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Discipline

Discipline Penalty Imposed on Canaccord Capital Corporation; Violation of By-law 29.1.

Person Disciplined A Hearing Panel of the Investment Dealers Association of Canada (IDA) appointed pursuant to Association By-law 20 has imposed discipline penalties on Canaccord Capital Corporation (Canaccord), an IDA Member with its head office in Vancouver, British Columbia.

By-laws, Regulations, Policies Violated After a Settlement Hearing on April 25, 2007 in Vancouver, British Columbia, a Hearing Panel considered, reviewed, and accepted a Settlement Agreement negotiated between Canaccord and Staff of the Enforcement Department of the IDA (Staff).

Pursuant to the Settlement Agreement Canaccord admitted that from November 2001 through November 2002 it failed to adequately supervise a pro account and engaged in business conduct or practice which was detrimental to the public interest, contrary to IDA By-law 29.1., by failing to restrict a trading strategy which it knew, or ought to have known, might be unfair to other market participants and contrary to the public interest, and by failing to establish procedures which would enable it to detect whether the trading in the account was fair to other market participants or contrary to the public interest.

Penalty Assessed The penalty imposed against Canaccord is an eighty thousand dollar (\$80,000) fine. Canaccord will also pay five thousand dollars (\$5,000) toward the Association's investigation and prosecution costs for a total monetary payment of eighty-five thousand dollars (\$85,000).

Summary of Facts **Background**

The Settlement Agreement relates to events which occurred from November 2001 through November 2002 (the Relevant Period).

Canaccord has 22 branch offices across Canada including one on Bay Street in Toronto (the Toronto Branch).

Michael Finkelstein (Finkelstein) was registered with the IDA from January 1985 to August 2004. During the Relevant Period, he was a Registered Representative (Options) at the Toronto Branch.

Elizabeth Leonard (Leonard) has been registered with the IDA since 1980. During the Relevant Period, she was a Registered Representative (Options) and a Portfolio Manager (Options) at the Toronto branch.

Stonestreet Limited Partnership (Stonestreet LP) was an Ontario limited partnership, which was sold in Ontario to “accredited investors” as defined by the Ontario *Securities Act*. The minimum investment in Stonestreet LP was \$150,000.

The general partner of Stonestreet LP was Stonestreet Corporation (Stonestreet Corp.). As general partner, Stonestreet Corp. administered all aspect of Stonestreet LP including making decisions on how to invest the assets of Stonestreet LP.

During the relevant period, Stonestreet Corp. maintained a pro account (the Stonestreet Account) at Canaccord in the name of Stonestreet LP. The Stonestreet Account operated as a hedge fund in that it used leverage, long, short and derivative positions with the goal of maximizing return on investment.

Finkelstein was one of the limited partners in Stonestreet LP and was the President and Chief Investment Officer of the general partner Stonestreet Corp.

Finkelstein was the RR for the Stonestreet Account. Leonard was the Chief Operating Officer and Portfolio Manager of the general partner, Stonestreet Corp. In practice, Finkelstein and Leonard were both jointly responsible for the investment of the assets in the Stonestreet Account.

The Trading Strategy

Finkelstein and Stonestreet Corp. became aware of private placement opportunities through “finders” who connected issuers with investors for the purposes of raising capital.

Stonestreet LP’s trading strategy involved securing private placement deals with various United States issuers, to acquire securities at a

discount to the market price. Stonestreet LP, however, did not acquire the securities with the intent of remaining long those securities.

Upon securing an agreement to purchase shares by way of private placement or upon learning that it would soon secure such an agreement, Stonestreet LP sold short the issuer's underlying common stock by initiating "naked" short sales in the Stonestreet Account.

Naked short selling generally refers to selling short without having borrowed the securities to make delivery. As a result, the seller fails to deliver securities to the buyer when delivery is due. This is known as a "failure to deliver" or a "fail."

Stonestreet LP continued to short the underlying stock until the accumulated short position was approximately equal to the number of shares that Stonestreet LP would receive through the private placement. Eventually the shares purchased in the private placement were used, either directly or indirectly, to close out the accumulated short positions.

This trading strategy generated profits for Stonestreet LP on the difference between the short sale price and the discount price of the private placement.

Unfair Trading

This trading strategy was unfair to other market participants and contrary to the public interest because when Stonestreet LP initiated naked short sales of the issuer's shares, it did so with knowledge of the terms of a private placement or with general knowledge of the terms of an imminent private placement at a discount to the market price of the shares, without that information having been publicly disclosed.

The naked short sale simply locked in Stonestreet LP's profit, based on the spread between the short sale price and the private placement price. They were, in effect, pre-selling shares they knew they would acquire without disclosing to the public that they had an agreement to acquire the shares.

Specific Instances of Unfair Trading

Between November 2001 and October 2002 on four separate occasions involving three United States issuers, namely: Trikon Technologies Inc.; Novatel Wireless Inc.; and General Magic Inc., (the Issuers) the Stonestreet Account executed naked short sales of the Issuers' shares after Stonestreet had entered into written share purchase agreements to acquire restricted shares of the Issuers at a discount to the market price as part of a private placement, but before the general terms of the private placement were publicly disclosed.

In each instance, Stonestreet eventually (at least one month later and

in one case more than three months later) received freely trading shares of the Issuer as part of the private placement after the Issuer made required filings with the United States Securities and Exchange Commission. Stonestreet then used its free trading shares to, directly or indirectly, close out its outstanding failed short positions.

Previous IDA Discipline Hearing

In September 2005 after a contested Discipline Hearing pursuant to Part 10 of IDA By-law 20, in which Finkelstein and Leonard were the named Respondents, a Hearing Panel dismissed all allegations against Finkelstein and Leonard after ruling there was “a state of real uncertainty about whether (their) conduct constituted a violation of Section 10(b)” of the United States Securities and Exchange Act of 1934.

Failure to restrict the trading activity

Canaccord supervisors were aware that Stonestreet LP’s general trading strategy was to sell short shares of companies to lock in profits on private placement shares already purchased in the same company.

In the Settlement Agreement, Canaccord admitted that reasonable and diligent supervisors, aware of Stonestreet LP’s basic trading strategy would have taken proactive measures to reduce the potential for improper trading.

In the Settlement Agreement, Canaccord further admitted that it allowed Stonestreet LP to execute its trading strategy, without taking any reasonable steps to determine, among other things:

- (i) whether Stonestreet LP, or any other Finkelstein Clients were trading ahead of news releases, during periods when they would be reasonably expected to be in possession of undisclosed material information;
- (ii) whether the practice of naked short selling the issuer’s shares without the intent of actually being in a short position, in combination with the resulting fails created a misleading appearance of trading activity and the true number of short shares; and/or
- (iii) whether the effect of naked short selling and subsequently covering the failed short position after the shares acquired in the private placement were no longer restricted had the effect of an illegal distribution because they were in effect selling restricted stock.

In the Settlement Agreement, Canaccord further admitted that it approved Stonestreet LP’s trading strategy without taking reasonable measures to ensure that the trading was not unfair or detrimental to the interest of the securities market.

A copy of the Settlement Agreement is posted on the IDA website

(www.ida.ca) under the heading “Enforcement”. The Hearing Panel’s written reasons will be posted in due course.

Kenneth A. Nason
Association Secretary