Citation: 2013 BCSECCOM 442

Saafnet Canada Inc., Nizam Dean, and Vikash Sami

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

Hearing

Panel	Brent W. Aitken	Vice Chair
	Judith Downes	Commissioner
	Suzanne K. Wiltshire	Commissioner
Hearing Dates	May 13-16, June 4, July 12, and October 9, 2013	
Submissions Completed	October 9, 2013	
Date of Findings	October 16, 2013	
Appearing		
Brigeeta Richdale	For the Executive Director	
Owais Ahmed	For Saafnet Canada Inc., Nizam Dean, and Vikash Sami	

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.

¶ 2 In a notice of hearing issued August 7, 2012 (2012 BCSECCOM 309), the executive director alleged that Saafnet Canada Inc., Nizam Dean, Vikash Sami, and Daljinder Nagra contravened the Act by trading and distributing securities without filing a prospectus, contrary to section 61(1) of the Act. Nagra subsequently entered into a settlement with the executive director (2013 BCSECCOM 85 and 86). On May 10, 2013, the executive director issued an amended notice of hearing (2013 BCSECCOM 164).

¶ 3 The original notice of hearing alleged that the respondents distributed securities to 72 investors for total proceeds of C$1.6 million and US$1.7 million. In the amended notice of hearing these numbers were reduced to 65 investors for total proceeds of C$1.3 million and US$1.0 million.

¶ 4 During the course of the hearing the respondents entered evidence about the availability to Saafnet of prospectus exemptions for many of the trades. Of the 65 investors referred to in the amended notice of hearing, the executive director now agrees that prospectus exemptions applied to trades to 31 of them. The executive director therefore now alleges a contravention of section 61(1) in relation only to 34 investors for total proceeds of C$275,000 and US$650,000.

II Background

A Saafnet's Business

¶ 5 In the late 1990's Sami designed and built a hardware computer security firewall for a friend. He made one for the friend and a couple of others for his own use. By a somewhat serendipitous route, the firewall was tested by a computer lab and found to be completely effective, a business plan was developed, and Sami was persuaded to develop and commercialize the product.

¶ 6 Sami and others incorporated Saafnet in 2000 and began work on the firewall, which was eventually named AlphaShield. Saafnet funded its start-up by raising $1.3 million through the sale of shares.

¶ 7 By 2003, AlphaShield was a commercial success. It had won awards at trade shows and enjoyed widespread third-party endorsement. It was sold by major retail outlets throughout North America. Saafnet sold 10,000 units in 2003, 20,000 in 2004, and 25,000 in 2005. Sami says the company did very little financing during this period because it had revenue to cover its cash flow needs.

¶ 8 By the end of 2005, a product redesign was necessary to adapt to advances in technology. To fund research, development, and commercialization, Saafnet raised $1 million through the sale of shares in 2006 and 2007.

¶ 9 By the end of 2006, Saafnet had developed and built a combined firewall and router, which it took to the Las Vegas Consumer Electronics Show Conference in January 2007. The product was an enormous success, winning recognition as one of the top 21 products in the Show among the thousands of products on display.

¶ 10 Saafnet's management had expected the Show to generate orders for between 5,000 and 10,000 units. To their surprise, orders came in for over 150,000 units. Suddenly, Saafnet was in urgent need of cash to fund production.

¶ 11 Saafnet retained accountants and a law firm with a view to making an initial public offering. Unfortunately, events associated with the 2008 financial crisis scuppered the intended financing. Saafnet never recovered and eventually ceased operations.

B The Distributions

¶ 12 The distributions to the 65 investors alleged by the executive director in the amended notice of hearing are broken down by time period roughly as follows (we have rounded the proceeds and converted US funds at average exchange rates for the periods):

- trades to 38 investors, for proceeds of $1.3 million, in the 16-month period September 2000 to December 2001 (to fund Saafnet's start-up);
- trades to 6 investors, for proceeds of $280,000, in the over 4-year period from the end of 2001 to February 2006 (two trades in August and September 2002, two in October and December 2003, and two in September 2005); and
- trades to 21 investors, for proceeds of $1.0 million, in the 18-month period February 2006 to July 2007 (to fund the new product).

¶ 13 Investors wishing to invest in Saafnet signed subscription agreements and paid for their investments at the time of signing or shortly afterward. Saafnet was dilatory when it came to issuing share certificates. They were issued, in batches, months and even years after the date of investment.

¶ 14 Of the trades to the 34 investors now in issue, trades to 20 investors were in 2000, 2001, and 2003.

III Analysis and Findings

A The Issues

¶ 15 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.

¶ 16 Section 1(1) defines "distribution" as "a trade in a security of an issuer that has not been previously issued".

¶ 17 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)".

¶ 18 It is not contested that Saafnet sold its shares to investors, that the shares are securities, that the sales of shares were distributions under the Act, and that no prospectus was ever filed in connection with the distributions.

