports.

[66] In addition, Carnes says that even if we find that the Alfred Little report suggests that the second geological consultant found the corporate presentations to be misleading, he did not have the mens rea for fraud as he honestly believed that the expert was of the opinion that the corporate presentations created the wrong impression or were misleading.

[67] Finally, with respect to the allegation that the Alfred Little report knowingly misrepresented the second geological consultant's views that the SGX mine required "expensive tunneling" and large amounts of labour, the respondent says that the expert did say that the SGX mine required large amounts of labour. Secondly, Carnes says that the second geological consultant's report said that the SGX mine required *extensive* underground tunneling and that his use of the phrase *expensive* tunneling was simply a typographical error. Carnes says that, notwithstanding the typographical error, the phrase expensive tunneling was a fair summary of the second geological consultant's views on the costs of operating the SGX mine due to its geological characteristics.

[68] In addition to these specific responses to the contents of the Alfred Little report that the executive director says constitute fraud, the respondent also says that there was no evidence tendered during the hearing to establish that any loss arose as a result of the Alfred Little report or its contents.

[69] The respondent says that no expert evidence was called to consider the issue of whether the alleged fraudulent content in the Alfred Little report was material information that would have caused a loss relative to all of the other content in the Alfred Little report which is not alleged to be fraudulent or misleading.

[70] The respondent says that there are other explanations for the drop in the Silvercorp share price on the day the report was released, notably the other short seller's link and support for the report.

[71] The respondent also says that no evidence was called of individual investors who read the Alfred Little report and relied upon it. He also says that within 16 days after publishing it the Silvercorp share price had recovered to its pre-publication price. Lastly, Carnes says that the current share price of the Silvercorp shares of less than $2 suggests that the true price of those shares was considerably lower than in 2011 and that the Alfred Little report did not cause a drop in the Silvercorp share price, it merely aided in the public's perception of the shares' true value.

b) Public Interest Order

[72] The executive director says that some of Carnes' conduct was contrary to the public interest and should result in our issuing an order against the respondent. We discuss the specific conduct below.

[73] The respondent portrays the public interest allegations as an indictment by the executive director of short sellers.

[74] He says the executive director led no expert evidence to suggest that short sellers harm the integrity of the capital markets. He says that his conduct as a short seller is in the public interest because:

a) concerns about public companies and their disclosure should be aired with the investing public and even if concerns expressed by short sellers are wrong, the impugned public companies can refute such claims;
b) short sellers help the market by conducting investigative due diligence;
c) North American regulators have had trouble investigating Chinese companies and short sellers generally and Carnes in particular have played an important role in assisting in regulators in their investigations.

[75] The respondent also says that where the alleged conduct contrary to the public interest was carried out by a non-registrant there is no need to make an order in the public interest to protect the public interest.

[76] He also points to his lack of any previous regulatory misconduct, his history of successfully uncovering misconduct by North American-listed Chinese companies, his previous assistance to regulatory authorities and that his charity benefitted from approximately 80% of the gains in this trade.

[77] He says that the public interest authority should not be used to deal with claims for which there is a civil remedy. The respondent notes that Silvercorp has unsuccessfully attempted to sue Carnes for defamation and lost and that investors have the ability to sue Carnes.

[78] Lastly, Carnes says that the conduct which the executive director says constitutes fraud should not be considered in assessing the public interest authority. Carnes says that if the conduct does not meet the statutory definition of fraud, it would be inappropriate to turn around and make an order in the public interest for the same conduct.

V Analysis and Findings

Fraud allegations

[79] The *Anderson* case makes clear that the starting point for the determination of fraud is whether the respondent has committed a prohibited act (be it deceit, falsehood or some other fraudulent means) and whether that prohibited act has caused deprivation (which may be found through actual loss or through the risk of loss).

[80] The executive director points to specific misstatements in the Alfred Little report that arise from both commissions and omissions. He says these misstatements were the prohibited acts for the purpose of fraud.

[81] It is clear that Carnes intended to write the most damaging report he could, to make the most money possible, and was prepared to write things in a way that connoted or implied things that were not explicitly said. This careful twisting of words and circumstances does not support his arguments about any altruistic motivations or public benefit to his report.

