

2012 BCSECCOM 377

**Yan Zhu (also known as Rachel Zhu), Guan Qiang Zhang
and Bossteam E-Commerce Inc.**

Securities Act, RSBC 1996, c. 418

Panel	Brent W. Aitken Kenneth G. Hanna Suzanne K. Wiltshire	Vice Chair Commissioner Commissioner
Date of hearing	July 18, 2012	
Date of Ruling	September 5, 2012	
Date of Reasons	September 27, 2012	
Appearing		
Neil Cave	For the Executive Director	
John R. Shewfelt George Lee David A. Schwartz	For Yan Zhu, Guan Qiang Zhang, and Bossteam E-Commerce Inc.	

Reasons for Ruling

I Introduction

- ¶ 1 On April 30, 2012, the executive director issued a notice of hearing and temporary orders against Yan Zhu, Guan Qiang Zhang, and Bossteam E-Commerce Inc. under sections 161(1) and (2) of the *Securities Act*, RSBC 1996, c. 418 (2012 BCSECCOM 143).
- ¶ 2 On the same day, the Commission made an order under section 151 freezing funds in certain of the respondents' bank accounts.
- ¶ 3 In the notice of hearing the executive director alleges that the respondents "appear to have contravened" sections 61 (requirement to file a prospectus) and 57 (prohibition against fraud) of the Act by promoting and selling securities of Bossteam from October 11, 2011 to January 24, 2012.

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- ¶ 4 The temporary orders are:
- a. under section 161(1)(a) of the Act, that the respondents comply with or cease contravening the Act;
 - b. under section 161(1)(b), that all persons cease trading in the Bossteam investments described in the notice of hearing, and
 - c. under section 161(1)(d)(iii), Zhu and Zhang cease all investor relations activities on behalf of Bossteam.
- ¶ 5 The executive director gave notice in the notice of hearing of his intention to have the temporary orders extended until a hearing is held and a decision is rendered.
- ¶ 6 On May 11, 2012, the respondents applied to have the temporary orders and the freeze order revoked.
- ¶ 7 The hearing of those applications was set down for May 15, 2012. On that day we, with consent, adjourned the hearing to June 8 and extended the temporary orders until a hearing is held and a decision is rendered. The hearing was subsequently adjourned to July 18, 2012.
- ¶ 8 At the conclusion of the hearing on July 18, we varied the temporary orders by ordering that all persons cease all investor relations activities on behalf of Bossteam.
- ¶ 9 On September 5, 2012, we ruled not to extend the temporary orders because we did not find that it was necessary and in the public interest to do so (2012 BCSECCOM 349). We also revoked the orders we made during the hearing extending and varying the temporary orders. We dismissed the respondents' application to revoke the freeze order. These are our reasons.

II Background

- ¶ 10 Bossteam is a federal corporation with its registered office in Burnaby, British Columbia. During the relevant period Zhu and Zhang were residents of British Columbia. Zhu is Bossteam's sole director and went to China in March. She was still there as of June 4, 2012. Zhang was deported to China in April.
- ¶ 11 An unsigned collaboration agreement dated January 2, 2012 between Zhu and Zhang set forth the terms on which they agreed to collaborate on the creation and operation of Bossteam. The agreement provided that Zhu would hold 2.4 million shares of the company and that Zhang would hold 3.8 million shares.

