Citation: 2014 BCSECCOM 93

IAC - Independent Academies Canada Inc., Micron Systems Inc., Theodore Robert Everett, Leonard George Ralph and Robert H. Duke

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

Hearing

Panel	Brent W. Aitken	Vice Chair
	Audrey T. Ho	Commissioner
	Gordon L. Holloway	Commissioner
Date of hearing	October 15-17 and 21, 2013	
Submissions completed	November 15, 2013	
Date of Findings	March 13, 2014	

Appearing

Brigeeta C. Richdale	For the Executive Director
Aengus RM Fogarty	For IAC - Independent Academies Canada Inc., Micron Systems Inc., Theodore Robert Everett and Robert H. Duke

Findings

I Introduction

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

¶ 2 On January 15, 2013 the executive director issued a temporary order and notice of hearing alleging that:

- between April 2002 and July 2011 IAC – Independent Academies Canada Inc., Theodore Robert Everett, Robert H. Duke, and Leonard George Ralph distributed securities of IAC without having filed a prospectus,
- between November 2009 and July 2011 all of the respondents perpetrated a fraud, and
- Micron Systems Inc. and the individual respondents contravened a July 19, 2011 cease trade order with respect to IAC securities issued by the executive director.

¶ 3 Ralph reached a settlement with the executive director prior to the hearing. These Findings deal only with the remaining respondents; Ralph is not included in our references below to the respondents as a group.

II Background

A Admissions

¶ 4 Between August 2002 and July 2011 IAC distributed securities to 126 investors for proceeds of $5.1 million without filing a prospectus and without the availability of any prospectus exemptions. All of the respondents admit that they did so and, in so doing, contravened section 61(1). The evidence corroborates the respondents' admissions.

¶ 5 On July 19, 2011 the executive director issued an order under section 164(1) that all persons cease trading IAC securities. The executive director issued the order after having determined that IAC had distributed securities in improper reliance on a prospectus exemption.

¶ 6 After this order was issued, Micron distributed promissory notes to existing IAC investors for proceeds of $195,000, in part to finance IAC expenditures. These promissory notes included a promise by Micron to issue IAC shares to the investors either immediately or in the future.

¶ 7 Micron, Everett and Duke admit that they contravened the July 2011 cease trade order. The evidence corroborates their admissions.

¶ 8 The respondents deny that they perpetrated a fraud contrary to section 57(b).

B Facts

¶ 9 IAC is a subsidiary of Micron. Both were incorporated in British Columbia. Neither has ever been registered or filed a prospectus under the Act.

¶ 10 During the relevant period, Everett and Duke were directors of both IAC and Micron. Both were officers of IAC and Everett was also an officer of Micron.

¶ 11 In 2006, IAC acquired a 2,040-acre property in the Comox Valley known as Sage Hills. IAC's promotional materials described Sage Hills as its "flagship project". (In fact, Sage Hills was IAC's only project.) IAC said it planned to develop a mixed-use community focused on private education with a sports and educational orientation. The development would include a private university, a private kindergarten-to-Grade-12 school, a professional sports academy, two 18-hole golf courses, over 5,000 residential units of various types, and a commercial village.

¶ 12 Between August 2002 and July 2011, IAC raised $5.1 million (through the illegal distribution mentioned above) to fund costs associated with the acquisition and development of Sage Hills.

¶ 13 In October 2007 IAC granted a mortgage on the Sage Hills property to Liberty Excell Mortgage Corp. in the amount of $4.2 million. The monthly payments, which started in December 2007, were $52,500.

¶ 14 Very soon, IAC had trouble making the payments. The April, May and June 2008 payments were late, although paid within the month. The September 2008 payment was a month overdue before IAC paid it. From October 2008 onward, IAC was never current in its payments and indeed made only four full payments on the mortgage between then and May 2009. Thereafter, IAC made only partial payments.

¶ 15 On November 16, 2009, Liberty commenced foreclosure proceedings under the mortgage and registered a certificate of pending litigation against the Sage Hills title.

¶ 16 On July 14, 2010, Liberty obtained from the court an Order Nisi and Conduct of Sale for Sage Hills.

¶ 17 On September 13, 2012 the court approved a sale of the Sage Hills property to the Province of British Columbia for $4.9 million. The sale completed within a few days.

¶ 18 IAC's unaudited financial statements for the year ended December 31, 2009 showed assets of $7.8 million. This included a book value of $4.8 million for Sage Hills and less than $200,000 in cash. There were no other assets with significant realizable value. Liabilities were recorded at $5.8 million, including the Liberty mortgage. IAC's retained earnings line showed an accumulated deficit of $7. 7 million.

¶ 19 From November 16, 2009 (the date the Sage Hills foreclosure commenced) until July 2011, IAC distributed securities to 55 investors for proceeds of $1.45 million. Micron distributed the promissory notes described above during this period. Neither IAC nor Micron disclosed the foreclosure to these investors.