¶ 19 Of the trades to the 34 investors that remain as the basis for the executive director's alleged contraventions of section 61(1), we find below that the trades to 20 of them are statute-barred.

¶ 20 That leaves for our consideration trades to 14 investors. Of those trades, the respondents admit that they have not established that prospectus exemptions were available for trades to 10 of the investors. Accordingly the respondents admit Saafnet contravened section 61(1) in relation to those trades.

¶ 21 That leaves trades to four investors in relation to whom the respondents say the accredited investor exemption was available to Saafnet. The executive director says the respondents have not proven that the exemption was available.

¶ 22 The issues are:

- Which allegations are statute-barred by the limitation period in section 159 of the Act?
- Did the respondents prove that the four investors described in the previous paragraph were accredited investors?
- Did Dean and Sami contravene section 61(1) because, under section 168.2(1), they authorized, permitted, or acquiesced in contraventions by Saafnet?

B Limitation period

¶ 23 Section 159 of the Act says:

> "159 Proceedings under this Act . . . must not be commenced more than 6 years after the date of the events that give rise to the proceedings."

¶ 24 It is not contested that the proceedings in this hearing were commenced by the original notice of hearing, issued on August 7, 2012. Therefore the trades in issue on the basis of section 159 are all those made on or before August 6, 2006 (which we refer to as the limitation date). Of the investors whose trades are in issue, trades to 18 of them were in 2000 and 2001, two were in 2003, and four were in February and May 2006.

¶ 25 The Commission has considered the application of section 159 in three cases: *Dennis* 2005 BCSECCOM 65, *Barker* 2005 BCSECCOM 146, and *Maudsley* 2005 BCSECCOM 463.

¶ 26 In *Dennis*, the panel found that Dennis had perpetrated fraud, based on his earlier criminal convictions on eight counts of fraud and theft. *Dennis* involved a fraud affecting four couples. The counts involving three of the couples related to misconduct by Dennis that occurred before the limitation date (which the panel found in that case to be May 31, 1995).

¶ 27 The panel stated the limitation period issue as follows:

> "23 For all counts on which Dennis was convicted, the last event of the series of events found *in each case* to constitute fraud and theft falls within the [limitation period]. There is a question however as to whether the whole of each series of events should be treated as falling within the . . . limitation period in section 159 of the Act and (accordingly) whether we may take into account the events which form part of the series but which pre-date [the limitation date]."[*our emphasis*]

¶ 28 The counts subject to the limitation period issue involved three couples who gave Dennis money both before and after the limitation date. One couple's first payment was in July 1994; the other two couples' first payments were in 1993. The panel found that the all of the funds were the subject of Dennis' ongoing deceit, which consisted of issuing purported interest payments, tax receipts, and portfolio reviews. The panel found as follows:

> "37 Section 159 ties the limitation period to the "date of the events". The ordinary meaning of "the events" encompasses all events (or one event) constituting a course of conduct that may be one or more breaches of the legislation on conduct contrary to the public interest. . . .
>
> 38 Therefore, we find that "date of the events" in section 159 means the date of the last event and so has the same meaning as "the date of the occurrence of the last event . . . ." [*the wording of the analogous provision of the* Securities Act (*Ontario*)]
>
> 42 . . . Dennis' course of conduct with Allen was entirely within the limitation period. We find that, in the case of *each of* the other victims whom Dennis was convicted of defrauding, some breaches in the continuing series of breaches or some part of the continuing conduct occurred before, and some during, the limitation period. We may therefore take into account the entire continuing series of breaches or course of conduct which *for each victim* made up the fraud and theft, whether occurring before or after May 31, 1995, in assessing whether Dennis breached section 57(b) . . ." [*our emphasis*]

¶ 29 The words we have emphasized in the two quotes from *Dennis* show that the panel considered the continuing conduct in relation to each investor in determining whether that the pre-limitation date conduct ought to be included.

¶ 30 *Barker* was a larger fraud than *Dennis*, involving $2.3 million and 58 investors. Barker's company, Double Eagle, raised the funds between November 1996 and August 2002. Of the $2.3 million raised, $875,000 was raised from 12 of the 58 investors before the limitation date, which was January 15, 1998.

¶ 31 The panel followed the reasoning in *Dennis* and concluded that the pre-limitation conduct in 1996 and 1997 was part of continuing conduct ending in events within the limitation period:

> "86 In this case, the events in issue constitute one course of conduct involving distributions of Double Eagle's shares, Barker's misrepresentations made in connection with those distributions, and the purposes to which Barker put the funds raised from those distributions. These events form a continuous pattern of conduct that began in 1996 and continued until August 2002. Under the reasoning in *Dennis*, we may therefore take into account all of this conduct in determining whether Barker and Double Eagle contravened the legislation . . . ."

