British Columbia Securities Commission

Citation: 2013 BCSECCOM 15

Damien Edward Reynolds

***Securities Act*, RSBC 1996, c. 418**

Hearing

Panel	Brent W. Aitken	Vice Chair
	Kenneth G. Hanna	Commissioner
	Suzanne K. Wiltshire	Commissioner
Dates of Hearing	May 15, 16, and October 22, 2012	
Date of Findings	January 21, 2013	

Appearing

H. Roderick Anderson Patricia A. A. Taylor	For Damien Edward Reynolds
Mila A. Pivnenko	For the Executive Director

Decision

I Introduction

¶ 1 This is a hearing under sections 161(1) and 162 of the *Securities Act*, RSBC 1996, c. 418.

¶ 2 In a notice of hearing dated February 24, 2012, the executive director alleges that in March 2010 Damien Edward Reynolds, contrary to section 57(a) of the Act, "caused or contributed to an artificially low price" for the shares of Coltstar Ventures Inc. when he placed orders on the TSX Venture Exchange to sell Coltstar shares.

¶ 3 In our opinion, the executive director failed to prove that Reynolds contravened section 57(a), for the reasons set out below.

II Applicable Law

¶ 4 Section 57(a) contains the prohibition against what is commonly referred to as market manipulation.

¶ 5 The relevant parts of section 57(a) say that a person "must not, directly or indirectly, engage in or participate in conduct relating to securities . . . if the person knows, or reasonably should know, that the conduct . . . results in or contributes to . . . an artificial price for, a security".

¶ 6 In *Hu* 2011 BCSECCOM 355, the Commission said:

> "13 It is well-established that the executive director must prove allegations in a notice of hearing on a balance of probabilities. The proof must be clear and convincing and based on cogent evidence. The Canadian Oxford Dictionary (Oxford University Press, 1998) defines cogent as 'convincing, compelling'."

III Issues

¶ 7 Here, there was no dispute that Reynolds made the trades in Coltstar shares alleged in the notice of hearing and, accordingly, engaged in conduct relating to securities. The case turned on two issues:

1. Did Reynolds' orders result in or contribute to an artificial price for Coltstar shares?

2. If so, did Reynolds know, or should he have known, that his conduct had that result, or contributed to that result? Having found that the evidence did not prove that Reynolds' orders resulted in, or contributed to, an artificial price for Coltstar shares, it was unnecessary for us to consider this issue.

IV Facts and Analysis

¶ 8 At the relevant time Reynolds was a director of Coltstar and was about to become its CEO.

¶ 9 This hearing was about two sell orders for Coltstar shares placed by Reynolds in March 2010, the first on March 12 and the second on March 19.

¶ 10 Reynolds placed the orders through an account in the name of his mother, Christine Wissink. He had the authority to give trading instructions. Wissink's account was flagged in her dealer's records as to the companies held in the account of which Reynolds was an insider. The evidence is that Reynolds made no attempt to conceal his trading instructions in relation to the Wissink account and took the expected steps to ensure Wissink's dealer knew of his status as an insider when relevant.

¶ 11 Wissink had a large inventory of Coltstar shares in her account. In December 2009 she acquired 2 million shares at a price of $0.125 (after giving effect to a subsequent stock split). On March 17, she acquired another 1.5 million shares at $0.13.

A The March 12 order

¶ 12 The first of the impugned orders was a sell order that Reynolds placed on Friday, March 12, 2010 about 10 minutes before the market closed.

¶ 13 The executive director said that Reynolds placed this order to create an artificially low price for Coltstar shares for the purpose of pricing the company's private placement of a convertible debenture to JAT 001 Holdings Ltd. on Wednesday, March 17, 2010. JAT is a family trust controlled by Reynolds, who is one of the beneficiaries of the trust.

¶ 14 The sell order was for 20,000 Coltstar shares at a minimum price of $0.15 per share.

