



INVESTMENT DEALERS
ASSOCIATION OF CANADA

bulletin



ASSOCIATION CANADIENNE DES
COURTIERS EN VALEURS MOBILIÈRES

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BULLETIN N°3514
February 13, 2006

Discipline

Discipline Penalties Imposed on Resolution Capital Inc., Gaston English and Eric English; Violations of By-law 3.3, By-law 16.10, By-law 29.1, By-law 30.5 and By-law 17.1

Persons Disciplined A Hearing Panel, appointed pursuant to By-Law 20 of the Investment Dealers Association of Canada (IDA) has imposed disciplinary penalties on Resolution Capital Inc. (RCI), an IDA member firm; on Gaston English who, at all material times, was President, Chief Executive Officer, Director, Secretary, Sales Manager and Ultimate Designated Person of RCI; and on Eric English who, at all material times, was a Senior Vice-President, Director, Chief Compliance Officer, Alternate Designated Person, Branch Manager and Chief Financial Officer of RCI.

By-laws, Regulations, Policies Violated A Disciplinary Hearing was held on June 15 and 16, 2005, and on August 31, 2005, in Montréal (Québec). The last written argument was filed on October 20, 2005. The Hearing Panel released its disciplinary decision on November 23, 2005. It then received the written arguments of the parties respecting penalties and rendered its decision in that regard on January 11, 2006.

In its disciplinary decision, the Hearing Panel concluded:

Respecting Resolution Capital Inc.:

1. Resolution Capital Inc. has violated Association By-law 3.3 and continues to violate this provision by neglecting or refusing to pay its Annual Membership fees for fiscal years 2003-2004 and 2004-2005;
2. Resolution Capital Inc. has violated Association By-law 16.10 (formerly Association By-law 16.20) and continues to violate this provision by neglecting or refusing to pay a late filing fee for the filing of its 2004 Joint Regulatory Financial Questionnaire and Report;

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3. Resolution Capital Inc. has violated Association By-law 29.1 by neglecting or refusing to pay its allocated portion of fees for the District Association Auditor, as required by former Association By-law 16.2, thereby engaging in a business conduct or practice that is unbecoming or detrimental to the public interest;
4. On or about September 30, 2004, Resolution Capital Inc. was designated in Early Warning Level 2. Resolution Capital Inc. has violated Association By-law 30.5 by refusing to acknowledge that it had been designated in Early Warning Level 2 and by refusing to comply with the terms and conditions applicable to an Association Member in Early Warning Level 2;
5. From or about October 31, 2004 to the present, Resolution Capital Inc. has violated Association By-law 17.1 by failing to maintain a positive Risk Adjusted Capital;
6. Since at least May 2003, Resolution Capital Inc. has violated Association By-law 29.1 by neglecting or refusing to apply Canadian Generally Accepted Accounting Principles in the preparation of its financial books and records, thereby engaging in a business conduct or practice that is unbecoming or detrimental to the public interest;

Respecting Gaston English:

7. Since at least February 2003 to the present, Gaston English, while President and Chief Executive Officer (“CEO”) of Resolution Capital Inc., has violated Association By-law 29.1 by failing to discharge his duties as President and CEO in a prudent and reasonable manner, thereby engaging in a business conduct or practice that is unbecoming or detrimental to the public interest;

Respecting Eric English:

8. Since at least February 2003 to the present, Eric English, while Chief Financial Officer (“CFO”) and a Senior Vice-President of Resolution Capital Inc., has violated Association By-law 29.1 by failing to discharge his duties as a director and CFO in a prudent and reasonable manner, thereby engaging in a business conduct or practice that is unbecoming or detrimental to the public interest.

Penalties
Assessed

The Hearing Panel has assessed the following penalties:

- RCI: a fine of \$51,729.83;
- Gaston English: permanent prohibition from acting in any registered capacity with the IDA;
- Eric English : suspension from approval by the Association for a period of three (3) years.

