BRITISH COLUMBIA SECURITIES COMMISSION
Securities Act, RSBC 1996, c. 418

Citation: Re Maddigan, 2016 BCSECCOM 379 Date: 20161110

0902395 B.C. Ltd. and Robert James Maddigan

Panel	Nigel P. Cave	Vice Chair
	George C. Glover, Jr.	Commissioner
	Gordon L. Holloway	Commissioner
Hearing Dates	April 4, 2016	
Submissions Completed	September 7, 2016	
Date of Findings	November 10, 2016	

Appearing

Olubode Fagbamiye	For the Executive Director
Robert James Maddigan	For himself and 0902395 B.C. Ltd.

Findings

I. Introduction

[1] This is the liability portion of a hearing under sections 161(1) and162 of the *Securities Act*, RSBC 1996, c. 418.

[2] In an amended notice of hearing issued January 23, 2015 (2015 BCSECCOM 31), the executive director alleged that:

a) the respondents committed fraud contrary to section 57 of the Act;

b) Maddigan, as the sole director and officer of 0902395 B.C. Ltd. (Maddigan's Company), authorized, permitted or acquiesced in Maddigan's Company's fraudulent conduct and, therefore, pursuant to section 168.2 of the Act, that he also contravened section 57 of the Act; and

c) the respondents' conduct, as set out in the amended notice of hearing, was contrary to the public interest.

[3] The parties tendered an agreed statement of facts (Statement of Facts) dated March 31, 2016 (described below).

[4] During the hearing the executive director called three witnesses, a Commission investigator and two investors; tendered documentary evidence; and provided written and oral submissions.

[5] Maddigan testified at the hearing; tendered documentary evidence; and made written and oral submissions.

[6] During the hearing, the executive director withdrew the allegations in the amended notice of hearing that Maddigan is vicariously liable for the fraudulent misconduct of Maddigan's Company and that the conduct of the respondents, as set out in the amended notice of hearing, is contrary to the public interest. As a consequence, the only remaining allegation is that the respondents committed fraud contrary to section 57 of the Act.

II. Background

Statement of Facts

[7] The exact text of the Statement of Facts is as follows:

> **"Background**
>
> 1. Robert James Maddigan is an Alberta resident. Maddigan was licensed as an engineer in Alberta until January 2010 and in the Northwest Territories and Nunavut until the end of 2012. He has served as a director, officer, or consultant to public junior mining companies.
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> 2. 0902395 B.C. Ltd. (Maddigan's Company) is a non-reporting British Columbia company. Maddigan is its sole director and officer.
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> 3. Maddigan's Company was a consultant to a coal company for the acquisition of a coal mine in Mongolia. In return, the coal company agreed to issue some of its shares to Maddigan's Company.
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> 4. In 2011, Maddigan's Company sold the shares before it had received them from the coal company. It entered into agreements with thirty-four investors, under which the investors provided funds to Maddigan's Company. These agreements appeared as loan agreements, with funds repayable in cash or shares in a new company at 10 cents a share, but investors were informed they were buying the coal company's shares. In total, investors paid $880,000 to Maddigan's Company for 8.8 million shares of the coal company.
>
> **Misconduct**
>
> ***Fraud***
>
> 5. In 2012, Maddigan's Company received 9 million shares from the coal company.

6. In 2013, Maddigan's Company transferred the shares to some of the investors. However, Maddigan's Company did not transfer the shares in accord with the agreements.

7. Certain investors, including a business associate and a friend of Maddigan, received more shares than they had paid for. Maddigan's business associate, acting through his company, paid for 250,000 shares. He received 2 million shares because Maddigan owed him a debt. Maddigan's friend paid for 150,000 shares but received 950,000, because Maddigan owed him rent.

8. Two investors Maddigan did not know – who paid $30,000 and US$12,500 for a total of 425,000 shares – received no shares. Maddigan, through his lawyer, told Commission staff that he would repay these two investors in cash. He has not done so."

Other Evidence

[8] In addition to the Statement of Facts, the executive director tendered other documentary and oral evidence.

[9] Included in this evidence are copies of the documentation that the respondents entered into with investors respecting the business transactions described in the Statement of Facts.

[10] Each of the investors entered into a loan agreement with Maddigan's Company, signed by Maddigan as its signing authority, which provided that Maddigan's Company would either repay the amount of the loan on the maturity date or deliver to the investor that number of shares of an unnamed company equal to the loan amount, where each share would be priced at $0.10 per share. These loans typically provided for short maturity dates of only several months after issuance.

[11] Maddigan's Company engaged finders to solicit investors. There was little evidence as to the terms of the arrangements with the finders; what these finders were authorized by the respondents to say to investors about the investment itself, or what in fact these finders told investors.