¶ 15 The order was filled as follows:

- 5,000 shares at $0.24
- 5,000 shares at $0.23
- 6,000 shares at $0.21
- 4,000 shares at $0.15

¶ 16 Reynolds' trades were the only trades that day, and Coltstar's share price closed at $0.15.

¶ 17 In *Siddiqi* 2005 BCSECCOM 416 the Commission listed (at paragraph 114) the "recognized hallmarks" of an attempt to manipulate the market. Only two have any possible application here: trades or orders that lead to an artificial price for a security (this includes trades or orders designed to set the closing price for the day) and market domination.

¶ 18 Neither of these two hallmarks were present here. In our opinion, for the reasons below, the evidence did not establish that either of Reynolds' March 12 and March 19 trades resulted in, or contributed to, an artificial price for the Coltstar shares. As for market domination, for a stock that traded as thinly as Coltstar's did, there was no real market context to assess domination. A single trade could have dominated trading on any given day.

¶ 19 Reynolds' sell order late on March 12 did have the result of setting the closing price for the day. Reynolds was also the only trader that day. The price of $0.15 was the lowest price for Coltstar shares during the previous three months.

¶ 20 However, it does not follow from those facts alone that the closing price of $0.15 on March 12 was an artificial price.

¶ 21 To say merely that Coltstar traded thinly in the period leading up to March 12, 2010 is an understatement. It traded on only eight days between December 1 and March 31. Excluding one anomalous trade on December 1 for 1,000,000 shares at $0.25, there were a total of 20 trades on those eight days representing a total volume of 109,000 shares. Prices ranged from $0.255 to $0.375 (but for two small trades in early January at $0.66).

¶ 22 In March, the trades before Reynolds' trade on the 12th were two on the 4th (one for 5,000 shares at $0.29 and one for 10,000 shares at $0.33) and one on the 11th (for 5,000 shares at $0.27).

¶ 23 The spreads were large. Between March 1 and 11, bids ranged from $0.22 to $0.30 and asks ranged from $0.32 to $0.45.

¶ 24 At a superficial level one could be tempted to conclude that, had the spreads been narrower, more trades would have occurred in the mid-$0.20 range, suggesting a floor price around that level. That in turn could lead to the conclusion that a price of $0.15 was artificial.

¶ 25 However, in our opinion it would be entering the realm of speculation to reach that conclusion on the basis of so few trades and such large spreads. We also have the luxury of hindsight, and note, as discussed further below, that 36,500 Coltstar shares traded in the $0.16 range a few days later, on March 17.

¶ 26 There is also the matter of motivation. The authorities cited to us (including *Podorieszach* [2004] ASCD No. 360; *Roche* [2004] ASCD No. 400; and *Universal Market Integrity Rules* IIROC Policy 2.2 – *Manipulative and Deceptive Activities*) recognize the importance of motivation as a factor in determining whether a price is artificial.

¶ 27 The *Siddiqi* panel, referring to *Sirianni* [1991] 40 BCSC Weekly Summary 7 and *Atlantic Trust Management Group* [1995] 14 BCSC Weekly Summary 54 said:

> "118 As is clear from these authorities, a person manipulating the market might use a variety of tools to do the job. Some of these tools are not inherently illegitimate trading practices – they only become so when employed with the intention of manipulating the market. It is also necessary to consider the conduct of the alleged manipulator as a whole. Some trading and order activity may not seem manipulative when viewed in isolation, but is clearly so when considered along with all of the manipulator's other conduct."

¶ 28 The evidence created two problems for the executive director's theory that Reynolds knowingly established an artificial price in order to price a financing of Coltstar through JAT.

¶ 29 First, Coltstar's chief financial officer testified that in early March 2010 the company's financial situation was becoming acute. "The company needed money and it needed it soon," he said. He testified, however, that as of Friday, March 12 the company had not planned a financing of any kind, and that the idea of the convertible debenture to JAT did not arise until March 17, the following Wednesday.

