

# 2008 BCSECCOM 560

## Virtual Community Exhibitions Inc. and Ralph Kelly

### Sections 161(1) and 162 of the Securities Act, RSBC 1996, c. 418

#### Hearing

<b>Panel</b>	Suzanne K. Wiltshire	Commissioner
	Bradley Doney	Commissioner
	Kenneth G. Hanna	Commissioner

**Hearing dates** July 7, 8, 9, 2008

**Final submissions filed** July 24, 2008

**Decision date** October 21, 2008

#### Appearing

Wietzke Gerber For the Executive Director

#### Decision

##### I. INTRODUCTION

- ¶ 1 These are our findings and decision after a hearing under sections 161(1) and 162 of the Securities Act, RSBC 1996, c. 418.
- ¶ 2 On December 14, 2006, the Executive Director issued a Notice of Hearing against Virtual Community Exhibitions Inc. (VCE), Ralph Kelly and Raymond Patrick Shaw. In August 2007, the Commission issued an order under section 161(1) of the Act against Shaw (2007 BCSECCOM 500) and the Executive Director discontinued these proceedings against him (2007 BCSECCOM 519). On August 30, 2007, the Executive Director issued an Amended Notice of Hearing against VCE and Kelly.
- ¶ 3 The Executive Director alleges that between May 1, 2001 and June 2003, Kelly contravened the Act by:
- distributing securities of VCE without a prospectus (illegal distribution)

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- trading in securities of VCE without being registered (trading without registration)
- making misrepresentations
- perpetrating a fraud

¶ 4 VCE was dissolved in November 2005 for failure to file annual reports. The Executive Director does not seek any orders against VCE.

¶ 5 Kelly was served with the notices of hearing and did not appear.

### **II. BACKGROUND**

¶ 6 VCE was incorporated in British Columbia in April 2001.

¶ 7 VCE and its affiliated companies, International Trade Technologies Inc. (ITTI), WorldXpo Online, Inc., World E-Tailers Inc., World E-Tailers Express Inc. and World E-Shoppers Inc. (together the Affiliated Companies), purported to create a virtual tradeshow and advertising website with product purchasing and delivery features.

¶ 8 VCE has never been registered or filed a prospectus under the Act.

¶ 9 Kelly, a resident of British Columbia, was the president, a director and the guiding mind of VCE and the Affiliated Companies.

¶ 10 Kelly has never been registered to trade in securities under the Act.

### **Illegal Distribution and Trading Without Registration**

¶ 11 Between May 1, 2001 and June 2003, Kelly promoted, offered and sold \$418,000 worth of shares of VCE to 58 investors in British Columbia. He did by this by:

- speaking directly with potential investors to solicit their investment in shares of VCE
- participating in the production of, approving and distributing to potential investors, directly or indirectly, promotional materials concerning the purported businesses and business plans of VCE and the Affiliated Companies
- providing subscription agreements for shares of VCE for completion by investors and signing those agreements on behalf of VCE
- providing repurchase agreements to investors with respect to the shares of VCE and signing those agreements on behalf of VCE
- receiving and depositing cheques and bank drafts from investors for their purchases of VCE shares
- causing VCE to issue shares to investors

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### **The Investors**

- ¶ 12 Three investors testified at the hearing.
- Investor 1
- ¶ 13 Investor 1 met Kelly on April 29, 2002 at the home of a friend who had invested in VCE.
- ¶ 14 Kelly told Investor 1 that VCE “was a large data base similar to Google” with subsidiary companies two of which were World E-Tailers Inc. and WorldXpo Online, Inc. that “were basically like E-Bay” and that WorldXpo Online “would be like an online tradeshow application”.
- ¶ 15 Kelly showed Investor 1 promotional materials indicating he had sold ITTI’s exclusive North American licence for the intellectual property relating to the virtual tradeshow concept to WorldXpo Online, Inc. for US \$300 million. Kelly, referring to the promotional materials, also pointed to projected first year revenues of \$38 million.
- ¶ 16 Kelly told Investor 1 his funds would be used to build the business and the online database.
- ¶ 17 According to Kelly, there were no risks, and Investor 1 invested that same day. He signed a subscription agreement to purchase 5,000 Class C shares. While paragraph 2(a) of the agreement was marked to indicate Investor 1 was a friend, relative or close business associate of Kelly, Investor 1 said he had not marked that paragraph and the statement could not be true since he had just met Kelly for the first time that day. Kelly signed the subscription agreement on behalf of VCE.
- ¶ 18 Investor 1 subscribed for additional shares on June 24 and July 5, 2002, completing the same form of subscription agreement each time to bring his total investment to \$15,000. He did this because Kelly told him at their initial meeting that VCE was selling out of shares quickly and was likely to be sold out by the end of the month.
- ¶ 19 Investor 1 received share certificates for 15,000 Class C shares of VCE.
- ¶ 20 Each time Investor 1 invested, he and Kelly, on behalf of VCE, also signed a repurchase agreement giving the investor the option to require VCE to repurchase the Class C shares at a premium of 20 percent after one year.
- ¶ 21 The repurchase agreement was the most important thing influencing Investor 1’s decision to invest because he viewed it as a guarantee of his money. It was the “clincher” for him.