¶ 20 Throughout the relevant period, IAC communicated with its investors regularly through "investor updates". It showed prospective investors marketing materials, including news releases. The respondents admit that none of these materials contained any information about the Sage Hills foreclosure, and that they informed none of the investors by any other means about the foreclosure.

¶ 21 In fact, investors learned of the Sage Hills foreclosure from one or more of only three sources:

- observing the "For Sale" on the Sage Hills property, if they happened to drive past it;
- reading newspaper articles about the foreclosure published in late 2012 and early 2013 (after Sage Hills had been sold under the foreclosure), and
- hearing about foreclosure from Commission staff in the course of the investigation (also after the Sage Hills property had been sold).

¶ 22 The respondents say they did not tell investors about the Sage Hills foreclosure because they believed Sage Hills would not be sold. This was because:

- Based on discussions they said they had with Liberty, Everett and Duke believed Liberty would not list the property for sale and would give them sufficient time to raise money to repay the mortgage. However, the respondents tendered no witness or documents from Liberty, or any other evidence, to support this assertion.

- The respondents say that Liberty agreed in July 2011 to forbear from taking action to list or sell Sage Hills until after October 2011. In support of this assertion, they tendered a copy of a purported forbearance agreement among Liberty, IAC, Everett, and Duke. However, the document is not signed by Liberty, and the respondents tendered no witness or documents from Liberty to show the agreement was executed or that Liberty conducted itself in accordance with its terms.

- Everett and Duke say they believed they would obtain alternate financing and pay out Liberty before there was any risk of losing Sage Hills. Everett testified that IAC had "financing commitments in place which eventually led to a plan in which these investors would get compensated", although he admitted that the plan did not happen. In fact, there is no documentary evidence that IAC had, at any time, any alternative financing in place. Neither is there any documentary evidence of any enforceable commitment from any lender to provide financing.

- Everett and Duke did not believe Liberty could find a buyer for Sage Hills through the foreclosure, because they say the land use designation IAC obtained for Sage Hills could not be used by any other developer to develop the property. They tendered no corroborative evidence that a similar land use designation could not be obtained by another developer on similar terms as IAC's.

III Analysis and findings

A Illegal distribution of securities

¶ 23 Based on the evidence, including the respondents' admissions, we find that IAC, Everett and Duke distributed securities without having filed a prospectus, in contravention of section 61(1).

B Breach of Cease Trade Order

¶ 24 Based on the evidence, including the respondents' admissions, we find that Micron, Everett and Duke contravened the July 2011 cease trade order.

C Fraud

¶ 25 Section 57(b) of the Act states that "A person must not, directly or indirectly, engage in or participate in conduct relating to securities or exchange contracts if the person knows, or reasonably should know, that the conduct perpetrates a fraud on any person."

1. Applicable law

¶ 26 In *Anderson v. British Columbia (Securities Commission)*, 2004 BCCA 7, the British Columbia Court of Appeal stated the following regarding fraud in the context of the Act (at page 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."

¶ 27 The British Columbia Court of Appeal in *Anderson* cited the elements of fraud from ***R. v. Théroux***, [1993] 2 SCR 5 (at page 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 interest are put at risk)."

2. Prohibited act and deprivation

¶ 28 Sage Hills was IAC's only significant asset. The development of the Sage Hills property was the entire focus of IAC's business plan. The Sage Hills development was what investors believed they were funding when they invested in IAC (and later, in the Micron notes).

¶ 29 Without the Sage Hills property, IAC's business plan was doomed. The respondents argued that there is value in IAC's business concept independent of Sage Hills. This argument has no credibility. Apart from the respondents' bald assertions, there is no evidence to support the notion. It has the flavour of an *ex post facto* invention. For example, we note the respondents made no mention of the so-called business concept until after the Sage Hills property had already been sold through the foreclosure.

¶ 30 The Sage Hills foreclosure clearly put the Sage Hills project, and consequently IAC's entire business, at severe risk of loss.

¶ 31 In *R. v. Cuerrier* [1998] 2 SCR 371, the court stated (at para. 116) that the element of dishonesty in fraud "can include non-disclosure of important facts." Clearly, the foreclosure of the Sage Hills property was an "important fact". Indeed, it would be hard to imagine a fact any more important to investors about IAC's prospects than the looming loss of the Sage Hills property through foreclosure. We find that the respondents' failure to disclose the Sage Hills foreclosure was dishonesty amounting to deceit.

¶ 32 We also find that the evidence establishes deprivation. Investors invested $1.45 million with IAC and $195,000 with Micron after the Sage Hills foreclosure commenced. As a result of the foreclosure, IAC lost the Sage Hills property and had no significant assets. At the end of 2009, IAC had no significant realizable assets other than the Sage Hills property, no income, and an accumulated deficit of $7.7 million. Its only potential source of cash was retail financing. There is no evidence that IAC's financial condition today is any better than it was at the end of 2009, and every reason to believe it is worse.

¶ 33 The respondents tendered no evidence of any credible hope that the investors will recover any part of the funds they invested.

