2004 BCSECCOM 289

COR#04/091

L.O.M. Medical International, Inc. and John Klippenstein

Section 161(1) of the *Securities Act,* RSBC 1996, c. 418

Hearing

Panel	Brent W. Aitken	Vice Chair
	Marc A. Foreman	Commissioner
	Robert J. Milbourne	Commissioner
Dates of Hearing	2003: June 9, October 9, 10; 2004: March 15, April 5	
Date of Decision	May 28, 2004	

Appearing

Joyce M. Joyner	For the Executive Director
Winton Derby, Q.C. T. McCafferty	For L.O.M. Medical International, Inc.
John Klippenstein	For himself

Decision

¶ 1 This is a hearing under section 161(1) of the *Securities Act*, RSBC 1996, c. 418. On October 24, 2002, the Executive Director issued a notice of hearing alleging that L.O.M. Medical International, Inc. and John Klippenstein contravened the Act. The Executive Director amended the notice of hearing on June 18, 2003 and July 30, 2003. Each amendment included new allegations.

Background to the Proceedings

¶ 2 The Commission set the hearing for June 9, 2003. On that date, LOM and Klippenstein applied for an adjournment. On June 24, 2003 the Commission granted the adjournment and issued a temporary cease trade order against LOM. This panel adjourned the hearing twice more by consent on July 9 and August 13, 2003 and set the hearing for October 9, 2003. On that date we refused an adjournment application by Klippenstein. We heard two days of evidence and adjourned to March 15, 2004.

¶ 3 On March 15, the parties presented Agreed Statements of Facts entered into between the Executive Director and each of LOM and Klippenstein, as well as a Joint Recommendation on Sanctions against Klippenstein made by the Executive Director and Klippenstein. These documents are attached as Appendices 1, 2 and 3.

¶ 4 Attached to Appendix 1, the LOM Agreed Statement of Facts, is a letter agreement between LOM and Le Monde International Holdings Ltd., in which Le Monde has agreed to purchase an LOM debenture on certain conditions. At the hearing, LOM applied for a variance of the June 24, 2003 cease trade order against LOM so that LOM could issue the debenture. On March 19, 2004 we granted the variance, on the condition that LOM use the proceeds of the debenture solely for the purpose of funding accepted rescission offers made, or to be made, by LOM to existing LOM securityholders.

¶ 5 The rescission offers arose from discussions that LOM and Klippenstein had with Commission staff in 2001 regarding compliance with the Act. In August 2001, LOM made rescission offers to the 344 British Columbia investors that had up to that time invested in LOM. As of April 2002, 59 investors had accepted the offers, but LOM had made refunds only to 25 of them ostensibly due to a lack of funds.

¶ 6 On April 5, 2004 we heard submissions on sanctions for LOM and on questions we had put to the parties arising out of the documents presented on March 15.

Agreed Facts

LOM

¶ 7 LOM agreed to these facts in its Agreed Statement of Facts:

1. During the relevant period (October 31, 1996 to March 6, 2003), LOM distributed securities to 352 British Columbia investors for total proceeds of about US$1.4 million and Cdn$279,000.

2. LOM was not registered under the Act, nor did it file a prospectus; none of the exemptions from the registration and prospectus requirements applied to the distributions. LOM therefore contravened sections 34(1) and 61(1) of the Act.

3. Klippenstein was the president, a director, controlling shareholder and controlling mind of LOM during the relevant period.

4. As of January 1, 2004, Klippenstein is no longer the president or a director of LOM, and has agreed to have his, and his family's, shares of LOM placed in a

voting trust that will essentially vote the shares as the LOM board of directors directs, as contemplated by the Le Monde agreement. Klippenstein has also agreed to play no management role in LOM and has acknowledged that the board of directors of LOM will be independent of his influence.

Klippenstein

¶ 8 Klippenstein agreed to these facts in his Agreed Statement of Facts:

5. The facts in paragraphs 1 through 4.

6. Klippenstein was not registered under the Act. Klippenstein participated in or directed the LOM distributions. Klippenstein therefore contravened sections 34(1) and 61(1) of the Act.

