Decision

Market Regulation Services Inc.
Services de réglementation du marché inc.

March 15, 2007 No. 2007-001

Suggested Routing
- Trading
- Legal and Compliance

UMIR Provisions Contravened
- 2.2(2)(b)
- 7.1(4) and Policy 7.1

Appendices
- Decision of the RS Hearing Panel

MICHAEL BOND AND SESTO DELUCA

Summary

On March 7, 2007, following a contested hearing, an RS Hearing Panel rendered a decision concerning Michael Bond and Sesto DeLuca. Mr. Bond was found to have contravened UMIR 2.2(2)(b). Mr. DeLuca was found to have failed to fully and properly supervise Mr. Bond contrary to UMIR 7.1(4) and Policy 7.1.

A Notice to Public will be issued with respect to the date and time for a hearing to consider sanctions.

Questions / Further Information

For further information or questions concerning this notice contact:

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IN THE MATTER OF
THE UNIVERSAL MARKET INTEGRITY RULES

AND

IN THE MATTER OF
MICHAEL BOND AND SESTO DELUCA

Hearing Panel:

The Hon. John B. Webber, Q.C.
Ms. Brigitte J. Geisler
Mr. Guenther W. K. Kleberg

Hearing Dates:

February 26, 27, 28, 2007
March 1, 2007

Counsel for Market Regulation Services Inc.	Chilwin C. Cheng Charles Corlett
Counsel for Sesto DeLuca:	Ellen J. Bessner James Camp
	Michael Bond in Person

DECISION OF THE HEARING PANEL

ALLEGATIONS

Market Regulation Services Inc. (RS) has requested a hearing pursuant to Part 9 of Policy 10.8 of the Universal Market Integrity Rules (UMIR) to determine whether Michael

Bond (Bond) and Sesto DeLuca (DeLuca) have contravened the requirements of UMIR Rules and Policy. RS alleges the following contraventions:

(a) Between 4 April 2005 and 29 July 2005, Michael Bond, a trader employed by a Member of the TSX Venture Exchange (the TSXV) and a Participating Organization of the Toronto Stock Exchange, entered orders on the TSXV to buy securities of Tearlach Resources Ltd., that he knew, or ought reasonably to have known, would create, or could reasonably be expected to create, an artificial bid price for Tearlach Resources Ltd. on the TSXV, contrary to Universal Market Integrity Rule (UMIR) 2.2(2)(b) and UMIR Policy 2.2, for which he is liable under UMIR 10.4(1).

(b) Between 4 April 2005 and 29 July 2005, Michael Bond, a trader employed by a Member of the TSXV and a Participating Organization of the Toronto Stock Exchange, entered orders on the TSXV to buy securities of Norzan Enterprises Limited, that he knew, or ought reasonably to have known, would create, or could reasonably be expected to create, an artificial bid price for Norzan Enterprises Limited on the TSXV, contrary to UMIR 2.2(2)(b) and UMIR Policy 2.2, for which he is liable under UMIR 10.4(1).

(c) Between 4 April 2005 and 29 July 2005, Michael Bond, a trader employed by a Member of the TSXV and a Participating Organization of the Toronto Stock Exchange, entered orders on the TSXV to buy securities of Gee-Ten Ventures Inc., that he knew, or ought reasonably to have known, would create, or could reasonably be expected to create, an artificial bid price for Gee-Ten Ventures Inc. on the TSXV, contrary to UMIR 2.2(2)(b) and UMIR Policy 2.2, for which he is liable under UMIR 10.4(1).

Bond did not file a reply as allowed under Part 9 of UMIR Policy 10.8 and he was not represented by counsel. He did not testify or present evidence. He did not cross-examine DeLuca or the witness called by RS. He made a brief closing submission.

RS alleges the following contravention against DeLuca:

(a) Between April 2005 and July 2005, Sesto DeLuca, an officer and employee, of a Member of the TSX Venture Exchange and a Participating Organization of the Toronto Stock Exchange, failed to fully and properly supervise Bond as necessary to ensure the compliance of Bond with UMIR and its Policies, contrary to UMIR 7.1(4) and Policy 7.1.

DeLuca was represented by counsel who filed a reply on his behalf as well as an amended reply. RS and DeLuca provided an Agreed Statement of Facts filed as Exhibit #1 which was signed by counsel for RS and DeLuca. This Exhibit refers to Bond in paragraphs 10 to 22. Bond was content with the Agreed Statement of Facts, with the exception of paragraphs 4 and 32 to 38, inclusive; on these paragraphs he offered no dispute.

BACKGROUND

W.D. Latimer Co. Limited (WDL) employed both DeLuca and Bond. The evidence presented consisted of Exhibits as follows:

Exhibit #1	Agreed Statement of Facts
Exhibit # 2	Joint Document Book, volumes 1 and 2, containing 33 tabs
Exhibit # 3	Notes of Jasmer Rai (Rai) as to the changes to paragraphs 17 to 35, inclusive, in the Notice of Hearing
Exhibit # 4 & 5	Transcripts of the sworn testimony of Bond and DeLuca conducted by RS staff.
Exhibit # 6	Extracts from Trading Blotters
Exhibit # 7	Traders' YA & YB Inventory - Daily Report as of the last last trading day of the month from January to July, 2005, inclusive.

The only viva voce evidence came from Rai, who is an RS investigator, and DeLuca.