[12] In total 34 investors entered into loan agreements with Maddigan's Company.

[13] We heard testimony from two investors (Investors A and B). Neither Investor A nor Investor B has yet received his loan amount back in cash or received shares having a value equal to the loan amount. Both investors testified that they were told by the finders that the shares that would be delivered would be shares of a specified coal company.

[14] Investor A entered into a loan agreement with Maddigan's Company for US $12,500 on May 11, 2011, although he appears to have advanced the funds to Maddigan's Company on June 22, 2011. Investor A's loan agreement had a maturity date of August 1, 2011.

[15] Investor B entered into a loan agreement with Maddigan's Company for CDN $30,000 on July 18, 2011. He appears to have advanced the funds to Maddigan's Company on or about the same date. Investor B's loan agreement had a maturity date of September 1, 2011.

[16] Investor B testified that several months after he advanced his funds to Maddigan's Company, he had a meeting with Maddigan who promised to deliver shares to him. This promise has not yet been fulfilled. It is not clear if this oral promise was made prior to or after the maturity date of Investor B's loan. Investor B said that he met with Maddigan "several months after his investment" and during the summer of 2011.

[17] Maddigan testified. He said that although he repaid certain debts owed to creditors of Maddigan's Company, other than Investors A and B, out of the 9,000,000 shares that he initially received, he believed that he still would have the ability to deliver shares to Investors A and B because he had a significant number of share purchase warrants of the coal company that he could exercise to acquire additional shares. However, the price of the coal company's shares remained significantly below the exercise price of the warrants and, accordingly, it never became economic to exercise the warrants.

III. Analysis and Findings

A. Positions of the parties

[18] The executive director submits that the facts set out in the Statement of Facts establish, on a balance of probabilities, that the respondents committed fraud.

[19] The executive director submitted during the hearing that the respondents only perpetrated one fraud, not two frauds (i.e. not one fraud against each of the two investors), and that the entire conduct of the respondents in relation to Investors A and B was one fraudulent scheme.

[20] The notice of hearing alleges that the deceit committed by the respondents with respect to Investors A and B was that, having received sufficient shares of the coal company to satisfy all of their obligations under the loan agreement to all 34 investors, the respondents did not transfer any shares to Investors A and B nor did Maddigan's Company repay the loans to Investors A and B on the maturity dates of their respective loans.

[21] During oral submissions, counsel for the executive director suggested that in addition to the above, Maddigan's subsequent oral promise to Investor B constituted part of the deceit, as the respondents failed to fulfill this oral promise.

[22] Maddigan submits that neither he nor Maddigan's Company committed fraud. He acknowledges that Investors A and B have not received the shares or repayment of their loans pursuant to the terms of their loan agreements.

B. Applicable Law

Standard of Proof

[23] The standard of proof is proof on a balance of probabilities. In *F.H. v. McDougall*, 2008 SCC 53, the Supreme Court of Canada held:

> 49 In the result, I would reaffirm that in civil cases there is only one standard of proof and that is proof on a balance of probabilities. In all civil cases, the trial judge must scrutinize the relevant evidence with care to determine whether it is more likely than not that an alleged event occurred.

[24] The Court also held (at paragraph 46) that the evidence must be "sufficiently clear, convincing and cogent" to satisfy the balance of probabilities test.

[25] This is the standard that the Commission applies to allegations: see *David Michael Michaels and 509802 BC Ltd. doing business as Michaels Wealth Management Group*, 2014 BCSECCOM 327, para. 35.

Fraud

[26] Section 57(b) states

> 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
> . . .
> (b) perpetrates a fraud on any person.

[27] In *Anderson v. British Columbia (Securities Commission)*, 2004 BCCA 7, the British Columbia Court of Appeal cited the elements of fraud from *R. v. Theroux*, [1993] 2 SCR 5 (at page 20):

> … the *actus reus* of the offence of fraud will be established by proof of:
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> 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).

C. Analysis

[28] This is not the usual case involving allegations of fraud under our Act relating to the diversion of investment funds for a purpose other than the one for which they were raised. Rather, it is an unusual case as the respondents are alleged to have fraudulently chosen to satisfy obligations to certain creditors ahead of other creditors (Investors A and B).

[29] There is no dispute that Maddigan's Company has failed to fulfill the terms of its loan agreement with each of Investor A and Investor B.

[30] As set out in *Anderson*, the executive director must prove the prohibited act (i.e. deceit) and that the prohibited act resulted in deprivation. We find that the executive director has not proved, on a balance of probabilities, the prohibited act of deceit, a falsehood or some other fraudulent means as required in the test set out in *Anderson*.

[31] The executive director said in his oral submissions that the prohibited act was either:

a) the decision by the respondents to allocate all of the 9,000,000 shares of the coal company to satisfy obligations to creditors of Maddigan's Company other than Investors A and B; or

b) the oral promise made by Maddigan to Investor B that he would pay his debt to Investor B in shares.