¶ 32 The panel in *Barker* did not trace the continuing conduct on an investor-by-investor basis. Instead, it considered the illegal distributions and fraud as a whole, found that the fraud spanned the limitation date, and found that all of the conduct relating to the distributions and fraud, including the conduct before the limitation date, could be taken into account.

¶ 33 *Maudsley* involved a mutual fund salesman who defrauded 23 of his clients of $1.6 million by redeeming their mutual funds, in some cases without their consent, and used the money, not to invest in other securities as he told them he would, but for his own purposes.

¶ 34 The redemptions in the case of one client occurred over a period of about a year before the limitation date. Following *Dennis* and *Barker*, the panel found this conduct to be part of the continuing conduct.

¶ 35 In *British Columbia (Securities Commission) v. Bapty* 2006 BCSC 638, the court considered the application of section 159 in the context of a continuing course of conduct. The court said this:

> "36 . . . A "continuing contravention", a "continuing violation", a "continuing offence", or a "continuing course of conduct" results in the commission of such an offence not being complete until the conduct has run its course. These terms are most often

> used to describe a succession of separate illegal acts of the same character which, in their entirety, make up a single continuing transaction . . . . Where there is a finding that there is a continuing contravention, the limitation period does not begin until the entire "transaction" is complete and discrete activities that occur outside of the limitation period are not statute-barred if they form part of the same transaction as events falling within the limitation period: *Re Dennis* 2005 BCSECCOM 65 . . . .
> . . .
> 40 The concept of a "continuing contravention" must be contrasted with the concept of "continuing ill-effects" of a past illegal act. The latter cannot extend a limitation period indefinitely as the limitation period is triggered by the completion of the offence, even though the ongoing effects arising from the original breach may continue . . . ."

¶ 36 The executive director says that Saafnet's illegal distributions were a continuing contravention that started in 2000 and ended in 2007, after the limitation date.

¶ 37 The executive director says that all that is necessary to defeat the application of section 159 on facts such as these is a single trade after the limitation date. Once that is established, says the executive director, all of the trades are part of the same continuing activity, and section 159 does not apply to allegations relating to any of the earlier trades.

¶ 38 The executive director says that in this case, the course of continuing misconduct is an illegal distribution that began in 2000 and continued through 2007. Accordingly, all of the events from 2000 onward are part of the events that ended after the limitation date, and therefore none of the allegations relating to trades before the limitation date are statute-barred under section 159.

¶ 39 We disagree.

¶ 40 In *Dennis*, *Barker*, and *Maudsely*, the panels found that the misconduct consisted of a pattern of deceit that spanned the limitation date. In all three cases, the events were found to be a continuing course of conduct: the continuity of misconduct was obvious.

¶ 41 Here, the continuity is far from apparent. The facts show that Saafnet was actively financing in 2000 and 2001, and raised about $1.3 million. It did not engage in any other significant financing activity until more than four years later, in 2006, when it again actively sought financing and raised about $1.0 million. Although it raised some funds in the 2002-2005 period, the activity was sporadic and the amounts raised were comparatively insignificant.

¶ 42 In our opinion, the gap of more than 4 years between Saafnet's financing activities in 2000-2001 and 2006-2007 is too large to be considered, in the language used in *Bapty*, a "continuing contravention" or a "continuing course of conduct." Saafnet's distributions to the investors in its 2000-2001 financing were complete at the latest when the investors purchased the securities. Applying *Bapty*, Saafnet's conduct in connection with the 2000-2001 financing had "run its course". The financing in 2006 and 2007 was not "a single continuing transaction" that included the transactions that took place over four years earlier.

¶ 43 These two financings were also distinct as to purpose. The first funded Saafnet's startup. The second was to fund the research, development and commercialization of the new product.

¶ 44 The 6 trades in the 2002-2005 period were isolated transactions. There is no apparent continuity between those trades and those associated with either of the financings in 2000-2001 or 2006-2007.

¶ 45 The executive director also argued that Saafnet's issue of share certificates after the limitation date in relation to trades made before the limitation date is a basis for finding a continuing course of conduct that spans the limitation date.

¶ 46 We disagree. The issuing of share certificates was an administrative matter, not part of the distributions.

¶ 47 We find that the trades in 2000, 2001 and 2003 made by Saafnet to 20 of the 34 investors that form the basis of the executive director's remaining allegations are statute-barred under section 159.

¶ 48 The respondents suggested that when considering the application of section 159 to allegations of contraventions of section 61(1), each trade must be considered as a separate allegation, and no allegation can survive that relates to a trade occurring before the limitation date. On that basis, they argue that trades Saafnet made to four investors in February and May 2006 are statute-barred. The four investors all invested further amounts later in 2006 and 2007.