[82] That is not, however, the legal test to determine whether conduct is a prohibited act for the purpose of fraud.

[83] The executive director alleges the following misstatements by commission. We do not find that these alleged misstatements by commission constitute prohibited acts for the purpose of fraud.

Carnes falsely claimed that the Chinese filings contradicted the North American filings because the Chinese filings had lower production, quality and resource estimates, and that the second geological consultant supported this claim

[84] Both geological consultants agreed that the Chinese Reports were significantly different than the NI 43-101 reports. The first bullet point in the Alfred Little report is objectively true – the reports were different in production, quality and resource estimates. This statement therefore is not false and does not constitute a prohibited act for the purpose of fraud.

[85] We address below the fact that the geological consultants were of the view that the reports should not have matched due to different reporting standards and circumstances.

Carnes falsely claimed that the second geological consultant was an "international geological consulting firm"

[86] Carnes' characterization of the second geological consultant is true – he is a geological consultant who has international experience. This statement was no doubt made to imply that the second geological consultant had some expertise and credibility because of this international experience or scope. The statement itself, however, is not false and therefore does not constitute a prohibited act for the purpose of fraud.

Carnes falsely claimed that the second geological consultant carried out a "thorough review" of the Chinese Reports and the NI 43-101 reports

[87] A "thorough review" is a vague statement and a flexible concept. Although the second geological consultant stated he would likely require additional steps to understand all the geological data, it is clear that he did analyze the Chinese Reports and NI 43-101 reports. We do not find the description in the Alfred Little report to be false or deceitful and therefore do not find that this statement constitutes a prohibited act for the purpose of fraud.

Carnes falsely claimed that the second geological consultant had "serious concerns" about the reliability of Silvercorp's NI 43-101 reports

[88] The Alfred Little report also states that the second geological consultant had "serious concerns" about the reliability of the NI 43-101 reports.

[89] Carnes makes the broad statement that the second geological consultant had serious concerns, which, when read carefully, appears to be Carnes opinion, and then follows this statement with a specific paragraph from the second geological consultant's report citing the expert's concerns about the lack of independent review of Silvercorp's data.

[90] Clearly, by placing Carnes' statement next to the excerpt from the consultant's report, Carnes intended to create the impression that the consultant had serious concerns (in the broad sense). That, in and of itself is not enough to constitute the prohibited act because the second geological consultant did express concerns about the NI 43-101 reports given the level of management involvement in the data (and lack of independent site visits etc.) and translations associated with the reports. That is objectively true and the excerpt from the report cited by Carnes is found in the consultant's report. Whether those were "serious concerns" or just "concerns" are a matter of subjective assessment and we do not find that this statement constitutes a prohibited act.

Carnes falsely claimed that the second geological consultant found Silvercorp's investor presentation to be misleading

[91] We agree with the respondent that a careful reading of the Alfred Little report shows that Carnes did not claim that the second geological consultant found the company's investor presentation to be misleading.

[92] In the Alfred Little report, Carnes stated that the investor presentation was misleading and then supported this statement with an excerpt from the second geological consultant's report that set out that the investor presentation numbers did not match either the Chinese Reports or the NI 431-101 reports. Again, by placing his opinion next to an excerpt from the second geological consultant's report, Carnes clearly attempted to create the implication in the reader's mind that the consultant found the investor presentation to be misleading but the Alfred Little report does not actually say that the consultant found the investor presentation to be misleading.

[93] We do not find that this constitutes a prohibited act for the purpose of fraud.

Carnes falsely claimed that the second geological consultant was of the opinion that the geology of the SGX mine required "expensive tunneling" and large amounts of labour

[94] Carnes says that the use of the word "expensive" rather than the word "extensive" (as used in the consultant's report) was a typographical error. Given how carefully the Alfred Little report was drafted, we do not accept that this was simply a typographical error.