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- ¶ 22 A shareholder communication in December 2002 reassured Investor 1 because it indicated the business was progressing as set out in the promotional materials.
- ¶ 23 In June 2003, Investor 1 met with Kelly and asked VCE to repurchase his shares. Kelly started talking about another business plan he had pending and asked Investor 1 for \$60,000 for development of a real estate project in Alberta. Investor 1 refused. He was told by Kelly that his VCE shares would be repurchased and to contact Kelly's assistant. While Investor 1 sent letters to Kelly's assistant and made telephone calls, his shares were never repurchased.
- ¶ 24 Investor 1 also introduced two personal friends to Kelly. The friends invested \$5,000 each and lost their money. Investor 1 was present when Kelly explained the investment to one of these friends and went through the promotional materials. Kelly told the friend essentially the same things he had told Investor 1 when he invested.
- ¶ 25 Investor 1 had little prior investment experience, having invested only in mutual funds. His risk tolerance was low. The funds he invested came from money he had set aside to make a down payment on a property and he could not afford to lose the funds. He said he would never invest in a small company again.
- Investor 2
- ¶ 26 Investor 2 met Kelly in April 2002 while working at a restaurant. A few days later, he and a friend both invested in VCE. Both the investor and his friend left their jobs at the restaurant to assist Kelly in developing the VCE virtual tradeshow business.
- ¶ 27 Kelly told Investor 2 that VCE was building an online exhibition. He showed Investor 2 promotional materials that explained the business.
- ¶ 28 The promotional materials indicated VCE planned to produce 35 theme related exhibitions and listed 35 virtual tradeshow with scheduled dates covering the period from March 29, 2002 to March 14, 2003. When Investor 2 asked about the first tradeshow since the date had already passed, Kelly explained the shows were just a few weeks behind, but they would catch up and get back on schedule. Investor 2 later learned no tradeshow were ever produced.
- ¶ 29 Kelly also reviewed the projected revenues of VCE. The promotional materials showed projected revenues of \$38 million based on the 35 exhibition events scheduled.

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- ¶ 30 The promotional materials also indicated that the “exclusive North American marketing licence... to develop and market a minimum of 35 theme related online “virtual” trade exhibitions per year” had been awarded to VCE for US \$100 million.
- ¶ 31 In the investment opportunity section of the promotional materials VCE undertook to repurchase the shares at a premium of 20 percent after one year. Investor 2 said while the business looked like it was ready to get up and get going, there were no real revenues yet, so the repurchase agreement was the most important factor in his decision to invest.
- ¶ 32 Investor 2 signed the subscription agreement and repurchase agreement and gave Kelly his cheque for \$10,000 for the purchase of 10,000 VCE shares. Kelly told him his funds would be used to finish off the infrastructure of the business and get the website ready for the online tradeshow. Investor 2 later received a share certificate for 10,000 VCE shares.
- ¶ 33 Kelly also encouraged Investor 2 to talk to his friends about investing. Kelly told him it was perfectly legal to tell his friends and associates about the investment opportunity and provided him with promotional materials for that purpose. Investor 2 observed that there were various versions of the promotional materials and Kelly had templates for the various documents and created them himself.
- ¶ 34 Investor 2 introduced Kelly to seven individuals who invested a total of \$55,000; five were residents of British Columbia and two were residents of Alberta. He also introduced two additional potential investors to Kelly, but was unsure if they had invested.
- ¶ 35 Investor 2 did not receive any salary for his work and even loaned money to VCE when Kelly told him he was having difficulty bringing money in from outside the country and would pay him back. Investor 2 calculated that he was still owed at least \$49,500 for salary and loans.
- ¶ 36 Investor 2 asked for the repurchase of his shares and the repayment of his loans, but never received anything.
- ¶ 37 Prior to investing, Investor 2 had minimal investing experience. He did not think the investment was risky because of the repurchase agreement. He was distressed because of the loss of his investment. He was ashamed and even more distressed that he had introduced friends and family to Kelly and they also lost their money by investing in VCE shares.