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- ¶ 12 Bossteam, through the website YouAdworld.com (which was registered to Zhu and her husband) purported to offer internet advertising services to small and medium-sized businesses.
- ¶ 13 Advertisers (which Bossteam called customers) could buy prepaid advertising space on YouAdworld.com in various denominations of advertising “credits”. Each credit provided the advertiser with a specified viewing time of its advertisement by potential customers.
- ¶ 14 Advertisers could earn cash rebates by browsing 20 advertisements daily on YouAdworld.com. The apparent objective was to achieve a higher search engine ranking of YouAdworld.com advertisers by increasing the number of hits on their websites.
- ¶ 15 Before 2012 the rebates were capped at 120% of the amount the advertiser paid for prepaid advertising. Sometime in early 2012 Bossteam lowered the cap to 70%.
- ¶ 16 Bossteam also offered “memberships”. Members had the right to sell advertising space on YouAdworld.com. Members could earn cash rebates at the same level as advertisers. Members were also eligible to earn commissions through a complex multi-level marketing structure.
- ¶ 17 Bossteam referred to its cash-rebate program as a profit sharing plan, perhaps a misnomer, as it appears from the evidence that the cash rebates were funded from Bossteam’s revenues.
- ¶ 18 The executive director alleges that Bossteam sold memberships for a fee, but the evidence of that is equivocal.
- ¶ 19 Members could earn remuneration on the basis of advertising space they sold. An undated Bossteam brochure points out that it was open to members to purchase advertising space themselves, in order to qualify for cash rebates and to become eligible for commissions. It is this aspect of Bossteam’s structure that has the appearance of a membership fee.
- ¶ 20 Yet the evidence is not clear. Zhu says Bossteam did not charge for memberships, and the brochure says that anyone can join as a member at no cost. This appears consistent with information on the Bossteam website that members could earn remuneration based, not on a membership fee, but on their “sales amount” (being, it appears, the amount of advertising space they sold).

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- ¶ 21 That said, this evidence is not conclusive that Bossteam did not charge a fee for membership, at least in order to qualify the member for cash rebates and to participate in Bossteam's multi-level marketing commissions.
- ¶ 22 Bossteam also offered on its website eight million shares in three tranches at prices ranging from 20 cents to 30 cents. The offerings under the three tranches were stated to end in February, April and June, 2012. Bossteam said the shares, once held for three months, would be tradable on a company platform. Bossteam said on its website that it had sold over 400,000 shares. Zhu says Bossteam never implemented the share offering plan, no shares were issued, and that it accepted no money for shares.
- ¶ 23 Commission staff received complaints from four investors who said they each purchased US\$10,000 worth of Bossteam shares.
- ¶ 24 In October and November 2011, Bossteam opened two accounts at a Burnaby branch of a Canadian chartered bank, one a Canadian dollar account and the other a US dollar account. Zhu and Zhang were the sole signatories on the accounts. From October 2011 through January 2012:
- a. deposits were made to the Canadian dollar account totalling nearly \$689,000;
 - b. deposits were made to the US dollar account totalling US\$591,000;
 - c. a total of \$405,000 had been withdrawn from the Canadian dollar account; \$150,000 of this amount was withdrawn in connection with the purchase of a 2012 Mercedes Benz S550; bank records suggest another \$51,000 of this amount represented payments to Zhu, to Zhang, and to Bossteam members; and
 - d. Bossteam transferred over \$1 million to a UK company called Earthport PLC (the evidence is not clear as to which Bossteam account was the source of these transfers).
- ¶ 25 An employee of the bank told the Commission staff investigator in April that one of Bossteam's accounts had a balance of \$4 million (he did not identify the account or the currency).

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III Analysis – Temporary Orders

A The law

¶ 26 Section 161(3) says:

“161(3) If the commission . . . considers it necessary and in the public interest, the commission . . . may . . . make an order extending a temporary order until a hearing is held and a decision rendered.”

¶ 27 When the executive director seeks an extension of a temporary order under section 161(3), the onus is on him to produce *prima facie* evidence of both the misconduct alleged and the reasons that it is necessary and in the public interest to extend the order. Even if there is *prima facie* evidence of misconduct, it does not follow from that alone that it is necessary and in the public interest to extend the order. See *Fairtide Capital Corp.* 2002 BCSECCOM 993.

B The Evidence

¶ 28 The executive director filed two affidavits of the Commission staff investigator. The respondents filed affidavits of Zhu and Zhang and of third parties.

¶ 29 The evidence from both sides is thin on some relevant issues and none of it is free of reliability concerns.

¶ 30 For example, the Bossteam website changed over time and the distinction between advertisers and members was, to put it mildly, blurred in earlier versions. It is not clear when in 2012 the rebate cap was reduced from 120% to 70%. The individual respondents and most of the Bossteam employees whose statements are part of the evidence are Chinese and English is their second language. This has led, we think, to an unfortunate and indiscriminate use of the term “membership” in the affidavits and submissions.