[95] However, in this particular case, we do not find the use of the word "expensive" creates a false impression of the expert's view of the mining requirements at the SGX mine. The expert's report shows that he thought the ore body, with its narrow veins, was difficult and expensive (relatively) to mine. Mining the ore body did not lend itself well to modern mining techniques and that it would require significant amounts of manual labour. In the context of the entire report, in our view it is not inaccurate or misleading to say the expert's opinion was that expensive tunneling was required.

[96] We do not find that this statement constitutes a prohibited act for the purpose of fraud.

[97] The executive director alleges the following misstatement by omission. We do not find that it constitutes a prohibited act for the purpose of fraud.

Carnes knowingly did not include in the Alfred Little report important facts about the second geological consultant and the second geological consultant's opinions

[98] The crux of this allegation is that Carnes did not include in the Alfred Little report some or all of the following two statements in the second expert's report which lessen the significance of the difference between the numbers in the Chinese Reports and the NI 43-101 reports:

> The author in reading the reports [the Chinese Reports and NI 43-101 reports] did not note blatant obvious errors or information that suggested misleading based on what is provided.

And later:

> The resource numbers the company producers [sic] for internal Chinese use are different than what it presents to the Canadian and external investors because of different reporting standards and a different focus. Inside China the focus is on total metal in the deposit but in Canadian reporting it is at a different cut off grade, thus a different average grade and focuses more on economics. I worked in China for 8 years back and forth and this issue is constantly coming up as a problem….The Chinese reserve information that was provided differs from the reports and presented by the company but this is due to different legislated cut-off grades and Chinese ways of reporting that are different from Canadian TSX policies.

[99] Carnes offers two explanations as to why he did nothing improper by not including the above two statements in the Alfred Little report.

[100] First, he says that the second geological consultant expressed to him an oral opinion that the differences in the numbers were simply too great to be explained by the rationale the expert provided in his written report. In other words, Carnes claims the consultant's oral opinion was different from what was in his written report. As noted above, we do not accept Carnes' evidence that the consultant gave this oral opinion.

[101] Second, Carnes says that in the Alfred Little report he did not attribute to the consultant the statement that the numbers in the Chinese Reports and NI 43-101 reports do not match, and therefore he did not need to include the two qualifying statements listed above. The parts of the Alfred Little report about the numbers not matching are his own views and are objectively true (the numbers do not match). Further, Carnes says that he was under no obligation to include all of the second geological consultant's views on this subject.

[102] We agree with Carnes that he did not attribute to the consultant the statements that the numbers in the Chinese Report and NI 43-101 reports do not match. Like most aspects of the Alfred Little report, this portion was structured to imply the consultant made these statements, but Carnes was careful to not make that attribution. Therefore, the statements are his views.

[103] In essence, what Carnes did was to cite those parts of the consultant's report that were negative to Silvercorp and used them to reinforce his own opinions in the Alfred Little Report. What Carnes did not do, however, was present any positive statements that the consultant made on the same matter. In doing so, Carnes did not give a full and fair picture of the consultant's opinion on the topic. That, however, falls short of deceit or a falsehood for the purpose of fraud and is therefore not a prohibited act.

[104] As we have found that none of the alleged statements the respondent made in the Alfred Little report constitute a prohibited act for the purpose of fraud, we dismiss the fraud allegation.

Public Interest allegation

(i) General principles

[105] The executive director says that the respondent's conduct was contrary to the public interest and seeks orders against the respondent without a finding that he contravened the Act. It is clear we have the authority to make an order in the public interest without finding a contravention of the Act: *Committee for Equal Treatment of Asbestos Minority Shareholders v Ontario (Securities Commission)*, 2001 SCC 37. The issue is when should a panel exercise that authority.

[106] The Commission made orders in the public interest, without finding a contravention of the Act, in the recent decisions of *Colin Robert Hugh McCabe and Erwin Thomas Speckert* 2014 BCSECCOM 512 and has noted an intention to do so in the findings in *Douglas William Falconer Wood* 2015 BCSECCOM 28. Neither of those decisions include a broader analysis of the appropriate framework in which to analyze the use of the Commission's public interest jurisdiction.

[107] The complexity of the public interest issues in the present case requires us to consider the legal framework of our public interest jurisdiction. The Ontario Securities Commission has dealt with this legal framework in several decisions.