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### Investor 3

- ¶ 38 Investor 3 met Kelly through Kelly's assistant who briefly explained the virtual tradeshow concept and investment opportunity and arranged for Investor 3 to meet Kelly.
- ¶ 39 At their first meeting in June 2002, Kelly explained the investment in VCE in more detail and set up another meeting with Investor 3 at her home.
- ¶ 40 At their second meeting on July 22, 2002, Kelly told Investor 3 that the virtual tradeshow had already been created and that distribution and licensing rights with respect to the virtual tradeshow were being sold. Kelly showed Investor 3 promotional materials with respect to ITTI. These materials stated WorldXpo Online Inc. had purchased the North American rights for intellectual property relating to the virtual tradeshow concept for US \$310 million.
- ¶ 41 Kelly told Investor 3 her investment funds would be used for the growth of the company, with the ultimate goal being to take the company public.
- ¶ 42 Kelly said if VCE had not achieved its goal of going public in a year, or if she was not comfortable, VCE would repurchase her investment at a 20 percent premium.
- ¶ 43 That same day, Investor 3 signed a subscription agreement to purchase 10,000 shares at \$1 per share and a share repurchase agreement, and gave Kelly her cheque for \$10,000. Kelly signed the agreements on behalf of VCE. Investor 3 subsequently received a share certificate for 10,000 Class C share of VCE.
- ¶ 44 Investor 3 said that absent the repurchase agreement she would have waited until VCE went public before investing.
- ¶ 45 Following that, Investor 3 received more promotional information. The information was essentially the same as that contained in the promotional materials she had seen in July at the time she invested.
- ¶ 46 Beginning in the fall of 2002, Investor 3 noticed the website was not always "up" on the internet and was still just a template. It was not yet interactive or capable of holding virtual tradeshow. There was also talk of other ventures. She requested financial statements in January 2003, but received no response, so she telephoned and emailed, but again received no response. In February 2003, the website ceased to appear on the internet.
- ¶ 47 In June 2003, Investor 3 wrote to VCE requesting repurchase of her VCE shares. Kelly's assistant wrote acknowledging receipt of the repurchase request and advised Kelly would deal with the repurchase on his return, enclosing a

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handwritten note from Kelly indicating he was out of the country and would return to finalize the legal procedures needed to repurchase the shares.

- ¶ 48 While Investor 3 continued to receive newsletters, her shares were not repurchased. In November 2004, she received a letter reiterating that her shares would be repurchased. Investor 3 has never received her investment funds back or any return on her funds.
- ¶ 49 Investor 3 could not afford to lose the amount she had invested. It had taken her about four years to save that amount. Her prior investment experience was limited to mutual funds and RRSPs.
- ¶ 50 The loss of her investment left Investor 3 feeling angry, foolish and unwilling to invest again in shares. She was shocked at how easy it had been for Kelly “to create such an elaborate scam to fool so many people”.

### Other Investors

- ¶ 51 Investigators obtained documents and other information with respect to all of the 58 British Columbia investors who purchased VCE shares. This evidence shows that Kelly, acting directly and indirectly, used the same tactics he had used with Investors 1, 2 and 3 to persuade the other 55 investors to invest in VCE shares. He solicited their investment in VCE shares using the promotional materials and making the same representations with respect to the businesses and business plans of VCE and the Affiliated Companies and the use of the investors’ funds. He represented that after one year VCE would repurchase the VCE shares upon request. He provided and signed, on behalf of VCE, the subscription agreements for the VCE shares and the repurchase agreements. He received and deposited the investors’ cheques and drafts in payment for their VCE shares. He had VCE issue the Class C shares to the investors.

### **Misrepresentations**

- ¶ 52 The promotional materials represented that VCE would buy back the VCE shares purchased, at the option of the investor, one year from the date of purchase at a 20 percent premium. The investors also signed repurchase agreements in which VCE agreed “to repurchase the \$1.00 shares for \$1.20 at the option of the purchaser...” exercisable one year after the purchase date. Kelly signed the repurchase agreements on behalf of VCE.
- ¶ 53 All three investors who testified said that VCE’s undertaking to buy back the VCE shares at a 20 percent premium was the most important reason they invested.

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- ¶ 54 All three investors requested the repurchase of their shares under the repurchase agreement. No shares were repurchased and no return was paid on their investment in shares of VCE.
- ¶ 55 None of the other British Columbia investors who requested repurchase of their shares got the monies they had invested in VCE shares back or any return on their investment.
- ¶ 56 The promotional materials projected first year revenues of \$38 million based on holding 35 virtual tradeshow events, which the materials represented had already been scheduled.
- ¶ 57 Investor 2 did some work for VCE out of his home on the web design for the virtual tradeshow website. When he visited the office of the contractor hired to develop the website, he noted the project appeared to have a low priority. At some point, probably in September 2002, he saw what had been developed and became aware that the website was not even close to being ready to actually host tradeshows. The virtual tradeshows never did become functional.
- ¶ 58 Kelly was the primary person giving directions and instructions to the contractor employed to develop a website with virtual tradeshow capability. The contractor working on the website development ceased all work for VCE about December 2002. The development of a website capable of technically providing a virtual tradeshow was not completed and the virtual tradeshow concept never came to fruition.
- ¶ 59 No tradeshow events ever took place. There was no evidence that VCE ever earned any revenues. Only investors' funds were deposited to VCE's account.
- ¶ 60 The promotional materials also stated that:
- ITTI had granted a worldwide licence of its intellectual property to WorldXpo Online, Inc. (Delaware) for US \$500 million.
  - WorldXpo Online, Inc. (Delaware) had sublicensed the intellectual property for all of Canada for US \$32.4 million plus a 3.5 percent royalty to WorldXpo Online (Canada) Inc. (Online Canada), a British Columbia company owned by Investor 2 and his friend.
  - Online Canada had sublicensed the intellectual property for British Columbia to WorldXpo Online, B.C. Inc., a British Columbia company owned by Kelly's assistant and her husband, for US \$4.4 million plus a 3.5 percent royalty.