Summary
of Facts

Charge #1 : Failure to Pay Annual Membership Fees (By-law 3.3)

The annual membership fee of the Association is the greater of either:

1. \$25,000;
2. The aggregate of the items described in Association By-law 3.2 (a) to (c).

In circumstances where the aggregate of the items described in Association By-law 3.2 (a) to (c) is less than \$25,000, the Member is entitled to have its Annual Membership fee reduced to \$15,000, provided that the total Association costs for servicing the Member in the preceding fiscal year were less than \$20,000.

RCI's Annual Membership fee for 2003-2004 and 2004-2005 was determined to be \$25,000. According to the Association, the exception allowing reduction of the Annual Membership fee from \$25,000 to \$15,000 did not apply, because the Association's annual costs for servicing RCI in 2002-2003 and 2003-2004 had exceeded \$20,000.

Of the \$50,000 owed by RCI in Annual Membership fees for fiscal years 2003-2004 and 2004-2005, RCI has only paid \$1,500.

RCI argued that the increase in the Association's Annual Membership fees did not respect its own by-laws. This increase should not have applied prior to the fiscal year of April 1, 2002 to March 31, 2003 but should only have taken effect for the period from April 1, 2003 to March 31, 2004. Its Membership fee should have been \$10,829 for 2001-2002, and \$10,000 for 2002-2003, namely the minimums provided under By-law 3.2 prior to the fee increase. Since it had paid the full membership fee for these two (2) years, RCI alleged that it should be granted a credit for overpayment for these two years.

RCI also argued that the Association had considerably exaggerated the hours actually spent in examinations at its premises. It challenged the statement that the Association's annual cost of servicing RCI exceeded \$20,000. The effect of this is that the fees payable would have been \$15,000, and not \$25,000. RCI claimed to have paid all of the fees that it should have been charged.

The Hearing Panel rejected all of RCI's arguments and found it guilty of the first charge.

Charge #2 : Failure to Pay Late Filing Fee (By-law 16.10)

RCI was required to file its Joint Regulatory Financial Questionnaire and Report (JRFQ&R) no later than June 21, 2004. The Association was informed by RCI's auditors that the JRFQ&R would be filed late. The Association accordingly took note of this notice of late filing. The auditors filed the paper copy of the JRFQ&R with the Association on July 8, 2004.

Pursuant to Association By-law 16.10 (formerly Association By-law 16.20), the Association may impose a late filing fee of \$250 per day on any Association Member who is late in filing any document that it must file pursuant to Association By-law 16, including its JRFQ&R.

On September 30, 2004, the Association imposed a late filing fee on RCI in the amount of \$ 2,500, namely \$250 per day for the 10-day period it was late between June 21 and

July 8, 2004 (excluding the statutory holidays). RCI refused or neglected to pay that invoice.

RCI is arguing that the Association is not empowered to demand deposit of the report and, even less, to impose penalties for late filing. Consequently, according to RCI, the Association should have waived any claim to late filing fees.

The Hearing Panel dismissed RCI's arguments and found it guilty of the second charge.

Charge #3: Failure to Pay District Association Auditor Fees (By-law 29.1)

Association Members were required to annually file audited financial documents, including their Joint Regulatory Financial Questionnaire and Report ("JRFQ&R"), with the District Association Auditors who would review them. In accordance with former Association By-law 16.2, which was amended on July 12, 2004, each Association Member was responsible for paying an allocated portion of all fees of the Association Auditors for their District.

On February 28, 2003, the Association accordingly sent RCI an invoice in the amount of \$384.76 for District Association Auditor fees in relation to the review of RCI's 2002 JRFQ&R. RCI has not paid this invoice.

On January 19, 2004, the Association sent RCI an invoice in the amount of \$345.08 for District Association Auditor fees in relation to the review of RCI's 2003 JRFQ&R. RCI has also not paid this invoice.