[108] In *Re Canadian Tire Corp* [1987], 10 OSCB 857, the OSC issued a cease trade order against a transaction that was artificially designed to avoid triggering a coattail provision (that would require all shareholders to participate in the transaction). In doing so, the panel adopted an abuse standard when considering whether to exercise its public interest jurisdiction. The panel said that

> in the absence of a demonstrated breach of the Act, the regulations or a policy statement, the conduct or transaction must clearly be demonstrated to be abusive of shareholders in particular, and of the capital markets in general. A showing of abuse is somewhat different from, and goes beyond, a complaint of unfairness. A complaint of unfairness may well be involved in a transaction that is said to be abusive, but they are different tests. Moreover, the abuse must be such that it can be shown to the Commission's satisfaction that a question of the public interest is involved. That almost invariably will mean some showing of a broader impact on the capital markets and their operation.

[109] The *Asbestos* case involved the acquisition of an asbestos manufacturing business by the Quebec government. The target had significant minority shareholders in Ontario. The purchaser acquired a controlling interest in the target from a US shareholder. Although the purchaser had previously indicated an intention to make a follow-up bid to the minority shareholders, as was required under Ontario's securities legislation, following acquisition of control, the purchaser subsequently indicated that it had no intention of making that follow-up bid.

[110] The Ontario commission held that the *Canadian Tire* abuse test was the appropriate test to determine whether it should exercise its public interest authority. In that case, the commission held that the controlling interest was acquired at a substantial premium and the failure to make the follow-up offer was inconsistent with the province's take-over bid legislation and abusive to minority shareholders. However, the commission did not make an order on the basis that there was not a sufficient connection to Ontario to trigger the commission's authority.

[111] The Supreme Court of Canada ultimately found the Commission's decision in *Asbestos* reasonable. In its decision, the Court set out the principles underlying securities commissions' public interest jurisdiction. The Court stated at paragraph 45:

> In summary, pursuant to s. 127(1), the OSC has the jurisdiction and a broad discretion to intervene in Ontario capital markets if it is in the public interest to do so. However, the discretion to act in the public interest is not unlimited. In exercising its discretion, the OSC should consider the protection of investors and the efficiency of, and public confidence in, capital markets generally. In addition, s. 127(1) is a regulatory provision. The sanctions under the section are preventive in nature and prospective in orientation. Therefore, s. 127 cannot be used merely to remedy *Securities Act* misconduct alleged to have caused harm or damages to private parties or individuals.

[112] Section 127(1) of the Ontario *Securities Act* is substantially similar to section 161 of the Act.

[113] It is important to note that the *Canadian Tire* and *Asbestos* decisions occurred in the context of the review and regulation of capital markets transactions, and not in the context of an enforcement hearing. However, the OSC considered those decisions in several enforcement cases: *Biovail Corp. Re* (2010), 33 O.S.C.B. 8914; *Re Donald* (2012), 35 O.S.C.B 7383; *Re Suman* (2012), 35 O.S.C.B. 2809 and *Re Jowdat Waheed and Bruce Walter* (2014), 37 O.S.C.B. 8007.

[114] In *Biovail* , the OSC considered whether Biovail, a TSX-listed issuer, had made misleading statements or statements that were untrue to a material extent in certain earnings related press releases. The panel found that the statements were misleading but held that there were no breaches of securities laws because the information was contained in press releases that was not required to be filed under the Ontario *Securities Act*.

[115] Although the OSC panel found no breach of securities laws, it made an order under its public interest jurisdiction against Biovail's CEO. In doing so, the panel determined that it was not necessary to find abuse (as required under the test in *Canadian Tire*) and outlined the following, at para 382:

> …where the conduct engages the animating principles of the Act, the Commission does not have to conclude that an abuse has occurred in order to exercise its public interest jurisdiction.

[116] And later, at para 388, it stated that there is an

> …essential public interest in ensuring that all public statements made by reporting issuers and others are accurate and not misleading or untrue and can be relied upon by investors in making investment decisions.