¶ 49 We disagree. It is true that a distribution is defined to include a single trade, but in our opinion the approach taken in *Dennis* is appropriate in considering continuing financing activity, such as that Saafnet undertook beginning in 2006. In our opinion, a series of contraventions of section 61(1) in connection with ongoing financing could well constitute a "continuing contravention" and a "continuing course of conduct", and *Bapty* would apply. In this case, there is the additional factor that each of the four investors continued investing in Saafnet after the limitation date.

¶ 50 We find that the trades to those four investors were part of a continuing course of conduct, being Saafnet's 2006-2007 financing. We find that the allegations relating to those trades are not statute-barred under section 159.

C Availability of the accredited investor exemption to Saafnet for trades to four investors

¶ 51 It is the responsibility of a person trading securities to ensure that the trade complies with the Act. This is so whether the person chooses to comply by filing a prospectus, or by using an available exemption: *Solara* 2010 BCSECCOM 163.

¶ 52 Sami and Dean say they relied on legal advice that exemptions were available to Saafnet, and that their reliance on that advice was reasonable.

¶ 53 That is not relevant to whether they contravened section 61(1). The onus is on those selling securities in reliance on an exemption to ensure that the exemption is available.

¶ 54 Reliance on legal advice is, however, a factor relevant to sanctions, which we will consider at the appropriate time.

¶ 55 In any event, Saafnet did not appear to keep adequate records of the exemptions available, and in preparation for this hearing the respondents made an attempt to show that exemptions were in fact available for trades to some investors. That the executive director dropped the allegations in relation to the trades to 31 investors shows that Saafnet had some success in doing so.

¶ 56 Saafnet says that four investors were accredited investors, who invested in total $305,979. The individuals concerned can be shown to have been accredited investors at the time only if they had realizable net assets of more than $1 million.

¶ 57 Whether the individuals concerned met the asset test depended upon the value of certain businesses they owned. In order to establish the value of these businesses, Saafnet entered into evidence valuation reports of the relevant businesses.

¶ 58 In our opinion, the reports do not prove that the individuals were accredited investors, because:

- The reports, although authored by an accredited business valuator, were prepared to "the lowest level of assurance and scope of review", and were "based on minimal review and analysis and little or no corroboration of relevant information".
- The reports were not prepared on the basis of comprehensive financial information about the businesses, nor did the evaluator have any discussions with the managements of the businesses.

- The reports depended heavily on assumptions and there was no evidence as to the reasonableness of those assumptions.

¶ 59 There was no other evidence that these four investors qualified as accredited investors at the time of their investment in Saafnet. We find that Saafnet failed to establish that an exemption was available for its trades to these investors.

D Summary of findings related to Saafnet's contravention of section 61(1)

¶ 60 The following table summarizes the trades that are the basis for our finding that Saafnet contravened section 61(1):

	AMOUNT INVESTED	
INVESTOR	**C$**	**US$**
Monsma	9,100	3,000
McEachern		3,000
Liddar		145,000
Madahar		35,000
Hayre, J		10,000
Hayre, G & J		5,000
Hayre, R & S		50,000
Sandhu, A		10,000
Sandhu, M		7,500
Dulay, J		135,979
Dulay, S		30,000
Bailes		20,000
Dhanda, K		100,000
Dhanda, B & K		50,000
Totals	**9,100**	**604,479**

E Liability of Dean and Sami under section 168.2(1) of the Act

¶ 61 Section 169.2(1) says:

> "168.2 (1) If a person, other than an individual, contravenes a provision of this Act . . . an employee, officer, director or agent of the person who authorizes, permits or acquiesces in the contravention . . . also contravenes the provision . . . ."

¶ 62 Dean and Sami were directors and officers of Saafnet. They both actively participated in the financing. Clearly, they authorized, permitted and acquiesced in Saafnet's contravention of section 61(1) and thereby committed the same contraventions under section 168.2(1).

IV Summary of Findings

¶ 63 We find that:

1. Of the trades to the 34 investors that formed the basis of the executive director's allegations, we find that 20 trades are statute-barred under section 159.

2. Saafnet contravened section 61(1) when it made trades to 14 investors, for proceeds of $C9,100 and US$604,479, without filing a prospectus and for which no exemptions were available

3. Dean and Sami contravened section 61(1) under section 168.2(1) when they authorized, permitted and acquiesced in Saafnet's contraventions of section 61(1).

V Submissions on sanction

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

By November 12	The executive director delivers submissions to the respondents and to the secretary to the Commission
By November 25	The respondents deliver response submissions to the executive director, to each other, 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 December 2	The executive director delivers reply submissions (if any) to the respondents and to the secretary to the Commission

¶ 65 October 16, 2013

¶ 66 For the Commission

Brent W. Aitken
Vice Chair

Judith Downes
Commissioner

Suzanne K. Wiltshire
Commissioner