In response to this charge, RCI argued that it had a substantial credit with the Association, for its Annual Membership fee should never have been \$25,000, but rather \$15,000 for 2004-2005; and that, moreover, the fee increase halfway through the year was illegal.

In its analysis of the first charge, the Hearing Panel concluded that RCI was subject to a \$25,000 Annual Membership fee for 2003-2004, as well as 2004-2005. The Hearing Panel also concluded that the retroactive change was valid. RCI could not therefore claim to owe the Association nothing.

Accordingly, RCI was found guilty of the third charge.

Charge #4: Refusal to Comply with Early Warning Conditions (By-law 30.5)

On September 30, 2004, RCI was designated in Early Warning Level 2 on a discretionary basis because of its low level of RAC. RCI was then asked to acknowledge that it would comply with the obligations and restrictions applicable to Early Warning Level 2, as required by Association By-law 30.5.

On October 4, 2004, RCI advised the Association that it did not "recognize or acknowledge" the Association's decision to designate it in Early Warning Level 2.

RCI claimed that the decision had been made illegally. The only person with the discretion to designate a member in Early Warning Level 2 was the Vice-President, Financial Compliance. Yet it was the Director, Member Regulation who had exercised the discretionary power reserved for the Vice-President, Financial Compliance, thus vitiating the activation of Early Warning Level 2 from the outset.

According to the Hearing Panel, it is evident that the action taken by the Director, Member Regulation met with the approval of the Vice-President, Financial Compliance, since the latter was informed of and upheld the decision.

RCI refused to comply with the applicable terms and conditions and, consequently, it has been found guilty of the fourth charge.

Charge #5: Capital Deficiency (By-law 17.1)

The Risk Adjusted Capital (RAC) amount shown in RCI's Monthly Financial Report (MFR) for October 31, 2004 was \$20,000, despite the fact that the Association had, on September 30 and October 13, invited RCI to adjust its MFRs to comply with Generally Accepted Accounting Principles (GAAP). While making the required adjustments to comply with GAAP, the Association determined that, as at October 31, 2004, RCI was capital-deficient by approximately \$32,000.

In a letter dated December 9, 2004, the Association put RCI on notice to modify its MFRs in order to comply with GAAP. RCI argues that it rightly refused to respond to this demand from the Association, the latter's calculations being erroneous in its view. It was only at the time of its resignation as a member, tendered December 31, 2004, that the RAC would have been negative.

RCI claimed that the Association could not validly rely on the calculation of the fees payable since these were being challenged. Moreover, the allegation was no longer relevant, since RCI notified the Association on December 31, 2004, that it was no longer a member of the Association.

According to the Hearing Panel, RCI's resignation was subject to specific requirements which it did not meet. The Association Staff established that the fees for which payment was being demanded were indeed payable and that RCI's financial statements should have reflected this. At all material times, the evidence revealed that RCI was capital deficient. For these reasons, the Hearing Panel concluded that RCI is guilty of the fifth charge.

Charge #6 : Refusal to Apply Generally Accepted Accounting Principles (By-law 29.1)

An important characteristic of Canadian GAAP is that expenses incurred by a business must be accounted for using the accrual basis of accounting, i.e. the expense must be accounted for when it is incurred regardless of whether or not it was paid.

The Association's examination of RCI's MFR for December 31, 2003 led it to conclude that RCI had failed to respect GAAP.

Indeed, RCI had not treated the Annual Membership fee owed to the Association for the fiscal year beginning April 1, 2003. It should at least have recorded the sum of \$17,000, prorating the Manual Membership fee for the period from April 1 to December 31, 2003. Since the Annual Membership fee must be reported as an expense, the retained earnings would have been offset accordingly.

Also, RCI had not accurately reported an account receivable, which it claimed it was owed, on the basis of its net recoverable value. RCI should have treated the receivable as a write-off. The invoices totalled \$12,722.