[117] Importantly, the panel went on to provide that it was not every issuance of a statement that was misleading or untrue in a material respect that should lead to a public interest order.

[118] In *Suman*, the respondent communicated undisclosed material information to his wife with respect to the proposed acquisition of a NASDAQ-listed company. The respondent and his wife purchased shares of the target and made a substantial profit on the purchase of those shares. The OSC panel determined that this conduct did not contravene the insider trading provisions of the Ontario *Securities Act* as the target was not a reporting issuer in Ontario. The panel found that had the target been a reporting issuer in Ontario, then the conduct would clearly have been a contravention of Ontario securities laws.

[119] In *Suman*, in making an order under its public interest jurisdiction, the panel held that it was not necessary to make a finding that the conduct was abusive to the capital markets. It held that the conduct in that case was merely inconsistent with the intent of the Ontario insider trading legislative provisions and therefore contrary to the public interest.

[120] In *Donald*, the OSC considered insider trading allegations against the respondent. Donald was an officer of Research in Motion when he learned from another officer of RIM that RIM, while not currently in discussions, had previously had acquisition discussions with, and had an ongoing interest in acquiring, another public company. Donald then purchased shares of the potential target company. RIM subsequently launched a bid for the target and Donald ultimately made a substantial profit on his purchase of the target's shares.

[121] The panel found that the above conduct did not amount to a contravention of insider trading provisions of the Ontario *Securities Act*, because, in order for those provisions to apply RIM must, at the time the information was disclosed to Donald, have made a decision to make an offer to acquire the target.

[122] In *Donald*, in making an order under its public interest jurisdiction, the panel returned to the *Canadian Tire* abuse standard and said that Donald's conduct was abusive to the capital markets.

[123] Further, Donald was an officer of a public company and was therefore expected to adhere to a high standard of conduct. Donald's purchase of the target's shares, when material facts were undisclosed, failed to meet this standard.

[124] In *Waheed*, an insider trading case, the panel found the respondents did not contravene the Ontario *Securities Act* because the confidential facts in issue, obtained during an consultancy arrangement, were no longer material facts at the time of trading activity by the respondents.

[125] The OSC panel dismissed staff's application for an order in the public interest, on the grounds that it would be inappropriate to make a public interest order for using confidential information that was neither a material fact nor a material change for the issuer.

[126] The panel also held that any breach of confidentiality provisions in Waheed's consulting arrangement or a breach of a duty of loyalty could not form the basis for a public interest order. The panel stated that the enforcement of private contractual arrangements should not form the basis of a public interest order.

[127] Importantly, *Waheed* suggests a narrower use of the public interest jurisdiction in Ontario from *Biovail, Donald* and *Suman*. The panel's rejection of staff's public interest allegation in *Waheed*, suggests that, having failed to establish that the respondents' conduct contravened the insider trading provisions of the Act, staff could not use the same evidence as the basis of a public interest order. In other words, the panel dismissed the notion that they should establish, via a public interest order, that an enforcement action could be brought for the alleged misuse of confidential information that was neither a material fact or a material change. Such an order would represent a new, and lower threshold, for regulatory misconduct, by way of illegal trading, by a market participant.

[128] As can be seen, the OSC cases diverge on whether to take a narrower or a broader basis for exercising the public interest jurisdiction. The narrower basis requires a finding that the conduct was abusive of capital markets, or that a particular financial structure was used with the intent of avoiding contravening a specific provision of the Act. The broader basis, represented by the *Biovail* decision, is founded upon the concept that a range of factors should be considered but that an order may be made without a finding of abuse where the conduct is inconsistent with the animating principles of the Act.

[129] We recognize that when a panel issues an order in exercise of its public interest jurisdiction, the order has the effect of restraining or prohibiting conduct that is not prohibited specifically by legislation. Market participants should be able to structure their affairs within the context of the specific provisions of the Act, without fear of enforcement actions alleging wrongdoing that is not encoded in the Act, regulation or rules of the Commission.

[130] This is not to say that the Commission's public interest jurisdiction should never be used in the enforcement context. In fact, the authority to issue orders in the public interest is a necessary and important enforcement tool to assist the Commission's mandate of protecting investors and the integrity of British Columbia's capital markets.