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- Online Canada had sublicensed the intellectual property for Ontario to WorldXpo Online, Ontario Inc., a company owned by Shaw for US \$12 million plus a 3.5 percent royalty.

- ¶ 61 Sometime after he invested, Kelly told Investor 1 about the sale of the Canadian sublicense to Investor 2 and his friend for \$32.4 million. Investor 1 knew Investor 2 and his friend and asked Kelly how they were able “to come up with this kind of money”. Kelly told him they had paid \$1 million and that he had financed them for the remainder.
- ¶ 62 Investor 2 saw several different versions of the promotional materials over time. He identified one of these as the document making the above representations with respect to licensing. When he saw the representations he became concerned and asked Kelly a number of questions.
- ¶ 63 Investor 2 asked Kelly about ITTI’s purported licensing of its intellectual property and business model for US \$500 million because this seemed to him to be an arbitrary amount. Kelly told him it was just a marketing number and more of a future projection.
- ¶ 64 Investor 2 and his friend had never paid any amount for a sublicense. They knew they had not purchased the exclusive Canadian licence for the intellectual property with respect to the virtual tradeshow concept for \$32.4 million. When they asked Kelly about this, he responded that he had been in business for a long time and it was perfectly legal and just a way of giving a dollar value to the Canadian sublicense for future projections.
- ¶ 65 As for the representations that a company owned by Investor 2 and his friend had granted two sublicences for substantial amounts for use of the intellectual property in British Columbia and Ontario, Investor 2 stated this had not happened.
- ¶ 66 When questioned by commission investigators, Kelly initially indicated the amount paid to ITTI for the worldwide licence was incorrect and was to his recollection US \$300 million. Subsequently, he stated that no amount was ever paid and that VCE had not purchased a licence.
- ¶ 67 As for the sublicences, Kelly described the amounts supposedly paid for the sublicences as arbitrary numbers he had selected and admitted no amounts had been paid for any sublicences.

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### **Fraud**

- ¶ 68 The promotional materials stated the investors' funds would be used for the general corporate purposes of VCE. Kelly told investors 1, 2 and 3 their money would be used for the growth of VCE, to build VCE's virtual tradeshow business and to get the website ready for the online tradeshow. In our view, these business activities fall within the general corporate purposes of VCE.
- ¶ 69 Kelly opened a bank account for VCE and had signing authority on the account. Funds paid by investors for VCE shares were deposited in the VCE account. The only deposits into the account were investor cheques and bank drafts.
- ¶ 70 Kelly had no personal account and he used the VCE account as his personal account.
- ¶ 71 Kelly entered into an agreement to purchase a residence (Saturna Drive residence) for himself. He made payments from the VCE account for the purchase price and rent for the Saturna Drive residence. Many of these payments corresponded in time to the deposit of investor funds into the VCE account. These payments totalled \$38,773.50.
- ¶ 72 Kelly contracted for renovations to the Saturna Drive residence. At least \$72,855.10 was paid from the VCE account for labour, material and services with respect to the renovations.
- ¶ 73 Kelly paid \$6,900 from the VCE account to Shaw for co-ordinating and overseeing tradesmen in connection with the renovations to the Saturna Drive residence.
- ¶ 74 Investor 1 visited Kelly at his Saturna Drive residence and observed that renovations were always ongoing. Kelly told him he had repainted twice, redone the kitchen, built special teak and mahogany desks and closets for his clothes and shoes, had glass specially etched and essentially had redone everything.
- ¶ 75 Investor 2 confirmed Kelly resided at the Saturna Drive residence, that VCE did not have an office there, and no VCE meetings were held there. He observed that the property was in a constant state of renovation. When he asked Kelly how he could pay for the work given his cash shortage, Kelly always explained it was just "trade of service" and that trades working on the property owed him something.
- ¶ 76 Kelly paid \$13,825 from the VCE account to his ex-wife with respect to a personal loan she had made to him.

