2005 BCSECCOM 648

Nano World Projects Corporation and Robert Papalia

Sections 161 and 162 of the *Securities Act,* RSBC 1996, c. 418

Hearing

Panel	Robin E. Ford	Commissioner
	Marc A. Foreman	Commissioner
	John K. Graf	Commissioner
Dates of hearing	March 7 and 8, 2005	
Date of findings	June 22, 2005	
Date of decision	October 27, 2005	
Submissions on sanctions by		
Adrianne Marskell	For the Executive Director	

Decision

Introduction

¶ 1 This is our decision on sanctions under sections 161 and 162 of the *Securities Act*, RSBC 1996, c. 418, which should be read with our findings on liability of June 22, 2005 (2005 BCSECCOM 441).

¶ 2 In our findings on liability, we directed the Executive Director to file written submissions on sanctions and costs. The Executive Director sent the submissions to Nano World Projects Corporation and Robert Papalia. Nano World and Papalia have neither filed submissions on sanctions nor requested an opportunity to make oral submissions.

¶ 3 The Executive Director also filed an affidavit setting out evidence of Papalia's links to British Columbia. We admit it as Exhibit 6.

Background

¶ 4 From April 2000 to February 2001, Papalia was a resident of British Columbia. He has never been registered under the Act.

¶ 5 Nano World was a company incorporated in Delaware. In filings with the United States Securities and Exchange Commission (SEC), it listed its principal place of

business as South Bothell, Washington until November 2000, then as New York, New York.

¶ 6 Papalia became a director of Nano World on April 17, 2000. He was chairman of the board from August 21, 2000. He became chief executive officer of Nano World on December 12, 2000.

¶ 7 Nano World's stock was quoted publicly on the US Over-The-Counter Bulletin Board (OTCBB). In April 2001, it was delisted for failing to file required periodic reports. On November 8, 2002, the Delaware Secretary of State deemed Nano World to be an "inactive" corporation.

¶ 8 Nano World had significant connections with British Columbia. The company reported a BC business and mailing address in SEC filings and maintained a corporate office in Vancouver, BC with support staff. It used the services of a securities law firm in Vancouver. Nano World has never been registered under the Act.

¶ 9 In summary, in our findings on liability, we concluded that:

1. in issuing seven press releases, Nano World and Papalia breached section 50(1)(d) of the Act (misrepresentation);

2. Nano World and Papalia breached section 57.1(b) of the Act (fraud) when Papalia and (through Papalia) Nano World knowingly or recklessly made false or misleading statements in the press releases that put investors' pecuniary interests at risk, and

3. Papalia breached section 57.1(b) of the Act (fraud) when he sold Nano World shares, knowing or reckless to the fact that he sold the shares into a market in which the material facts necessary to correct his misrepresentations had not generally been disclosed, and so put investors' pecuniary interests at risk.

¶ 10 We also found that Nano World's and Papalia's conduct which breached sections 50 and 57.1 of the Act was contrary to the public interest.

Executive Director's submissions

¶ 11 The Executive Director asks that we:

- ban Papalia permanently from acting as a director or officer of an issuer and performing investor relations activities,
- impose an administrative penalty of $75,000, and

- order that all persons cease trading in the securities of Nano World until Nano World has filed a prospectus and obtained a receipt for it from the Executive Director, except that a beneficial shareholder of Nano World who is not, and during the period from September 2000 through January 2001 was not, an insider or control person of Nano World may sell securities of Nano World acquired before the date of the order if:

    1. the sale is made through a market outside Canada,
    2. the sale is made through an investment dealer registered in British Columbia, and
    3. the investment dealer maintains a record of the details of the sales made under this provision.

¶ 12 The Executive Director also asks us to order that, under section 174 of the Act and *Securities Regulation*, BC Reg. 196/97, section 22, items 27 and 28, Papalia pay the prescribed fees or charges of or related to the hearing in the amount of $36,766.40.

¶ 13 The Executive Director says that previous Commission decisions provide limited guidance in assessing what sanctions are appropriate in this case. There is only one recent decision involving the use of news releases to manipulate the market or perpetrate a fraud under sections 57 or 57.1 of the Act - *Durante* 2004 BCSECCOM 634. However, unlike Papalia, Durante deliberately set out to take money from investors, knowing they would not get it back. He was substantially enriched by his fraudulent activity; it appears that Papalia and Nano World were not.

¶ 14 Nevertheless, says the Executive Director, by conducting Nano World's corporate activities from British Columbia and committing fraud, Papalia and Nano World harmed this province's capital markets. Any cross-border misconduct originating in British Columbia threatens investors and the reputation of British Columbia as a good place to invest and raise capital. Papalia's conduct in knowingly or recklessly making false and misleading statements in news releases put investors' pecuniary interests at risk.

¶ 15 The Executive Director asks for reasonably stiff sanctions so wrongdoers will not make British Columbia a preferred jurisdiction in which to do business. The Commission sanctions should recognize the gravity of Papalia's misconduct and the risk he presents to our capital markets.

