

2012 BCSECCOM 284

**Photo Violation Technologies Corp.,
Frederick Lawrence Marlatt, also known as Frederick Lawrence Mitschele,
Michael Wallace Minor, and
Michael Garfield Timothy Minor, also known as Tim Minor**

Securities Act, RSBC 1996, c. 418

Hearing

| | | |
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| Panel | Brent W. Aitken Bradley Doney Shelley C. Williams | Vice Chair Commissioner Commissioner |
| Hearing Dates | December 12, 15, 19 and 21, 2011 and February 27, 2012 | |
| Submissions Completed | April 17, 2012 | |
| Date of Findings | July 16, 2012 | |
| Appearing | | |
| Derek J. Chapman | For the Executive Director | |
| Frederick Mitschele | For himself | |
| Michael Minor | For himself | |
| Tim Minor | For himself | |

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. Commissioner Williams was appointed to the hearing panel but was unable to attend one of the hearing days. Commissioner Williams took no part in drafting these findings and we did not discuss the evidence with her.
- ¶ 2 In a notice of hearing dated December 7, 2010 the executive director alleges that, between August 2005 and June 2008, Photo Violation Technologies Corp. (PVT), Frederick Lawrence Marlatt, also known as Frederick Lawrence Mitschele, Michael Wallace Minor, and Michael Garfield Timothy Minor contravened

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sections 34(1) and 61(1) of the Act by trading and distributing securities of PVT, without being registered and without filing a prospectus, to at least 280 investors for proceeds of more than \$3.7 million. The impugned trades were part of a distribution to 322 investors for proceeds of \$5.2 million.

- ¶ 3 In a statement of admission dated December 18, 2011, Michael Wallace Minor and Michael Garfield Timothy Minor (whom we refer to as Michael and Tim Minor, respectively) admitted that they “traded and distributed \$3.2 million worth of PVT securities without being registered or having filed a prospectus, and when no exemptions from the from the registration and prospectus requirements applied” and in doing so contravened sections 34(1) and 61(1).
- ¶ 4 PVT is bankrupt. It did not appear, nor was it represented, at the hearing.

II Evidentiary matters

- ¶ 5 Mitschele applied to enter evidence that was not relevant to the allegations in the notice of hearing. This evidence related primarily to four things: people and circumstances connected to a civil lawsuit in which PVT was involved; PVT’s dealings with Commission compliance staff before the notice of hearing was issued; PVT’s legal advice in connection with its distributions; and the executive director’s decision to issue the notice of hearing.
- ¶ 6 Mitschele also applied for summons for witnesses to testify on matters that were similarly not relevant, or who were outside the jurisdiction.
- ¶ 7 We dismissed both applications.
- ¶ 8 The respondents say that they obtained legal advice and followed it, that they attempted to regularize PVT’s affairs when they discovered compliance problems with its distributions of securities, and that they drew the Commission’s attention to the problems in their attempts to bring PVT into compliance. These issues, although not relevant to liability, are relevant to sanction. We will consider evidence and submissions on those issues in the sanctions phase of the hearing.

III Analysis and Findings

A Distributions by Michael and Tim Minor

- ¶ 9 Michael and Tim Minor have admitted that they contravened the Act by trading and distributing PVT securities for proceeds of \$3.2 million. Based on their admissions, we find that they contravened sections 34(1) and 61(1) when they distributed \$3.2 million worth of PVT securities.

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B Distributions by PVT and Mitschele

- ¶ 10 Mitschele was PVT's president and chief executive officer, and a director. He owned the original patent for the technology that was the foundation of PVT's business. PVT's business was the development and commercialization of parking meter technology. It appears that PVT was operating as a legitimate business.
- ¶ 11 Mitschele was actively involved in PVT's financing activities. He signed subscription agreements on behalf of PVT and authorized (with the other directors) the issuance of PVT shares to investors. He signed all of the share certificates PVT issued and all of the exempt distribution reports that PVT filed with the Commission.
- ¶ 12 Section 34(1) says "a person must not . . . trade in a security . . . unless the person is registered in accordance with the regulations"
- ¶ 13 Section 61(1) says ". . . a person must not distribute a security unless . . . a preliminary prospectus and a prospectus respecting the security have been filed with the executive director" and the executive director has issued receipts for them.
- ¶ 14 Section 1(1) defines "trade" to include "(a) a disposition of a security for valuable consideration" and "(f) any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the activities specified in paragraphs (a) to (e)".
- ¶ 15 Section 1(1) defines "distribution" as "a trade in a security of an issuer that has not been previously issued".
- ¶ 16 PVT's shares are securities and PVT traded in them by receiving valuable consideration for them.
- ¶ 17 The shares PVT sold to investors were not previously issued, so PVT's trades were distributions.
- ¶ 18 We find that PVT distributed its securities without being registered and without filing a prospectus.

C PVT's purported use of the exemptions

1 General

- ¶ 19 PVT purported to rely on two exemptions in National Instrument 45-106 *Prospectus and Registration Exemptions*: the one permitting distributions to accredited investors, and the one permitting distributions to family, friends and business associates.