¶ 31 The affidavits submitted by the executive director contain statements that are not merely hearsay, but sometimes double or triple hearsay. It is difficult to attach significant weight to statements that remote from the deponent’s actual knowledge.

¶ 32 Some statements by the respondents in their affidavits raise more questions than they answer. Some of this could perhaps have been cleared up through cross-examination, but they were not available to testify.

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1. Evidence related to the alleged contravention of section 61

Bossteam shares

- ¶ 33 Section 61 of the Act requires that a person not distribute a security unless a prospectus respecting the security has been filed with, and a receipt for the prospectus issued by, the executive director.
- ¶ 34 Bossteam's shares were clearly securities and we so find.
- ¶ 35 Bossteam offered its shares for sale on its website. Whether or not it issued any shares under its share offering plan, its offer was a "trade" as defined in the Act because it was a solicitation in furtherance of a disposition of its shares for valuable consideration. The trade was a distribution because the shares were not previously issued.
- ¶ 36 No prospectus has been filed respecting the Bossteam shares.
- ¶ 37 We find that the executive director has provided *prima facie* evidence that the respondents contravened section 61 of the Act in offering the Bossteam shares.

Bossteam's cash rebate plan

- ¶ 38 The executive director alleges that Bossteam's cash rebate plan, which it called a profit-sharing plan, was a security because the definition of "security" in section 1(1) of the Act includes "a profit sharing agreement" and an "investment contract".
- ¶ 39 As we noted above, it appears that Bossteam's cash rebate program may not, in substance, be a profit sharing plan. In any event, the executive director did not provide *prima facie* evidence that the program can be properly characterized as a security under the "profit sharing agreement" head of the definition.
- ¶ 40 Was the cash rebate program an investment contract? Well-known common law defines an investment contract as an investment of money in a common enterprise with profits to come from the efforts of others. (See *SEC v. W. J. Howey Co.* 328 US 293 (1946), *SEC v. Glen Turner Enterprises, Inc.* 474 F. 2d 376 (1973), *Pacific Coast Coin Exchange v. Ontario Securities Commission* [1978] 2 SCR 112).
- ¶ 41 In our opinion, the evidence is not conclusive as to whether the cash rebate plan for Bossteam advertisers and members was an "investment" in the context of an investment contract.

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- ¶ 42 It appears that the amounts advertisers paid Bossteam were for prepaid advertising, and that the cash rebate plan was no more than a vehicle to reduce the advertisers' cost of advertising.
- ¶ 43 The evidence is not so clear about members' participation in the cash rebate plan.
- ¶ 44 The evidence does not establish conclusively that Bossteam required the payment of a fee to become a member. Indeed, there is some evidence that a fee was not required. If no membership fee was required, then there would be no "investment" and therefore no investment contract.
- ¶ 45 It appears that members could become eligible for cash rebates and to earn commissions by selling advertising space on YouAdworld.com.
- ¶ 46 There is also evidence to suggest that a member's outlay, although in form a purchase of advertising space, was in substance simply an investment. The member's expectation of profit would be based on the potential of earning 120% on the investment (before the rebate cap was lowered). That profit would come primarily from Bossteam's efforts in raising revenue; in our opinion, a member's "effort" in clicking on YouAdworld.com websites was not a significant effort in the context of the investment contract definition. That analysis would lead to a finding that the cash rebate plan as offered to members was a security.
- ¶ 47 We find that there is some evidence that Bossteam's cash rebate plan is a security, but that evidence is not sufficient to meet the standard of *prima facie* evidence the executive director must provide for the purposes of extending the temporary order under section 161(3).