7. In contravention of section 50(1)(d) of the Act, Klippenstein misrepresented to investors of LOM, both orally and in newsletters that:

   a. LOM securities would shortly be listed and posted for trading on a stock exchange and would then trade at higher prices, and
   b. a product would be shortly manufactured by LOM and ready for distribution.

8. In November 1993, the Saskatchewan Securities Commission sanctioned Klippenstein for contravening the provisions of the *Securities Act (Saskatchewan)* that correspond to sections 34 and 61 of the Act, for the distribution of securities in three companies related to LOM.

¶ 9 The Saskatchewan Commission removed exemptions from Klippenstein for a 5-year period ending in November, 1998.

Submissions

¶ 10 At the April 5 hearing, we asked Klippenstein to detail the impact of his involvement with LOM on his personal finances. This is a summary of the information that Klippenstein provided in response to that request:

- Between December 1996 and April 2004, Klippenstein, his family, and related corporations received $1,568,713 in salaries, directors' fees and management fees ($1,357,716), rent for LOM office space ($166,022), and reimbursed automobile expenses ($44,975).

- During the same period, Klippenstein his family, and related corporations funded LOM in the amount of $1,230,244 through purchases of LOM shares

and cash infusions ($748,840), unpaid salaries ($446,427) and unpaid rent ($34,977).

Decision

¶ 11 In *Re Eron Mortgage Corp.*, [2000] 7 BCSC Weekly Summary 22, the Commission cited a non-exhaustive list of factors that are usually relevant to making orders against a person under sections 161(1) and 162. They are:

- the seriousness of person's conduct,
- the harm suffered by investors as a result of the person's conduct,
- the damage done to the integrity of the capital markets in British Columbia by the person's conduct,
- the extent to which the person was enriched,
- factors that mitigate the person's conduct,
- the person's past conduct,
- the risk to investors and the capital markets posed by the person's continued participation in the capital markets of British Columbia,
- the person's fitness to be a registrant or to bear the responsibilities associated with being a director, officer or adviser to issuers,
- the need to demonstrate the consequences of inappropriate conduct to those who enjoy the benefits of access to the capital markets,
- the need to deter those who participate in the capital markets from engaging in inappropriate conduct, and
- orders made by the Commission in similar circumstances in the past.

¶ 12 In *Re Cartaway Resources Corp.*, 2004 SCC 26, the Supreme Court of Canada confirmed the appropriateness of general deterrence as a factor to consider in making orders in the public interest. The court said:

> 55 In this appeal we are asked whether it is reasonable to decide that general deterrence has a role to play in the policing of capital markets. The conventional view is that participants in capital markets are rational actors. This is probably more true of market systems than it is of social behaviour. It is therefore reasonable to assume, particularly with reference to the expertise of the Commission in regulating capital markets, that general deterrence has a proper role to play in determining whether to make orders in the public interest and, if they choose to do so, the severity of those orders.
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> 56 This approach is consonant with United States securities jurisprudence, which accepts that general deterrence may be a consideration in imposing penalties for fraudulent behaviour. The rationale