¶ 34 We find that IAC and Micron committed a prohibited act when they failed to disclose the Sage Hills foreclosure to investors, and that those investors suffered actual deprivation of $1.645 million as a consequence.

3. The respondents' subjective knowledge of the prohibited act and deprivation

¶ 35 The evidence, including Everett's and Duke's testimony, establishes that Everett and Duke knew about the Sage Hills foreclosure and knew that they did not tell investors about it.

¶ 36 We find that Everett and Duke had subjective knowledge of the prohibited act, being IAC's and Micron's failure to disclose the Sage Hills foreclosure to investors.

¶ 37 The respondents say, however, that they "did not have the subjective belief that the prohibited act could have as a consequence the deprivation of another nor that such persons' pecuniary interests would be at risk", because:

- they believed that the Sage Hills foreclosure would not be completed because no buyer would be found for the property, and
- they believed they would find replacement financing for the Liberty mortgage.

¶ 38 That the respondents held those beliefs does not establish that they did not have subjective knowledge of the possible consequences of the prohibited act. In *Théroux* the court said this (at pages 18-19):

> "The test is not whether a reasonable person would have foreseen the consequences of the prohibited act, but whether the accused subjectively appreciated those consequences at least as a possibility.
> ...
> The fact that the accused may have hoped the deprivation would not take place, or may have felt there was nothing wrong with what he or she was doing, provides no defence."

¶ 39 The evidence, including Everett's and Duke's testimony, is that they well knew that the sale of the Sage Hills property was at least a possibility arising from the foreclosure. Their belief that Liberty would be unsuccessful in finding a buyer shows that they knew the sale of the property was at least possible. They just thought it was not going to happen. They may have thought it unlikely, even highly unlikely, that the property would be sold, but they clearly understood what a foreclosure was and that its outcome could be the sale of Sage Hills.

¶ 40 For the same reason, Everett and Duke knew that that the loan had to be repaid to stop the Sage Hills foreclosure. Almost every month they were forced to take steps to try to keep the mortgage in some semblance of good standing. Indeed, they were attempting to find replacement financing, because they knew that if they failed to do so, the foreclosure would proceed and the Sage Hills property could be lost.

¶ 41 The development of Sage Hills was IAC's whole business. It was what investors believed they were financing. The Sage Hills development was the entire story told to investors about IAC. All of IAC's promotional materials and all of the communications to investors spoke of nothing else. Clearly, Everett and Duke had to have known that without the Sage Hills property, IAC had no business. They had to have known that without the Sage Hills property, the investors would have no identifiable means of recovering their investment.

¶ 42 In summary, Everett and Duke knew that:

- IAC and Micron did not tell their investors about the Sage Hills foreclosure
- the foreclosure could lead to the sale of the Sage Hills property,
- if the Sage Hills property was sold under the foreclosure, IAC's business would be finished, and
- the Sage Hills foreclosure accordingly put the investors' pecuniary interests at risk.

¶ 43 That Everett and Duke believed the worst would not happen is irrelevant and affords them no defence.

¶ 44 We find that Everett and Duke had subjective knowledge that the failure to disclose the Sage Hills foreclosure could, as a consequence, put the investors' pecuniary interests at risk.

¶ 45 Everett and Duke were the acting and directing minds of IAC and Micron, so their state of mind is attributable to those companies. We find that IAC and Micron had subjective knowledge of the prohibited act and of the consequent risk to the investors' pecuniary interests.

4. Finding

¶ 46 We find that Everett, Duke, IAC and Micron perpetrated a fraud, contrary to section 57(b).

¶ 47 Section 168.2(1) says that if a company like IAC or Micron contravenes a provision of the Act, an individual who is director or officer of the company also contravenes the same provision of the Act, if the individual "authorizes, permits, or acquiesces in the contravention".

¶ 48 Everett and Duke were directors of IAC and Micron, Duke was an officer of IAC, and Everett was an officer of both IAC and Micron. The evidence is clear that they directed the affairs of IAC and Micron. Although we have found that Everett and Duke contravened section 57(b) directly, we also find that Everett and Duke authorized, permitted and acquiesced in IAC's and Micron's contravention of section 57(b) and therefore also contravened section 57(b) under section 168.2(1).

IV Summary of Findings

¶ 49 We have found that:

- IAC, Everett and Duke contravened section 61(1);
- Micron, Everett and Duke contravened a cease-trade order issued by the executive director on July 19, 2011; and
- all of the respondents perpetrated a fraud, contrary to section 57(b).

V Submissions on Sanctions

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

By April 14	The executive director delivers submissions to the respondents and to the secretary to the Commission
By May 2	The respondents deliver response submissions to the executive director and to the secretary to the Commission. Any party seeking an oral hearing on the issue of sanctions so advises the secretary to the Commission
By May 9	The executive director delivers reply submissions (if any) to the respondents and to the secretary to the Commission.

¶ 51 March 13, 2014

¶ 52 **For the Commission**

Brent W. Aitken
Vice Chair

Audrey T. Ho
Commissioner

Gordon L. Holloway
Commissioner