¶ 16 In the action brought by the SEC against Papalia, the US District Court, Western District of Washington at Seattle (Case No. C03-683P) found that Papalia had

committed securities fraud under US law by approving four of the seven news releases. The Court also found that he was substantially unfit to serve as an officer or director of a publicly held company. The Court permanently prohibited Papalia from acting as a director and officer of any issuer that has a class of securities registered under section 12 of the US Securities Exchange Act of 1934 or that is required to file reports under section 15(d) of that Act. This, says the Executive Director, would include all OTCBB issuers, because they are all subject to this requirement.

¶ 17 The US District Court said:

> The Court finds that this sanction is appropriate because of the repeated nature of the violation. The defendant's failure to recognize that his statements were misleading and his lack of recognition that public companies must engage in business practices that reflect due diligence, caution and documentation. Mr. Papalia has been a businessman all his life and there is little doubt that if he chooses to work again it will be in a business related capacity and that he will capitalize on his long-standing friendships and business acquaintances. It is his lack of understanding of the heightened requirements for publicly traded companies that makes it inappropriate to allow him to be an officer or director. (para II.B.3.17 of the judgment referred to in our findings on liability at para 15)

¶ 18 The US District Court fined Papalia US$33,000, noting that it had imposed the minimum fine because counsel for the SEC had not presented any basis or argument for a more severe penalty.

¶ 19 We relied in large part on the US District Court's findings and the evidence before it to make our findings against Papalia and Nano World. It is appropriate, says the Executive Director, for the Commission to come to the same conclusion, that a permanent ban is necessary to protect the public in British Columbia and the reputation of our capital markets.

¶ 20 The Executive Director says that any prohibition against Papalia's involvement in the securities market that falls short of a permanent ban risks encouraging Papalia, once the prohibitions in British Columbia are exhausted, to resume carrying on business in British Columbia to take advantage of US investors. For example, Papalia could choose to run an OTCBB issuer from BC through nominees to avoid detection for breaching the US District Court order.

¶ 21 The Executive Director says that there is a strong possibility that Papalia will return to do business in British Columbia. Although he has apparently moved to Italy, he continues to have personal and business ties to British Columbia. Papalia

has been a director or officer of public companies with head offices in British Columbia for approximately 20 years. His brother is often involved in the same companies. His brother continues to reside in West Vancouver, British Columbia.

¶ 22 Before Papalia made his misrepresentations, the price of Nano World shares was $10.19 USD. By January 2001, the price had dropped below $1 USD. The company's lack of any inherent value, says the Executive Director, shows that the misrepresentations in the news releases were the only possible cause of the temporary price and volume spikes. This means that the news releases were directly responsible for investor losses.

¶ 23 The Executive Director says that it is appropriate to impose an administrative penalty of $75,000 on Papalia because he knew he was issuing false or misleading news releases and he intended that the market act on those news releases. He did that seven times. This is a significant administrative penalty, and will send a message to the market that this behaviour will not be tolerated. This amount takes into consideration the fact that Papalia sold securities when he knew material facts about Nano World had not been generally disclosed, but did not profit from that sale. The Executive Director does not ask us to impose an administrative penalty on Nano World.

¶ 24 The Executive Director also asks us to impose a cease trade order on the securities of Nano World until Nano World has filed a prospectus with the Executive Director and obtained a receipt for it. This would prevent distributions in British Columbia and alert the market to the problems with Nano World's disclosure. Nano World was removed from the OTCBB quotation system in April 2001 for failure to make required filings, but, says the Executive Director, has been quoted on the US Pink Sheets at least as recently as October 2003. The cease trade order should not prejudice the rights of any Nano World shareholders who never were insiders or control persons of Nano World. These innocent shareholders, says the Executive Director, should still be permitted to sell their securities into whatever market that may exist for them. This would be consistent with *BC Instrument* 57-501 – Partial Variation for Cease Trade Orders of Certain Issuers.

¶ 25 Our earlier findings on Papalia's conduct, says the Executive Director, show his blatant disregard for the pecuniary interests of investors and the integrity of British Columbia markets. His behaviour calls for a clear message that the Commission will take a firm stand against serious misconduct in British Columbia that preys on investors and markets, wherever they are.

Our Reasons

¶ 26 In making our decision, we are guided by the Commission's decision in *Re Eron Mortgage Corp,* [2000] 7 BCSC Weekly Summary 22. The decision sets out a

non-exhaustive list of factors we usually consider when making orders against a person under sections 161(1) and 162 of the Act:

- 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.

¶ 27 Applying the *Eron* criteria, Papalia's conduct was serious and prejudicial to the public interest. As a long-time businessman involved in raising capital, Papalia knew about the requirements of the securities legislation and about the requirements for disclosure. Papalia reviewed, and approved the issue of, each of the seven press releases. Papalia also directed or was fully involved in all the negotiations referred to in the press releases. He was well aware of the circumstances of each arrangement. He completely disregarded the securities law requirements. He knowingly or recklessly put investors' economic interests at risk.