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- ¶ 77 When he deposited the investors' drafts and cheques, Kelly frequently made cash withdrawals or wrote cheques to himself. From May 1, 2001 to December 1, 2003, Kelly withdrew \$109,800 from the VCE account.
- ¶ 78 These payments and withdrawals from the VCE account, totalling \$242,153.60, are not in our view the use of the investors' funds for the general corporate purposes of VCE.
- ¶ 79 Kelly told commission staff that he had contributed \$80,000 to \$100,000 to VCE and that there was a shareholders loan agreement to support this arrangement. No evidence of such an agreement or of the payment of such amounts to VCE by Kelly was found by commission staff and Kelly failed to provide any documentation to support his assertion.
- ¶ 80 The British Columbia investors did not get the monies they had invested in shares of VCE back or any return on their investment.

### III. ANALYSIS AND FINDINGS

- ¶ 81 The Executive Director alleges that Kelly contravened the Act by:

- making an illegal distribution of shares of VCE
- trading in shares of VCE without registration
- making misrepresentations
- perpetrating a fraud

#### Illegal Distribution

- ¶ 82 The Executive Director alleges that Kelly contravened section 61(1) of the Act by distributing securities of VCE when VCE had never filed a prospectus under the Act.
- ¶ 83 Section 61(1) of the Act says:
- Unless exempted under this Act or the regulations, a person must not distribute a security unless
- (a) a preliminary prospectus and a prospectus respecting the security have been filed with the executive director, and
  - (b) the executive director has issued receipts for the preliminary prospectus and prospectus.
- ¶ 84 Section 1(1) defines "security" to include a share.

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- ¶ 85 Section 1(1) defines “distribution”, if used in relation to trading in securities, as “a trade in a security of an issuer that has not previously been issued...”
- ¶ 86 Section 1(1) defines “trade” as including:
- (a) a disposition of a security for valuable consideration whether the terms of payment be on margin, instalment or otherwise,...
  - ...
  - (f) any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the activities specified in paragraphs (a) to (e);
  - ...
- ¶ 87 The investors entered into subscription agreements to purchase shares of VCE and VCE issued Class C shares to the investors. The shares of VCE are securities as defined in section 1(1) of the Act.
- ¶ 88 We find that VCE issued shares to the investors for \$418,000. Those are trades as defined in section 1(1) of the Act. None of those VCE shares had been previously issued. Therefore VCE made a distribution (as defined in section 1(1) of the Act) of its shares.
- ¶ 89 VCE has never filed or obtained a receipt for a preliminary prospectus or a prospectus for the VCE shares.
- ¶ 90 The evidence presented did not establish that any of the exemptions to the prospectus requirements under the Act or regulations were applicable.
- ¶ 91 We find that VCE contravened section 61(1) of the Act when it distributed the shares to the investors for \$418,000.
- ¶ 92 Kelly as the president, a director and the guiding mind of VCE, directly and indirectly, through his actions and conduct, advertised, solicited, and negotiated the disposition of the shares of VCE to the investors. In so doing, he traded in shares of VCE in British Columbia. We have already found those shares had not previously been issued, VCE had never filed a prospectus under the Act and there was no applicable exemption.
- ¶ 93 We find therefore that Kelly distributed securities in British Columbia and in doing so contravened section 61(1) of the Act.

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### **Trading Without Registration**

- ¶ 94 The Executive Director also alleges that Kelly contravened section 34(1)(a) of the Act by trading in securities without being registered to do so.
- ¶ 95 Section 34(1) says, “a person must not...trade in a security...unless the person is registered in accordance with the regulations...”
- ¶ 96 The evidence presented did not establish that any of the exemptions to the registration requirements under the Act or regulations were applicable.
- ¶ 97 Kelly was not registered to trade in securities in British Columbia.
- ¶ 98 We have already found that Kelly traded in shares of VCE in British Columbia.
- ¶ 99 We find therefore that Kelly traded in securities in British Columbia without being registered and in doing so contravened section 34(1) of the Act.

### **Misrepresentations**

- ¶ 100 The Executive Director alleges Kelly contravened sections 50(1)(a) and (d) of the Act by:
- representing that VCE would repurchase the VCE shares
  - making misrepresentations.
- ¶ 101 Sections 50(1)(a) and (d) state:
- 50(1) A person, while engaging in investor relations activities or with the intention of effecting a trade in a security, must not do any of the following:
- (a) represent that the person or another person will
- (i) ...repurchase the security...
- ...
- (d) make a statement that the person knows, or ought reasonably to know, is a misrepresentation;...
- ¶ 102 Section 1(1) defines “misrepresentation” as:
- (a) an untrue statement of a material fact, or
  - (b) an omission to state a material fact that is...necessary to prevent a statement that is being made from being false or misleading in the circumstances in which it was made.