¶ 30 Second, even if Reynolds had been contemplating a future financing when he traded on March 12 (of which there is no evidence), the theory overlooks the fact that there were two trading days, March 15 and 16 (Monday and Tuesday) before the convertible debenture was announced. The debenture was priced on the closing price of the date before it became effective. How could Reynolds be confident that the price he established on Friday would stick until the close of the market on the following Tuesday?

¶ 31 In addition, Reynolds' trades were economic – the shares he sold had an acquisition cost of $0.125. Of the 20,000 shares sold under the order, 16,000 were sold at prices between $0.21 and $0.24, and 4,000 sold at $0.15 – all prices higher than $0.125.

¶ 32 The executive director said that we should find that Reynolds knowingly established an artificial price because:

- Reynolds "could feel quite comfortable" that the $0.15 price he established would stick because of the illiquidity of the stock
- As a director, he knew that Coltstar would not be issuing any news releases until March 17, when it announced the debenture financing
- Even if an intervening trade occurred, he could easily repeat the exercise to bring the price down again
- Reynolds entered no evidence to propose an alternative rational explanation for the sell order, so it is reasonable to infer that he "drove the price down on March 12 to get the benefit of the cheap convertible debenture"
- It is not believable that, as a practical matter, there was enough time on one day – March 17 – to conceive the debenture financing, negotiate it, approve it, implement it, and announce it; it is "much more logical" that the debenture "was discussed prior to March 12"
- Alternatively, "another rational explanation" is that Reynolds thought of the debenture idea before March 12 without telling anyone
- Reynolds did not tell the Coltstar board or anyone else at the company that he was the one who set the price for the debenture "because he knew what he did was wrong"

¶ 33 The evidence shows that Reynolds was a beneficiary of JAT. There is no evidence to support any of the rest of the executive director's theory, and in the absence of that evidence, the theory amounts to little more than speculation.

¶ 34 We therefore find that the executive director failed to provide clear and convincing proof, based on cogent evidence, that Reynolds' March 12 order resulted in, or contributed to, an artificial price for the Coltstar shares in contravention of section 57(a).

B The March 19 order

¶ 35 The second of the impugned orders was a sell order that Reynolds placed a week later, on Friday, March 19, 2010 at about 12:30 Eastern time – about three and a half hours before the market closed.

¶ 36 The executive director said that Reynolds placed this order to knowingly establish an artificially low price for Coltstar shares for the purpose of pricing stock options to Reynolds and others announced by Coltstar on March 22. Reynolds received 1,000,000 of the options approved by the Coltstar board on that day.

¶ 37 The sell order was for 10,000 Coltstar shares at prevailing market prices.

¶ 38 The order was filled as follows:

- 5,000 shares at $0.30
- 5,000 shares at $0.22

¶ 39 Reynolds' trades were the only trades that day, and Coltstar's share price closed at $0.22.

¶ 40 The trading picked up on the two days before. On March 17, there were six trades for 51,500 shares at prices ranging from $0.16 to $0.30. On March 18, 13,000 shares traded in three trades at $0.27, $0.28, and $0.35.

¶ 41 On March 19, there were four opening bids at $0.21, $0.215, and $0.22. These were followed by two bids at $0.30. Until Reynolds' market order appeared, the asks were at $0.40. Reynolds' market order was filled in part by the $0.30 bids and the balance was filled at $0.22.

¶ 42 After Reynolds' order, the bids for the remainder of the day ranged from $0.22 to $0.25.

BCSC

¶ 43 In this case, the evidence that the price of $0.22 was artificial was even weaker than for the March 12 trades. All of the bid prices for March 19 ranged from $0.21 to $0.25, and half of Reynolds' order was filled at $0.22. If there was a price that looked unusual in the context of that day, it was the bid at $0.30 that filled the first half of Reynolds' order.

¶ 44 A total of 47,500 Coltstar shares also traded at prices below $0.22 on March 17, when 11,000 shares traded at $0.20, 6,000 at $0.16, and 30,500 at $0.165.