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- ¶ 20 In *Solara* 2010 BCSECCOM 163, the Commission explained the obligations on those who seek to rely on the exemptions under the Act. The elements of that decision relevant to his case we summarize as follows:
- the person relying on an exemption has the onus of proving that the exemption is available
 - lack of documentation will make it difficult for the person to meet that onus
 - mere assertions or ticked boxes on subscription forms from investors that they meet the criteria for an exemption is not adequate; the issuer must establish and document the facts that demonstrate that the investor is, as PVT contends in this case, an accredited investor, or a family member, close personal friend, or close business associate of a director, officer or founder
 - after making the appropriate inquiries, the issuer must have a reasonable belief that the facts are true and that the legal requirements for use of the exemption have been met
- ¶ 21 The companion policy to NI45-106 notes the value of the issuers retaining all necessary documents that show that the exemption was available to the issuer. Here, PVT either never had documents of that nature, or failed to retain them. In any event, the respondents did not produce them.
- ¶ 22 Part of the reason for that, Mitschele says, is that as a result of PVT's bankruptcy, he was unable to gain access to PVT's corporate records. However, Mitschele, the Minors, and PVT director James Scott all testified about their relationships with investors relevant to the application of the exemptions. None of this testimony suggests there is anything in PVT's corporate records to show that PVT met the *Solara* standard in its purported use of the exemptions.
- ¶ 23 Although the companion policy correctly identifies the importance of the issuer's documents, if a respondent can establish by other means that a trade, as a matter of fact and law, did meet the requirements of the exemption at the time it was made, that is sufficient to prove that the exemption was available for that trade.
- ¶ 24 Mitschele has attempted to do that. However, as we explain below, he has failed to prove the availability of the exemptions to all but a handful of the trades in issue.
- 2 Accredited investor exemption**
- ¶ 25 Sections 2.3(1) and (2) of NI45-106 remove the registration and prospectus requirements if the purchaser purchases the security as principal and is an accredited investor. Under the definition of "accredited investor" in the

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instrument, an individual qualifies as an accredited investor by meeting high net worth or high income thresholds.

- ¶ 26 In its exempt distribution reports PVT identified the accredited investor exemption as the one it relied upon to make distributions to 49 investors who invested, in the aggregate, just under \$1 million. As noted earlier, this is merely an assertion of their status, not evidence of it.
- ¶ 27 There is no evidence that any of these investors qualified as accredited investors at the time of the trades, apart from the boxes the investors ticked on subscription forms and from testimony from the Minors and Mitschele that some of them were wealthy individuals.
- ¶ 28 This fails to meet the *Solara* standard. The definition of accredited investor for the purposes of the exemption is technical and excludes assets that would, in other contexts, be included in an individual's net worth – for example, the individual's personal residence. Investors who indicated on their subscription forms that they were accredited were not provided with the definition of accredited investor nor with the appropriate interpretation of the exemption. In these circumstances, it has not been established that any of them were, in fact, accredited investors.
- ¶ 29 We find that Mitschele has failed to prove that the accredited investor exemption applies to trades to these 49 investors.

3 Family, friends or business associates exemption

- ¶ 30 Sections 2.5(1) and (2) of NI45-106 remove the registration and prospectus requirements if the purchaser is a family member, close personal friend, or close business associate of a director, executive officer, or founder of the issuer.
- ¶ 31 In its exempt distribution reports PVT identified the family, friends or business associates exemption as the one it relied upon to make distributions to 229 investors who invested, in the aggregate, nearly \$2.7 million. Again, this is merely an assertion of their status, not evidence of it.
- ¶ 32 For PVT to be able to rely on this exemption for the trades to the 229 investors made in purported reliance on this exemption, those investors would have to be family members, close personal friends, or close business associates of a director, executive officer or founder of PVT. Mitschele says this includes him, Michael Minor (a director), Tim Minor, and Scott.
- ¶ 33 The parties made lengthy submissions about whether Tim Minor was a founder of PVT for the purposes of the exemption. We make no finding on that point

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because it is not significant. As explained below, the exemption would apply only to four investors on the basis of a friendship with Tim Minor.

- ¶ 34 Scott was involved with PVT at an early stage of its development, then left the company. About a year later, in April 2007, he rejoined PVT as Vice President of Operations and Trials. There are only two investors whose relationship with Scott would have attracted application of the exemption. They invested during the period that Scott was not associated with PVT.

Family members

- ¶ 35 NI45-106 specifies the family members for whom the exemption provides relief from the registration and prospectus requirements: spouses, parents, grandparents, brothers, sisters, children, and grandchildren.
- ¶ 36 Michael Minor, Tim Minor, Mitschele and Scott all testified about their relationships with the investors that were relevant for the purposes of the exemption. This testimony is the only evidence of those relationships. None of the investors falls into the categories of spouse, parent, grandparent, brother, sister, child, or grandchild of any of the four.