[131] In the enforcement context, where the Act prohibits specific conduct, and an allegation involving that type of conduct is found not to contravene the Act, then only in very rare circumstances would it be in the public interest to issue an order based on that same conduct. Generally, the conduct would need to be abusive of the capital markets in order to make such an order. A finding that a respondent had artificially structured their affairs with the intent of placing their conduct outside of the wording of the Act would also be relevant but not a necessary element of such an order.

[132] Where the Act is generally silent with respect to a type of conduct alleged as the basis for a public interest order, as was the case with the respondent Speckert in *McCabe*, then the above may or may not be the applicable test. As discussed below, we do not need to decide that in this case because those are not the circumstances before us.

(ii) Application of general principles

[133] The executive director says that the respondent's following conduct was contrary to the public interest:

a) the use of a fake name to author his reports;
b) the use of a fake biography to enhance the credibility of his reports;
c) creating a fake research organization, IFRA to enhance the credibility of his reports;
d) misleading investors by making his website look like an independent clearinghouse where there were multiple contributors, in order to enhance the credibility of the reports found on the site;
e) the conduct that the executive director says constitutes fraud;
f) retaining the first geological consultant using a fake name, a fake company and a retainer agreement signed with the fake company that was not enforceable;
g) publishing the negative report on Silvercorp at a time that would cause the biggest drop in its share price; and
h) failing to mention that his Silvercorp report was published just four days prior to the expiry of his put options.

[134] The allegation that the circumstance of retaining the first geological consultant (item (f.), above) is contrary to the public interest fails on the basis outlined in *Waheed* – the engagement of a geological consultant is a private matter for which there are civil remedies, if any, available through the courts. Our mandate does not include regulating these matters.

[135] The remaining allegations all relate to Carnes' public statements about an issuer and matters related to those statements, such as creating a fake biography and a fake research organization to enhance the credibility of his reports.

[136] The fraud and misrepresentation provisions of the Act prohibit certain conduct related to statements made in relation to securities. In this case, we have determined that the respondent's conduct does not constitute fraud and there was no allegation of misrepresentation.

[137] Further, this case is really about the contents of Carnes' disclosure in the Alfred Little report. The allegations about Carnes' fake identity only become relevant in the context of the concerns about the contents of his report. In these circumstances, given that the central element of the impugned conduct is the content of the disclosure, which is an area where the Act has articulated specific acts which constitute misconduct, the appropriate test is whether the conduct is abusive to the capital markets.

[138] Carnes carefully crafted the Alfred Little report to achieve a specific end – to create the most damaging report to drive down the price of Silvercorp shares. The report did not fairly present the full results of his due diligence, for example by omitting to state the explanation for the difference between the resource numbers in Silvercorp's Chinese Reports and NI 43-101 reports. Further, as we note above, the report is full of implication and innuendo to compel the reader to a certain conclusion. Carnes achieved his goal and profited from the decline in Silvercorp's share price.

[139] We find Carnes' claim that his conduct had a public benefit to be specious and self-serving.

[140] However, if we were to make an order in the public interest in this case, we would, in effect, be creating a new requirement for statements which would be something akin to "fair presentation". That is beyond what the legislature has enacted. We have significant concerns about the implications of such a finding. For example, would research analysts who publish recommendations on stocks be subject to such a standard and what would that mean when those reports are built upon opinion? It is not our role to sanction all persons who publish opinion about public companies, regardless of how fair or warranted some of those opinions might be.

[141] While we may find Carnes' conduct unsavory, we do not find it was clearly abusive to the capital markets and therefore it is not necessary to make an order in the public interest. It is not our role to sanction conduct we find morally unsupportable. As the Supreme Court of Canada noted in *Asbestos*:

> The focus of regulatory law is on the protection of societal interests, not punishment of an individual's moral faults.
>
> (paragraph 42)

[142] We dismiss the executive director's application for an order in the public interest.

May 14, 2015

For the Commission

Nigel P. Cave
Vice Chair

Judith Downes
Commissioner

Audrey T. Ho
Commissioner