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- ¶ 103 Section 1(1) also defines “material fact”, where used in relation to securities issued or proposed to be issued, as “a fact that significantly affects, or could reasonably be expected to significantly affect, the market price or value of those securities.”
- ¶ 104 To find that Kelly contravened section 50(1)(a) we must conclude that:
- Kelly represented that VCE would repurchase the VCE shares.
  - Kelly made the representation with the intent of effecting a trade in the VCE shares.
- ¶ 105 Kelly orally, and through the promotional materials that he participated in preparing, approved and distributed to investors, represented on behalf of VCE that VCE would repurchase the VCE shares one year after their sale at a premium of 20 percent. On behalf of VCE, he also signed the repurchase agreements.
- ¶ 106 Kelly made this representation with the intention of effecting trades in VCE shares.
- ¶ 107 We find therefore that Kelly contravened section 50(1)(a) of the Act.
- ¶ 108 To find that Kelly contravened section 50(1)(d) we must conclude that:
- Kelly made untrue statements of material facts, and they were misrepresentations.
  - Kelly knew or ought reasonably to have known that they were misrepresentations.
  - Kelly made the misrepresentations with the intention of effecting trades in VCE shares.
- ¶ 109 Kelly made untrue statements orally and in the promotional materials he participated in preparing, approved and distributed to investors:
- He stated that VCE had scheduled 35 virtual tradeshow, when he knew no virtual tradeshow were scheduled and none could be held because VCE did not have the technical capability to conduct virtual tradeshow online.
  - He projected first year revenues of \$38 million based on the holding of 35 virtual tradeshow in that year, when he knew VCE did not have the technical capability to conduct any virtual tradeshow and there were no virtual tradeshow scheduled.

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- He made statements about the licensing of intellectual property in relation to the purported virtual tradeshow business, knowing that no funds had been paid for any licences or sublicenses.
- ¶ 110 We find the untrue statements individually could reasonably be expected to significantly affect the value of the VCE shares and were therefore material facts. That being so, they were misrepresentations.
- ¶ 111 As a signing officer on the VCE account and the person writing cheques on the account and making deposits and withdrawals from the account, Kelly knew VCE was not generating any revenues. He knew virtual tradeshows were not scheduled or taking place. He knew VCE did not have a website capable of conducting virtual tradeshows. He knew no funds had been paid for the licensing or sublicensing of the intellectual property.
- ¶ 112 We find Kelly knew that the untrue statements were misrepresentations.
- ¶ 113 Kelly made these misrepresentations with the intention of effecting trades in shares of VCE.
- ¶ 114 We therefore find that Kelly made misrepresentations to the investors and in so doing contravened section 50(1)(d) of the Act.

### **Fraud**

- ¶ 115 The Executive Director alleges that instead of using the proceeds from the sale of VCE shares for VCE's general business purposes, Kelly used the proceeds to:
- pay rent and deposits on account of the purchase price for his Saturna Drive residence, totalling \$38,773.50
  - pay \$72,855.10 to various contractors, labourers and suppliers with respect to renovations to the Saturna Drive residence
  - pay at least \$121,025.00 to himself, his ex-wife and Shaw
- ¶ 116 Section 57 says:
57. A person...must not, directly or indirectly, engage in or participate in a transaction or series of transactions relating to a trade in or acquisition of a security...if the person knows, or ought reasonably to know, that the transaction or series of transactions
- ...
- (c) perpetrates a fraud on any person anywhere in connection with trading in or acquiring securities...in British Columbia.

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¶ 117 We have already found that Kelly traded in shares of VCE in British Columbia.

¶ 118 Section 57 was considered by the British Columbia Court of Appeal in *Anderson v. British Columbia (Securities Commission)*, 2004 BCCA 7. The Court said:

[29] Fraud is a very serious allegation which carries a stigma and requires a high standard of proof. 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.

¶ 119 The Court cited the elements of fraud from *R. v. Theroux*, [1993] 2SCR 5 (at p. 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).

¶ 120 The evidence provides clear and convincing proof that Kelly committed what Theroux describes as a "prohibited act" and that it caused deprivation. We have found that Kelly made misrepresentations about VCE and its Affiliates, by definition an act of deceit.

¶ 121 The promotional materials stated the investors' funds would be used for the general corporate purposes of VCE. Kelly told investors 1, 2 and 3 the proceeds from the issue of the VCE shares would be used for the growth of the company, to build VCE's virtual tradeshow business and to get the website ready for the online tradeshow. Kelly, acting directly and indirectly, used the same tactics he had used with Investors 1, 2 and 3 to persuade the other 55 investors to invest in VCE shares. He solicited their investment in VCE shares using the promotional



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materials and making the same representations with respect to the use of the investors' funds.