Close personal friends and close business associates

- ¶ 37 In *Solara*, the Commission approved the interpretations in the companion policy to NI45-106 of the meaning of “close personal friend” and “close business associate” of a person who is a director, officer or founder. These policies say that the relationship must, at the time of the trade, be of a nature that the investor can assess the person’s capabilities and trustworthiness. An investor purportedly a close personal friend must have known that person well enough, and have known them for a sufficient period of time, to make that assessment. An investor purportedly a close business associate must have had sufficient prior business dealings with the person to make the assessment.
- ¶ 38 The companion policies say “the relationship . . . must be direct. For example, the exemption is not available to a close personal friend of a close personal friend of a director of the issuer.”
- ¶ 39 The testimony of Michael Minor, Scott and Mitschele establishes the requisite relationships of close business association for no investors. Their evidence establishes close personal friendship for only five investors. Referring to them by their investor numbers in hearing exhibit 425, they are:
- investor 45 (whom Michael Minor describes as a “dear friend” for 10 years)
 - investor 58 (with whom Michael Minor co-owns a condominium and who Minor describes as a close friend)

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- investor 180 (whom Michael Minor describes as a teacher who has been close to his family for many years)
- investor 213 (whom Mitschele describes as his “best friend, or one of his best friends”)
- investor 262 (whom Michael Minor describes as one of his best friends)

¶ 40 These investors invested a total of \$142,732.

¶ 41 The testimony of Tim Minor establishes these relationships for only four investors:

- investor 32 (whom he describes as “a friend for 50 years”)
- investor 114 (whom he describes as a family friend for 20 to 30 years – “for as long as we have lived in Kelowna”)
- investor 120 (whom he describes as a family friend “for as long as we have lived in Kelowna”)
- investor 174 (whom he describes as a family friend “for as long as we have lived in Kelowna”)

¶ 42 These investors invested a total of \$25,702.

¶ 43 The evidence these witnesses gave about their relationships with the remaining investors otherwise failed to prove that the relationships met the requirements of the exemption. The descriptions of the relationship were too vague, or made it clear that the relationship was one of mere acquaintance. For example, the great majority of Tim Minor’s relationships were with a large group of people he met regularly at a pub, and whose last names he did not know. He testified that the people at the pub “were my friends, but not my close friends.”

Finding

¶ 44 We find that, at most (including investors related or associated with Tim Minor), the family, friends, or business associate exemption applied to trades to nine PVT investors. We find that Mitschele failed to prove that the exemption applied to trades to the remaining 220 investors for whom PVT relied on the exemption.

4 Finding

¶ 45 Exhibit 425 lists 281 investors who invested a total of \$3,740,038. PVT relied on the accredited investor exemption for 49 of them, and on the family, friends and business associates exemption for 229 of them. PVT filed no exempt distribution report for three investors (investors 89, 238 and 262).

¶ 46 We find that the accredited investor exemption was not available for the trades that PVT made to the 49 individuals in purported reliance on the accredited

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investor exemption. We find that PVT contravened sections 34(1) and 61(1) in making those trades.

- ¶ 47 We find that the family, friends, and business associates exemption was not available for 220 trades that PVT made in purported reliance on that exemption. We find that PVT contravened sections 34(1) and 61(1) in making those trades.
- ¶ 48 We find that there was no exemption available for the trades PVT made to investors 89, 238 and 262. We find PVT contravened sections 34(1) and 61(1) in making those trades.
- ¶ 49 Mitschele actively participated in PVT's capital raising activities. In doing so, he authorized, permitted and acquiesced in PVT's contraventions of sections 34(1) and 61(1). We find that Mitschele, under section 168.2, also contravened sections 34(1) and 61(1).

IV Summary of Findings

- ¶ 50 We find that:
1. Based on their admissions, Michael and Tim Minor traded in securities without being registered to do so, contrary to section 34(1) of the Act, and distributed those securities without filing a prospectus, contrary to section 61(1) of the Act when they distributed \$3.2 million in PVT securities when no exemptions from the registration and prospectus requirements applied; and
 2. PVT traded in securities without being registered to do so, contrary to section 34(1) of the Act, and distributed those securities without filing a prospectus, contrary to section 61(1) of the Act, when it distributed PVT securities for proceeds of \$3,571,604 to 272 investors in purported reliance on exemptions from the registration and prospectus requirements that were not available.
 3. Mitschele, when he authorized, permitted and acquiesced in PVT's contraventions, also contravened sections 34(1) and 61(1) under section 168.2.

V Submissions on sanction

- ¶ 51 We direct the parties to make their submissions on sanctions as follows:

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|-----------------|--|
| By August 24 | The executive director delivers submissions to the respondents and to the secretary to the Commission |
| By September 14 | The respondents deliver response submissions to the executive director and to the secretary to the Commission. |

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Any party seeking an oral hearing on the issue of sanctions so advises the secretary to the Commission

By September 21

The executive director delivers reply submissions (if any) to the respondents and to the secretary to the Commission

¶ 52 July 16, 2012

For the Commission

Brent W. Aitken
Vice Chair

Bradley Doney
Commissioner