2. Evidence related to the alleged contravention of section 57

- ¶ 48 Section 57 says a person must not engage in or participate in conduct relating to a security if the person knows, or reasonably should know, that the conduct perpetrates a fraud on any person.
- ¶ 49 The executive director alleges that Bossteam was perpetrating a fraud, contrary to section 57, and that Zhu and Zhang had knowledge of the fraud because:
- a. the sale of Bossteam memberships was a Ponzi scheme;
 - b. Bossteam promised a rate of return on the membership fee that is economically impossible; and

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- c. there is evidence of the misuse of funds - Zhu and Zhang are parties to the collaboration agreement, were the sole signing authorities on Bossteam's bank accounts, and Zhang is the principle operator of the Mercedes S550.

Ponzi scheme

- ¶ 50 The executive director says that Bossteam was operating a Ponzi scheme because it had no source of revenue other than the sale of prepaid advertising and membership fees, and paid out monies to its customers and members from that revenue. (The executive director does not allege the existence of any Ponzi scheme involving the Bossteam shares.)
- ¶ 51 The only evidence about Bossteam's source of revenue is:
- a. the bank employee's conclusion that "there was nothing to indicate that Bossteam received any 'normal business revenue'";
 - b. the Commission staff investigator's opinion that "it does not appear that the deposits into Bossteam's account came from medium or small businesses"; and
 - c. a statement by Zhu's husband, Zhuang Zhi Hu, in an interview with Commission staff, that, according to the Commission staff investigator, "Bossteam has no real source of income, other than the funds received from investors".
- ¶ 52 The bank employee based his conclusion, in part, on a discussion he says he had with employees of Bossteam who told him that "currently the only source generating revenue was the pre-sell of advertisement space, that is, membership fees". This is an example of triple hearsay. The words quoted are from the Commission staff investigator's affidavit. Are the words "that is, membership fees" hers, the bank employee's, or the Bossteam employees'?
- ¶ 53 In support of her conclusion that it does not appear that Bossteam's deposits came from medium or small businesses, the Commission staff investigator deposes that the deposits consist of cash, inter-branch transfers, and cheques. The cheques account for \$480,000 out of \$689,000 in deposits and some of them bear the notations "membership fees" or "youadworld.com". It seems clear that some portion of two-thirds of the deposits may well have been for prepaid advertising. As for the balance, we have already commented on the equivocal character of the term "membership fees" in the circumstances of this case.
- ¶ 54 Whatever Hu said in his interview, it is worth noting that Zhu describes Hu as her "estranged" husband.

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¶ 55 This evidence falls far short of *prima facie* evidence of a Ponzi scheme.

Rate of return

¶ 56 There is no *prima facie* evidence to support the executive director's submission that the return on the membership fee under the cash rebate plan was economically impossible.

¶ 57 The cash rebate plan was initially capped at 120% of the member's cost. This amounts to a return of the member's capital and a 20% gross return.

¶ 58 To undertake the analysis of whether a 20% gross return is economically impossible, it is necessary to express it as an annual return, or a return over some other specified time period. It is impossible from the evidence to determine how to express the 20% gross return in terms of any time frame, because Bossteam made no promises about the time frame in which the 20% gross return could be realized. In fact, the evidence is that Bossteam did not promise any return. It only established a maximum aggregate level of cash rebates.

¶ 59 Once the rebate cap was reduced to 70%, there is no return, other than a return of 70% of the member's capital.

Misuse of funds

¶ 60 There is no *prima facie* evidence before us that any of the disbursements from Bossteam's accounts were fraudulent. For example, the executive director infers that the purchase of the Mercedes was for Zhu's and Zhang's personal use. Zhu says the Mercedes was bought to impress out of town clients and that it is now registered to Bossteam. The executive director infers that the disbursements to Earthport were somehow improper but offered no evidence in support. Zhu identified Earthport as an international payment processing firm that Bossteam uses to transfer funds to its international clients.

¶ 61 Although it is reasonable to assume that any funds that Bossteam may have raised through the sale of securities were deposited into its accounts, there is very little other evidence about the source of deposits to, and the destination of withdrawals from, the Bossteam accounts.

Finding

¶ 62 We do not find *prima facie* evidence that the respondents have contravened section 57.