- ¶ 122 The evidence establishes that instead Kelly converted more than 50 percent of the proceeds to his personal uses, as follows:
- cash payments to himself totalling \$109,800
  - payments for renovations to the Saturna Drive residence totalling \$72, 855.10
  - payments to Shaw for coordination and supervision of the renovations totalling \$6,900
  - rent and purchase payments for the Saturna Drive residence totalling \$38,773.50
  - payments to his ex-wife totalling \$13,825
- ¶ 123 We conclude that these payments, totalling \$242,153.60, were not payments for the general corporate purposes of VCE.
- ¶ 124 Kelly deprived the investors of their investment and the prospects of any return on it. Of the \$418,000 they invested, Kelly converted at least \$242,153.60 to his own use.
- ¶ 125 The investors did not get their money back, their VCE shares were not repurchased and they received no return on their investment.
- ¶ 126 The evidence also provides clear and convincing proof that Kelly had subjective knowledge of the deceit and that it would result in the deprivation of others.
- ¶ 127 We have found that Kelly knew he was making misrepresentations. His statements to prospective investors and the promotional materials he participated in preparing, approved and distributed to investors were a tissue of outright lies. He knew the purported licences and sublicences of intellectual property with respect to the virtual tradeshow concept were a sham and that no funds had changed hands. He knew VCE did not have the technical capability to conduct any tradeshow and that the list of tradeshow scheduled was a fiction. He knew VCE had no revenues and no prospects of any revenues for the year in which revenues of \$38 million were projected.
- ¶ 128 Kelly knew investors funds were not being used only for VCE's general corporate and business purposes because he was converting VCE investor funds to his personal uses. Kelly was the person who managed and controlled the VCE account. He admitted to using the VCE account as his own personal account, he signed cheques on and withdrew cash from the VCE account for personal uses and

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the rent, purchase and renovation of his personal residence. His conversion of at least \$242,153.60 to his own personal uses was deliberate. He knew that VCE had no revenues and that withdrawing funds from the VCE account for such personal uses would be to deprive the investors of the funds they had invested and any prospect of return on their investment.

- ¶ 129 We find therefore that Kelly perpetrated a fraud on the investors and in so doing contravened section 57(c) of the Act.

### IV. SUMMARY OF FINDINGS

- ¶ 130 We find that Kelly:

- distributed shares of VCE without filing a prospectus, contrary to section 61(1) of the Act
- traded in VCE shares without registration, contrary to section 34(1) of the Act.

- ¶ 131 We find that Kelly, with the intention of effecting a trade in VCE shares:

- represented that VCE would repurchase the VCE shares, contrary to section 50(1)(a) of the Act
- misrepresented the tradeshow scheduled by VCE, the projected revenues of VCE and the license and sublicense agreements concluded, contrary to section 50(1)(d) of the Act

- ¶ 132 We find that Kelly perpetrated a fraud, contrary to section 57(c) of the Act, when he knowingly used the investors' money for his own personal uses thereby depriving the investors of their investment and any return on it.

### V. SANCTIONS

- ¶ 133 The Executive Director seeks permanent orders under section 161(1) of the Act against Kelly denying him the use of the exemptions under the Act, prohibiting him from being a director or officer of any issuer, and prohibiting him from engaging in investor relations activities.
- ¶ 134 The executive director seeks an order under section 161(1)(g) of the Act that Kelly pay to the commission \$242,153.60 in respect of amounts misappropriated.
- ¶ 135 The Executive Director seeks an order under section 162 of the Act that Kelly pay an administrative penalty of \$200,000.
- ¶ 136 Sections 161(1) and 162 of the Act were amended after Kelly's misconduct.

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¶ 137 In *Thow*, 2007 BCSECCOM 758, this commission considered the issue of retrospectivity in the context of securities legislation in these circumstances and concluded the presumption against the retrospective operation of the amendments to sections 161(1) and 162 is rebutted.

¶ 138 Based on *Thow*, we conclude that in the circumstances of this case, it is appropriate to apply sections 161(1) and 162 as they now read.

### **Factors to consider**

¶ 139 In *Re Eron Mortgage Corporation*, [2000] 7 BCSC Weekly Summary 22, the commission discussed the factors relevant to sanction as follows (at page 24):

In making orders under sections 161 and 162 of the Act, the Commission must consider what is in the public interest in the context of its mandate to regulate trading in securities. The circumstances of each case are different, so it is not possible to produce an exhaustive list of all of the factors that the Commission considers in making orders under sections 161 and 162, but the following are usually relevant:

- the seriousness of respondent's conduct,
- the harm suffered by investors as a result of the respondent's conduct,
- the damage done to the integrity of the capital markets in British Columbia by the respondent's conduct,
- the extent to which the respondent was enriched,
- factors that mitigate the respondent's conduct,
- the respondent's past conduct,
- the risk to investors and the capital markets posed by the respondent's continued participation in the capital markets of British Columbia,
- the respondent'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.