¶ 45 The executive director said we should find that Reynolds knowingly established an artificial price on March 19 because:

- Due to his involvement in the Board's discussions on the subject of options, Reynolds must have known about the recipients and allocations of the options and the plan to announce them on March 22
- The board must have discussed and finalized the recipients and allocations of the options before 2:00 on March 19 because the chief financial officer sent his inquiry to counsel about the related legal requirements just before 2:00 p.m that day (in fact we are apparently asked to find that their discussions were in fact concluded before 9:30 a.m. that day, when Reynolds placed his order
- Reynolds "could feel quite comfortable" that the $0.22 price he established on March 19 would stick (even though he placed his order in the middle of the day) because of the illiquidity of the stock
- Even if an intervening trade occurred, he could easily repeat the exercise to bring the price down again
- Reynolds did not tell the Coltstar board or anyone else at the company that he was the one who set the price for the options "because he knew what he did was wrong"
- There is no evidence that the trades on March 17 for $0.16 and $0.165 were at arms' length
- There is no rational explanation for Reynolds to sell Coltstar shares at such a low price other than an intent to drive down the price

¶ 46 This theory is not supported by evidence and is essentially speculation.

¶ 47 The evidence was that Reynolds, as a director and incoming CEO, had been involved in the discussions about the issuance of options generally, but there was no evidence as to whether or when Reynolds knew of the company's plans to announce on May 22 the issue of stock options, and if so, when.

¶ 48 On the last point in the list, Reynolds said in his submissions that he sold the shares as part of a series of sales he made to clear a debit position in the account (the overall debit position, about $190,000, arose from the acquisition of the 1.5 million shares on March 17; the debit was due a week later).

¶ 49 The executive director said the March 19 sale was too small to have any impact on the debit and that it does not follow that Reynolds was selling shares to clear the debit position. "The explanation consistent with the evidence is that the account sold on these dates to make a profit," said the executive director, pointing out that the shares were acquired at "a very low price of $0.13".

¶ 50 Two scenarios were offered up as reasonable explanations for his March 19 order: to clear the debit position and to make a profit on Coltstar shares. It is not implausible that the March 19 trade was made to begin the process of clearing the debt position – that had to be done by the following Wednesday – but whatever one might think about that, the shares Reynolds sold were acquired at $0.125 and $0.13 and were sold at $0.30 and $0.22, clearly yielding a profit. In any event, there were reasonable explanations for his trades other than an intent to manipulate the market.

¶ 51 The executive director's response to the trades at $0.16 and $0.165 was curious. These trades, like all the others, were listed in the trade summaries in the record. They were clearly relevant to the issue of whether trades at $0.15 and $0.22 would be artificially low, yet the investigator testified he did not investigate them. Reynolds did not invent this evidence – he merely referred to it in submissions. The burden is not on him to establish that these trades were not at arm's length. The burden is on the executive director to prove his case.

¶ 52 The only evidence that the executive director offered to prove that the trades at $0.16 and $0.165 were not at arm's length is that the seller of the 1.5 million Coltstar shares that Wissink bought on March 17 was a client of a dealer whose clients, according to the investigator, "did a lot of trading" in Coltstar shares. These clients, testified the investigator, "seemed to be insiders of Coltstar". This evidence is clearly insufficient to cast doubt on the integrity of the $0.16 and $0.165 trades.

¶ 53 We therefore find that the executive director failed to provide clear and convincing proof, based on cogent evidence, that Reynolds' March 19 order resulted in, or contributed to, an artificial price for the Coltstar shares in contravention of section 57(a).

BCSC

V Order

¶ 54 We dismiss the allegations in the notice of hearing that Reynolds contravened section 57(a) of the Act when he placed his orders on March 12 and 19, 2010.

¶ 55 January 21, 2013

¶ 56 **For the Commission**

Brent W. Aitken
Vice Chair

Kenneth G. Hanna
Commissioner

Suzanne K. Wiltshire
Commissioner