> is that the public interest demands appropriate sanctions to secure compliance with the rules, regulations and policies of the Securities and Exchange Commission ("SEC"): see, e.g., United States v. Matthews, 787 F.2d 38 (2d Cir. 1986), at p. 47. Civil penalties are increasingly important to the SEC for a number of reasons, including general deterrence: see R. G. Ryan, "Securities Enforcement: Civil Penalties in SEC Enforcement Cases: A Rising Tide" (2003), 17 Insights 17.
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> 60 In my view, nothing inherent in the Commission's public interest jurisdiction, as it was considered by this Court in [*Committee for Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)* [2001] 2 S.C.R. 132] prevents the Commission from considering general deterrence in making an order. To the contrary, it is reasonable to view general deterrence as an appropriate, and perhaps necessary, consideration in making orders that are both protective and preventative.
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> 61 The Oxford English Dictionary (2nd ed. 1989), Vol. XII, defines "preventive" as "[t]hat anticipates in order to ward against; precautionary; that keeps from coming or taking place; that acts as a hindrance or obstacle". A penalty that is meant to deter generally is a penalty that is designed to keep an occurrence from happening; it discourages similar wrongdoing in others. In a word, a general deterrent is preventative. It is therefore reasonable to consider general deterrence as a factor, albeit not the only one, in imposing a sanction under s. 162. The respective importance of general deterrence as a factor will vary according to the breach of the Act and the circumstances of the person charged with breaching the Act.
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> 62 It may well be that the regulation of market behaviour only works effectively when securities commissions impose ex post sanctions that deter forward-looking market participants from engaging in similar wrongdoing. That is a matter that falls squarely within the expertise of securities commissions, which have a special responsibility in protecting the public from being defrauded and preserving confidence in our capital markets.

Klippenstein

¶ 13 In the Klippenstein Joint Recommendation on Sanction, the Executive Director and Klippenstein recommended that we remove exemptions from Klippenstein, prohibit him from acting as a director or officer of any issuer, and prohibit him

from engaging in investor relations activities, all for 7 years, and order him to pay an administrative penalty of $10,000 and costs of $20,000.

¶ 14 Applying the factors cited in *Eron*, we note the following:

¶ 15 LOM, under Klippenstein's direction, raised over Cdn$2 million from 352 British Columbia investors without being registered, filing a prospectus, or using an exemption. Klippenstein also made misrepresentations to investors. The registration and disclosure requirements (including the prohibition against making a misrepresentation) are the heart of the investor protection regime in the Act. The integrity of British Columbia's capital markets is damaged when substantial sums are raised from investors in contravention of those requirements.

¶ 16 The harm to the LOM investors has not been quantified. It is possible that ultimately their investment may pay off, but as matters stand now they have invested over $2 million and appear to have little to show for it. At a minimum, they have, at this point in time, suffered an opportunity cost.

¶ 17 Meanwhile, since 1996, Klippenstein and his family have received about $1,569,000 in cash through various forms of compensation, rent and allowances. This exceeds by about $339,000 their cash investment in LOM of about $1,230,000. If they are successful in ultimately collecting the approximately $481,000 that Klippenstein claims they are owed by LOM, their net cash take from LOM since 1996 will rise to about $820,000, an amount that represents roughly 40% of the amount British Columbia investors have invested in LOM.

¶ 18 Klippenstein's conduct also has to be considered in light of his prior regulatory sanction. He was sanctioned by the Saskatchewan Commission for exactly the same conduct – selling shares in companies he was promoting without being registered, and without filing a prospectus. Furthermore, the Saskatchewan Commission orders were still in force when he began his illegal distributions in British Columbia (those orders did not expire until November 1998, two years after he began his activities here).

¶ 19 The Joint Recommendation offers as a mitigating factor Klippenstein's use of attorneys and accountants in the United States to ensure compliance with US securities laws. We do not view this as a mitigating factor – LOM was required to comply with British Columbia law, not US law, in connection with its distributions of securities to residents of British Columbia.

¶ 20 Klippenstein has demonstrated that he is a threat to the capital markets of British Columbia. When he began his activities in British Columbia, he was under sanction by another securities regulator for the same conduct. He knew there were

regulatory requirements that applied to the sale of securities. Nevertheless, he proceeded to sell securities in contravention of the Act. In addition, he made misrepresentations to investors both orally and in newsletters during the relevant period. This conduct shows an utter disregard for the Act, and that he is unfit to act as a director or officer of an issuer or to engage in investor relations activities.

¶ 21 In *Re Gordon Dix Jr., Ronald James Henry and Sota Mining Group*, 2001 BCSECCOM 944, the Commission removed exemptions from Dix and Henry, prohibited them from acting as directors and officers, and prohibited them from engaging in investor relations activities, all for 10 years. The Commission also ordered each of them to pay an administrative penalty of $25,000. They had raised $128,000 from 12 investors in an illegal distribution. An aggravating factor was their targeting of the elderly and unsophisticated.