¶ 140 Kelly contravened sections 34(1) and 61(1) by trading and distributing VCE shares without being registered and without filing a prospectus. These provisions

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are designed to prevent exactly the kind of abuse of the markets that has happened in this case.

- ¶ 141 More seriously, Kelly deceived the investors and took their money. He raised \$418,000 from 58 British Columbia investors.
- ¶ 142 Kelly led the investors to believe that their money was not at risk because VCE would, on request, repurchase the VCE shares after one year at a 20 percent premium. He signed the repurchase agreements on behalf of VCE. The three investors who appeared as witnesses all said the agreement to repurchase was the main reason they decided to invest in VCE shares.
- ¶ 143 Kelly knew the representation that VCE would repurchase the VCE shares in one year at a premium was untrue because VCE had no revenue and no prospects of revenue to do so, and he was at the same time withdrawing the monies received from investors for his own personal uses.
- ¶ 144 Kelly knew he was making misrepresentations, both in what he told investors and through the promotional materials he participated in preparing, approved and distributed. He knew the purported licences and sublicences of intellectual property with respect to the virtual tradeshow concept were a sham and that no funds had changed hands. He knew VCE did not have the technical capability to conduct any tradeshows and that the list of tradeshows scheduled was a fiction. He knew VCE had no revenues and no prospects of any revenues for the year in which revenues of \$38 million were projected.
- ¶ 145 Kelly perpetrated a fraud on the investors. He deprived the investors of their funds by converting \$242,153.60 to his own personal uses.
- ¶ 146 Kelly's misconduct was premeditated and calculated. Through this serious misconduct, Kelly significantly harmed investors and damaged the integrity of British Columbia's capital markets.
- ¶ 147 Kelly's conduct shows he is not fit to participate in our capital markets. We must also make orders that will demonstrate the consequences of his conduct, and that will have an appropriate deterrent effect.
- ¶ 148 This case involves clear breaches of the Act to facilitate a deliberate fraud. It calls for orders that are protective of our markets and likely to prevent future harm. To do this, the orders we make need to have a strong deterrent effect, both specific and general.

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### *Section 161(1)*

- ¶ 149 We conclude Kelly ought to be permanently prohibited from trading or purchasing securities in British Columbia on any basis, so we have not included provisions in the orders allowing him to trade in the capital market for his own account.
- ¶ 150 Kelly appropriated investors' funds for his own use. In these circumstances, we order disgorgement of those funds.

### *Section 162*

- ¶ 151 Section 162 allows us to order payment of the maximum administrative penalty for each contravention. We have found that Kelly contravened four sections of the Act. He contravened those sections in his dealings with each of the 58 investors in British Columbia and contravened those sections more than once in his dealings with some investors. There are therefore hundreds of contraventions for which we could order an administrative penalty.
- ¶ 152 Rather than deal with the contraventions separately, we have considered Kelly's conduct globally, and made an order under section 162 that imposes an administrative penalty for all of the contraventions.
- ¶ 153 The Executive Director seeks an administrative penalty of \$200,000, noting that this amount was applied in two earlier cases having similar features, when the maximum penalty at the time was \$250,000.
- ¶ 154 We consider an administrative penalty in that amount, in addition to the order for disgorgement, to be the minimum appropriate in light of Kelly's blatant disregard of important fundamentals of our system of regulation, the seriousness of his conduct, the harm suffered by the investors, the damage he has inflicted on the integrity of our capital markets, and the extent of his enrichment.

### **VI. Orders**

- ¶ 155 Therefore, considering it to be in the public interest, we order:
1. under section 161(1)(b) of the Act, that Kelly cease trading permanently, and is prohibited permanently from purchasing, securities or exchange contracts;
  2. under section 161(1)(d)(i), that Kelly resign any position he holds as a director or officer of an issuer, registrant or investment fund manager;
  3. under section 161(1)(d)(ii), that Kelly is prohibited permanently from becoming or acting as a director or officer of any issuer, registrant or investment fund manager;

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4. under section 161(1)(d)(iii), that Kelly is prohibited permanently from becoming or acting as a registrant, investment fund manager or promoter,
5. under section 161(1)(d)(iv), that Kelly is prohibited permanently from acting in a management or consultative capacity in connection with activities in the securities market;
6. under section 161(1)(d)(v), that Kelly is prohibited permanently from engaging in investor relations activities;
7. under section 161(1)(g), that Kelly pay to the commission any amount obtained, or payment or loss avoided, directly or indirectly, as a result of his contraventions of the Act, which we find to be not less than \$242,153.60;
8. under section 162, that Kelly pay an administrative penalty of \$200,000.

¶ 156 October 21, 2008

¶ 157 For the Commission

Suzanne K. Wiltshire  
Commissioner

Kenneth G. Hanna  
Commissioner

Bradley Doney  
Commissioner