On June 10, 2004, the chartered accountants retained as auditors by RCI, from the Association's list, concurred with the Association examiners. However, RCI refused to acknowledge what its own auditors had rightly concluded.

RCI argued that it had not treated the Annual Membership fees being claimed because there were no monies owing to the Association. Since the Hearing Panel, in its analysis of the first charge, concluded that the claim for the unpaid membership fees was justified, RCI was required to treat it. Also, RCI had agreed to re-evaluate the account receivable of its client. However, no adjustment has been made to ensure compliance with GAAP.

The Hearing Panel concluded that RCI had rendered itself liable for the sixth charge.

Charge #7: Failure to Discharge His Duties as President and CEO in a Prudent and Reasonable Manner (By-law 29.1)

Charge #8 : Failure to Discharge His Duties as a Director and CFO in a Prudent and Reasonable Manner (By-law 29.1)

Gaston English has been registered with the Association since 1969. He has been a director and officer of RCI since 1993.

Eric English, for his part, has been registered with the Association since 1998. He has been a director and officer of RCI since 2001.

The Association Staff have alleged a lack of cooperation and openness in Gaston and Eric English's behaviour towards the Association, inasmuch as they:

- have challenged the propriety of the calculation of the annual fee since 2002 and have refused to pay it since 2003;
- challenge the Association's right to conduct a financial compliance examination;
- refuse to comply with the resignation process;
- refuse to pay the late filing fees;

- refuse to pay the District Association Auditor fee;
- refuse to acknowledge that RCI was designated in Early Warning Level 2 and to submit to the conditions and restrictions of the Early Warning system;
- refuse to conform to GAAP;
- refuse to take the necessary measures to maintain a positive Risk Adjusted Capital for RCI;
- demand that all of the Association's requests for information and documentation be in writing;
- demand that all contact be with the Vice-President, Québec, rather than the usual designated person;
- level unfounded criticisms at the Association and accuse it unjustly of harassment.

According to the Hearing Panel, the analysis of the other charges shows that the Association Staff have proven the guilt of Gaston English respecting the seventh charge, and that of Eric English respecting the eighth charge.

For purposes of assessing penalties, the Hearing Panel has taken the following facts into consideration:

- The respondents have not benefited financially from the infractions they have committed, except as regards the non-payment of the sums legally owed the Association since their due date;
- RCI and Gaston English have already been found guilty of numerous violations. On May 22, 2003, the District Council assessed discipline penalties jointly against Gaston English and Resolution Capital Inc. consisting of an aggregate fine of \$100,000, apportioned equally among the two respondents. Gaston English was also required to take the Conduct and Practices Handbook Course again and to successfully re-write and pass the examination within six months of the decision date. The Council also imposed conditions on the respondent's activities, namely the obligation to appoint a second person in charge of reviewing the opening of client accounts; that no person having opened an account in his or her capacity as a representative shall approve the opening of the account in his or her management capacity; and the obligation to ensure that monthly statements of account are issued for all client accounts, in accordance with the requirements prescribed by the Association's by-laws and regulations. The respondents RCI and Gaston English requested a review of these decisions and filed an appeal with the Court of Québec. They have since abandoned all of these proceedings;

- Almost all of the charges are the consequence of the determination of the Annual Membership fees payable for the years 2001 to 2005. If RCI had won its case against the fee assessment, it would not have been late filing its MFRs, no monies would have been owed to the Association, and the Early Warning system would not have been triggered;
- The evidence did not reveal any fraud, manipulation or deception on the part of the respondents;
- There has never been a complaint filed against Eric English.

On April 13, 2005, following an expedited hearing, the Hearing Panel ordered the immediate suspension of RCI's membership in the Association, since it was no longer registered with the Autorité des marchés financiers. The Autorité deregistered the RCI as a full service dealer on October 7, 2005.

Kenneth A. Nason
Association Secretary