¶ 22 In *Re Foster*, 2002 BCSECCOM 392, Foster consented to orders made by the Executive Director that removed exemptions from Foster, prohibited him from acting as a director or officer, and prohibiting him from engaging in investor relations activities, all for 12 years. Foster also agreed to pay to the Commission the sum of $35,000, of which $5,000 represented the costs of the investigation. Foster raised hundreds of thousands of dollars from investors in an illegal distribution. Aggravating factors were his failure to discharge his duties to his clients as a registrant, and his complicity in misrepresentations made to investors. The Executive Director considered Foster's loss of $40,000 as a mitigating factor.

¶ 23 Klippenstein raised more funds from more investors than either of these cases. He demonstrated disregard for the Act. His prior sanction for the same conduct apparently had no effect whatsoever on his behaviour. Klippenstein also caused LOM to pay him and his family substantial sums of cash while his investors waited (to this point in time, in vain) for a return on their investment. We are therefore of the view that a significant sanction is necessary to impress on Klippenstein the seriousness of contravening the core elements of investor protection contained in the Act.

¶ 24 It is also appropriate that the sanctions we impose demonstrate to others the consequences of inappropriate behaviour, and act as a deterrent.

LOM

¶ 25 During the relevant period, Klippenstein was the acting and directing mind of LOM.

¶ 26 A consideration of what orders are in the public interest requires us to consider the interests of the LOM shareholders. If the shares of LOM continue to be cease traded, or if we were to impose sanctions on LOM that would be financially

burdensome, or unduly restrict its ability to continue with the financing and development of its business, any opportunity for its shareholders to recoup their investment could be lost.

¶ 27 Klippenstein has already resigned as a director and officer of LOM, and by the orders below is unable to act in that capacity for another 10 years. In addition, if the Le Monde agreement becomes effective, Klippenstein's control of LOM as a shareholder will effectively be severed.

¶ 28 As noted above, the contraventions attributable to LOM are solely as a result of Klippenstein's actions. We do not think, in these circumstances, that it would serve either the public interest or the interests of LOM's shareholders to impose sanctions on LOM.

Orders

¶ 29 Therefore, considering it to be in the public interest, we order:

Klippenstein

1. under section 161(1)(c) of the Act, that the exemptions described in sections 45 to 47, 74, 75, 98 and 99 of the Act do not apply to Klippenstein for a period of 10 years expiring on May 28, 2014, except that Klippenstein may rely on the exemption in section 45(2)(7) of the Act to trade securities for his own account through a registrant, if he gives the registrant a copy of this decision;

2. under section 161(1)(d)(i), that Klippenstein resign any position he holds as a director or officer of any issuer, except an issuer owned solely by himself or his family;

3. under section 161(1)(d)(ii), that Klippenstein be prohibited from becoming or acting as a director or officer of any issuer for a period of 10 years expiring on May 28, 2014, except an issuer owned solely by himself or his family;

3. under section 161(1)(d)(iii), that Klippenstein be prohibited from engaging in investor relations activities for a period of 10 years expiring on May 28, 2014;

4. under section 162, that Klippenstein pay an administrative penalty of $100,000;

5. under section 174, that Klippenstein pay costs of or related to the hearing in the amount of $20,000; and

LOM

6. under section 171, that the cease trade order against LOM made by this Commission on June 24, 2003 (COR #03/099) is revoked, on the conditions that:

    a) LOM complete the rescissions contemplated in our March 19, 2004 variation order (COR#04/037), and

    b) Klippenstein and his family members comply with conditions substantially the same as those contained in paragraph 6(g) of the Le Monde agreement (attached to Appendix 1 to this decision).

¶ 30 May 28, 2004

¶ 31 **For the Commission**

Brent W. Aitken
Vice Chair

Marc A. Foreman
Commissioner

Robert J. Milbourne
Commissioner