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3. Evidence related to reasons of necessity and public interest

- ¶ 63 The Commission staff investigator deposes that in early May she visited YouAdworld.com and saw a notice that “From now on, Bossteam E-Commerce, Inc. will temporary [*sic*] stop running.” She deposed that the name Bossteam no longer appears anywhere on the website, other than in the notice.
- ¶ 64 In May the Commission investigator found a new website, new.youadworld.com. The name Bossteam is not associated with the new website. The owner of the website purports to be Mont Fort Ltd. Otherwise, the website is similar in appearance to the Bossteam website. There is no evidence that establishes any relationship between Mont Fort and Bossteam, Zhu or Zhang.
- ¶ 65 Commission criminal investigation staff obtained computer hard drives and documents from Bossteam’s offices under a court-authorized warrant. Some of the information from these sources is in the evidence. The information is equivocal – it could be interpreted as either innocent or sinister, depending on the context. Unfortunately, Commission staff has not had the material long enough to establish a context, if there is any, that would help in interpreting this material.
- ¶ 66 We have found that the executive director has provided *prima facie* evidence only of a distribution of Bossteam shares it offered for sale on its website. We found that the respondents distributed those shares without filing a prospectus by offering them for sale. Whether or not Bossteam actually sold any shares, the evidence is that it is no longer offering them for sale.
- ¶ 67 We have not found *prima facie* evidence of fraudulent conduct.
- ¶ 68 In these circumstances, we did not find it either necessary or in the public interest to extend the temporary orders.

IV Analysis – Freeze Order

- ¶ 69 The respondents have applied under section 171 of the Act for a revocation of the freeze order. Section 171 authorizes the Commission, if it “considers that to do so would not be prejudicial to the public interest” to “make an order revoking . . . a decision the commission . . . has made under this Act”.
- ¶ 70 The onus is on the respondents, as the applicants under section 171, to show that revoking the freeze order would not be prejudicial to the public interest.

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¶ 71 It does not follow that because we did not find it necessary or in the public interest to extend the temporary orders under section 161(3), that it would not be prejudicial to the public interest to revoke the freeze order under section 171.

¶ 72 In *Amswiss* [1992] 7 BCSC Weekly Summary 12, a panel of the Commission said this about the purpose of freeze orders issued under section 151 (at page 32):

“In our view, the purpose of section [151(1)] is to preserve property for persons who may have common law or statutory claims to or interests in it, for example by way of rescission or damages under . . . the Act.

. . .

The immediate effect of a freeze order is to maintain the status quo, ensuring that the frozen property is not dissipated or destroyed before the Commission is in a position to determine what, if any, further steps or orders in the public interest should be made under the Act.

. . .

Like a section [161(2)] temporary cease trade order or a section [89] halt order, a freeze order enables the Commission to respond immediately to information that, in its opinion, warrants regulatory intervention to prevent or minimize prejudice to the public interest. Often it is necessary to take these steps before any investigation is commenced or concluded. The ability of the Commission to act in this fashion is necessary to instil and maintain public confidence in the integrity of the capital markets.”

¶ 73 The panel in *Amswiss* said this about what the Commission needs to consider in making a freeze order:

“Although there is no specific reference to the public interest in section [151], in our view, the Commission may only exercise the powers under this section where it considers that there is some connection to trading in securities and that an order is in the public interest.

¶ 74 The court in *Exchange Bank & Trust*, 2000 BCCA 389 cited with approval these passages from *Amswiss*.

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- ¶ 75 Although we have declined to extend the temporary orders, and found at the date of the hearing no *prima facie* evidence of fraud, the allegations in the notice of hearing are serious and the investigation is continuing. We have found that the respondents engaged in an illegal distribution of Bossteam shares. There is some evidence that the Bossteam cash rebate plan as offered to members was a security, and the respondents did not provide evidence sufficient to establish that it was not.
- ¶ 76 In our opinion it is premature to revoke or vary the freeze order because the Commission is not yet in a position to determine what, if any, further steps or orders in the public interest should be made under the Act in connection with the allegations in the notice of hearing.
- ¶ 77 September 27, 2012
- ¶ 78 **For the Commission**

Brent W. Aitken
Vice Chair

Kenneth G. Hanna
Commissioner

Suzanne K. Wiltshire
Commissioner