[32] There was no suggestion by the executive director, nor was there any evidence to show, that the debts repaid by the respondents ahead of their obligations to Investors A and B were anything other than bona fide legal obligations. Nor was there any suggestion by the executive director, or was there any evidence to show, that the creditors repaid ahead of Investors A and B were in any manner colluding with the respondents with respect to preferential payment of their obligations ahead of Investors A and B.

[33] The promise that the respondents made to Investors A and B which resulted in their deprivation (i.e. failure to repay their funds under the loan agreements) is that Maddigan's Company would either repay their loaned funds or that they would receive shares of an unnamed coal company.

[34] There is no evidence that this promise was, at the time made, in any way deceitful or false. In fact, the evidence is that there was a transaction under which the respondents were to receive shares from a coal company, those shares were received and 32 of the investors did in fact receive the shares promised pursuant to the terms of their loan agreements.

[35] There is no evidence to suggest that the respondents' subsequent decision to satisfy obligations to creditors, other than Investors A and B, with all of those 9,000,000 shares (ahead of Investors A and B) was anything other than a bona fide business decision. Further, there also is no evidence that either respondent told Investors A and B that they would not fulfill their obligations under the loan agreements with Investors A and B. In fact, the terms of the loan agreements (i.e. the original promises to Investors A and B) specifically allowed the loans made under the loan agreements to be repaid in cash – from which we infer that there was an understanding that there were circumstances in which the investors could get their loans repaid and not receive shares.

[36] The executive director argues that, regardless of the reason for making it, the decision on the part of the respondents to favor one group of creditors over another is the *actus reus* for fraud as it relates to Investors A and B. In particular, this conduct constitutes the "other fraudulent means" as included in the test for fraud outlined in *Theroux*, above.

[37] The Supreme Court of Canada provided guidance for the analysis of "other fraudulent means" in *Theroux*, and *R. v. Zlatic*, [1993] 2 SCR 29. Both these cases (*Theroux* at paras. 17-18 and *Zlatic* at paras. 33-37) make it clear that "other fraudulent means" must be determined objectively, by considering what a reasonable person would consider a dishonest act. For example, using corporate funds for personal purposes, exploiting the weakness of another, or unauthorized diversion of funds have been found to fall under this category. When considering the unauthorized diversion of funds, the consideration includes whether the diversion served personal rather than bona fide business ends.

[38] Applying this guidance in the current matter, we would have to find that a reasonable person would consider the respondents dishonest in satisfying obligations to some legitimate business creditors, in favor of others, when faced with the reality of being unable to satisfy all creditors. If we were to accept this argument, it would create a situation where businesses that found themselves unable to satisfy in a timely manner all investor obligations as they come due, regardless of the reason, could contravene the fraud provisions of the Act. In the circumstances of this case, we disagree with the executive director, and find that it was not "some other fraudulent means" as outlined in *Anderson*, to make a legitimate business decision to satisfy in a timely manner only some creditors and not others at the same time. This conduct lacks the requisite element of dishonesty for fraud.

[39] This is not to say that a decision not to satisfy in a timely manner obligations to investors can never be fraudulent in the context of the Act. Had there been evidence that the respondents knew at the time of the investments by Investors A and B that they would never receive the consideration contracted for, or if the creditors that did receive satisfaction were not bona fide, then the analysis could be different. However, the parties agree that, in this matter, the obligations facing the respondents at the time were legitimate, and the executive director has not provided any authority to support his interpretation of the *actus reus* for fraud in these circumstances. As a result, we find that the executive director has not proven the *actus reus* for fraud.

[40] Finally, the executive director's submissions that Maddigan's oral promise to pay Investor B in shares does not lead us to find that the *actus reus* of fraud has been made out in this case for the following reasons:

a) the executive director submitted that there was only one allegation of fraud by both respondents in this case, yet the oral promise of Maddigan that formed the basis for the alleged deceit or falsehood relied upon in this submission was only made by one respondent to one investor (Investor B) – we could not reconcile these two submissions; and

b) the oral promise made by Maddigan is no more than a restatement of one aspect of the terms of the loan agreement.

[41] For all of the reasons set out above, we find that the executive director has not proven the *actus reus* elements of the allegation of a contravention of section 57 of the Act by the respondents, on the balance of probabilities. Given this finding, we find it unnecessary to consider the submissions of the parties on the *mens rea* elements of the allegation of fraud.

[42] We dismiss the allegations against the respondents.

November 10, 2016

For the Commission

Nigel P. Cave
Vice Chair

George C. Glover, Jr.
Commissioner

Gordon L. Holloway
Commissioner