¶ 28 Under ever increasing pressure to obtain financing for the company, Papalia announced contracts that were not settled or for which the necessary financing had not been found. He knew that the market was not aware that the company had little or no money and any prospective financing was subject to some important contingencies. Papalia released the Euroinks, Frefax and OOM Lab press releases without following Nano World's press release policy. He ignored warnings from Andrew Cochrane, a lawyer on the board of Nano World who also acted as secretary and chief financial officer.

¶ 29 The Executive Director says that Nano World shares had no inherent value and the market price was solely a reflection of the false and misleading information

that Papalia put into the market. We are unable to reach this conclusion on the information before us.

¶ 30 We did find, however, that Papalia intended that the rosy picture painted by the press releases would attract new financing and that the market would act on the information in the press releases. It is common sense that the rosy picture would also have a positive effect on the market price of the shares of Nano World already trading and that investors in shares already trading would also be affected by the misleading information in the press releases. Papalia decided to increase the risk to all investors (or was wilfully blind or reckless to it) by making the company look more valuable than it was.

¶ 31 None of the failures to disclose was later corrected by Papalia or anyone.

¶ 32 Papalia hoped, and perhaps expected, that the information in the press releases would come true, or the omissions would not matter in future. Although his behaviour was reckless, there is no evidence that Papalia's motive was to cause loss to investors. He did not personally gain from his wrongdoing. Cochrane attributed inaccuracies and omissions in the press releases to disorganization, sloppiness, and a desire to put out optimistic, premature versions of events in hopes of obtaining financing and investors for the company.

¶ 33 We do not accept the Executive Director's argument that in assessing the period of a ban from the markets, we should take into account the risk that once any shorter prohibitions in British Columbia are exhausted, Papalia will resume carrying on business in British Columbia to avoid the US ban and take advantage of US investors. In our view, we should impose the ban that is appropriate under our legislation even if it is different than the ban imposed in another jurisdiction. The period of the ban should be sufficient to deter Papalia from breaching our securities laws again.

¶ 34 In setting the period of a ban we should take into account the extent to which the public will remain at risk, but we do not think the continued existence of a longer ban in the US is material to that assessment. Furthermore, if Papalia were to take advantage of US investors from British Columbia after any orders in BC had ended, the Executive Director would no doubt consider whether to take action against Papalia under the Act.

¶ 35 Nevertheless, Papalia poses a significant risk to investors and markets in British Columbia. His contraventions were serious. He is clearly unfit to hold a position of trust as a corporate director and officer and he should not be involved in investor relations. We must deter him, and others, from similar conduct.

¶ 36 We consider it to be in the public interest to remove Papalia from our markets for a significant period and to impose on him a substantial administrative penalty, which takes into account the penalty already imposed by the US Court.

¶ 37 We do not accept the Executive Director's submission that we should impose a cease trade order on Nano World. We have no evidence of conduct by Nano World or trading in its shares since the Spring of 2001. Indeed, we have evidence that in November 2002, Delaware deemed Nano World to be an "inactive corporation". There is no support for a finding that a cease trade order is in the public interest.

Orders

¶ 38 Subject to paragraph 39, we order that:

1. under section 161(1)(d)(i) of the Act, Papalia resign any position he holds as a director or officer of any issuer;

2. under section 161(1)(d)(ii) of the Act, Papalia is prohibited from becoming or acting as a director or officer of any issuer for 25 years ending on October 26, 2030;

3. under section 161(1)(d)(iii) of the Act, Papalia is prohibited from engaging in investor relations activities for 25 years ending on October 26, 2030; and

4. under section 162 of the Act, Papalia pay an administrative penalty of $75,000.

¶ 39 The period of prohibition imposed under sub-paragraphs 2 and 3 of paragraph 38 will end on the later of:

- payment of the amount due under sub-paragraph 4 and any amount due under any future order for costs in this matter, and

- October 26, 2030.

Costs

¶ 40 The litigation costs seem high compared to those in the similar case of *Durante* 2004 BCSECCOM 634. As in this matter, in *Durante*, the Executive Director relied primarily on admissions, findings of fact and evidence in US proceedings. Litigation costs were, however, considerably less. We do not know why the litigation costs in this matter were higher, apart from the fact that liability and sanctions were not considered together. More information about the litigation

costs would help us to assess whether the costs are reasonable. In particular it would be helpful to receive submissions as to why it was necessary for counsel to attend Court proceedings. It also appears that an error has been made in the calculation of administration costs since the panel met for two half days rather than two full days.

¶ 41 We direct the Executive Director to send more information and any submissions in support of the desired order for litigation costs to the Secretary to the Commission and to the respondents at their last known addresses by November 11, 2005. If the respondents wish to make submissions, we direct them to notify the Secretary to the Commission as soon as practicable and to send their submissions to the Secretary to the Commission and to the Executive Director by December 2, 2005. Our decision on costs will follow.

¶ 42 October 27, 2005

¶ 43 **For the Commission**

Robin E. Ford
Commissioner

Marc A. Foreman
Commissioner

John K. Graf
Commissioner