STANDARD OF PROOF

The parties are agreed that the burden on RS is to establish the allegations on a standard of clear and convincing proof based upon cogent evidence. We understand that the onus of proving each of the required elements of the allegations is higher than the balance of

probabilities standard in civil cases. (See also *Re Boulieris* (2004), 27 OSCB 1597 and *D. M. Graydon,* [1987] T.S.E.D.D. No 20). Both counsel for RS and DeLuca agreed that these decisions accurately state the law as to the onus upon RS and that this standard applies to all four allegations.

BOND

RS contends Bond has breached UMIR 2.2(2)(b) and UMIR Policy 2.2 by creating an artificial bid price for Tearlach (TEA), Norzan (NRZ) and Gee-Ten Ventures (GTV). Schedule A to the Notice of Hearing sets out these specific sections of UMIR requirements.

The allegations cover a specific trading period from April 4, 2005 to July 29, 2005 (the relevant period). RS contends that Bond entered day orders on the 83 trading sessions during the relevant period, and that 45% of these orders were entered within the last minute of the trading session. RS contends that the entry of these day orders was specifically done to create an artificial bid price for the three stocks.

Bond has been employed in the securities industry as a trader since 1987. He joined WDL in October, 2002 and left in April, 2006. Bond was a principal trader, using WDL's capital to trade securities for WDL through two inventory accounts, YA (Cdn) and YB (US). Bond did not take issue that the orders entered for TEA, NRZ and GTV found in paragraphs 17 to 34 of the allegations in the Notice of Hearing and in Schedule B to the Notice of Hearing as amended by Rai's evidence, were incorrect.

A careful review of Exhibit #2, tabs 16 to 21 inclusive, discloses that there were many end of day orders as noted above, entered by Bond for the purchase of TEA, NRZ and GTV. These orders disclose two things: bid orders improved the best bid price; and, the shares of the three securities were thinly traded. The effect of these orders was to increase the bid price. Additionally, the bid price had an impact upon Bond's

compensation arrangement, which was factored off the month-end closing bid price of securities in his inventory accounts.

CONCLUSION

Bond presented no evidence, however we were referred to the transcript of his interview by RS. In that transcript, his explanation for the entry of these orders is that he wished to purchase the stock and increase his holdings. Since almost all of the orders were for a minimum board lot and of insignificant value this explanation is not convincing; neither is the explanation provided by RS that Bond's motivation in placing these orders was to increase his compensation. That argument is only applicable for orders placed at the end of the month, which constituted only 4 of the 83 trading sessions in the relevant period. Further, during the relevant period, there was no significant impact upon Bond's compensation. In fact, if one reviews the financial impact of the bid orders placed by Bond at the end of the month for the 4 dates in question, only 50% of the orders entered showed an increase in the pricing of the securities in question.

The Panel notes that orders placed so late in the trading session for thinly traded stocks were unlikely to be filled. In the absence of any other explanations, the panel is not satisfied with Bond's explanation that he wished to acquire additional stock and concludes that his intention was to create an artificial bid to influence management's perception and/or to influence the market's perception in general.

We are satisfied that RS has met the onus which has been described above and accordingly find that RS has proven the allegations against Bond.

DELUCA

RS contends that DeLuca, as Bond's trading supervisor, has failed to take the steps that a reasonable compliance officer would have taken to ensure Bond's compliance with UMIR 7.1(4) and Policy 7.1.

> UMIR 7.1 states: The head of trading together with each person who has authority or supervision over or responsibility to the Participant for an employee of the Participant shall fully and properly supervise such employee as necessary to ensure the compliance of the employee with these Rules and each Policy.

Analysis - RS

RS did not present any evidence which showed that RS staff's expectation was that unfilled orders should be monitored at all times. WDL's Compliance Procedures Manual and UMIR's Minimum Compliance Procedures for Trading Supervision state that the review for establishing artificial prices requires a review of tick setting trades entered at or near the close and that this review is to be conducted on a monthly basis.

There is no evidence that RS staff educated the industry about the need to include unfilled orders in its daily review, especially trades at or near the close of the trading session. Further, there is no evidence that RS staff addressed the lack of tools in the industry to conduct this review. In fact, the Agreed Statement of Facts addresses this point at paragraph 32:

> During the Relevant Period, there was no technological compliance software that could detect or provide alerts of possible artificial pricing or manipulative or deceptive trading with respect to unfilled orders.

WDL was subject to an audit of its compliance practices by the RS compliance department in May, 2005, which was within the relevant period. Staff did not raise any issues about the requirement in WDL's Compliance Procedures Manual for a *monthly* review to check for establishing artificial prices, which in fact, is the same requirement in UMIR's Policy. We take note of UMIR Policy 7.1 which states in Part 1 as follows:

> When the Market Regulator reviews the supervision system of a Participant (for example, when a violation occurs of Requirements), the Market Regulator will consider whether the supervisory system is reasonably well designed to prevent and detect violations of Requirements and whether the system was followed.

We heard evidence that RS staff requested and secured changes to other sections of WDL's Compliance Procedures Manual, but did not request changes or clarifications to

the testing procedure of the monthly only review for artificial pricing. If this shortcoming was in fact an "extremely egregious breach" of UMIR 2.2(2)(b), then the Panel is left with the question as to why this issue was not brought to the attention of WDL or DeLuca at the May, 2005 RS audit.

RS counsel claimed that losses in the inventory account should have been a red flag for DeLuca to probe further into Bond's trading. There were losses in the three securities in question, but in fact, contrary to the statement in paragraph 41 (b) of the Statement of Allegations, the inventory account itself did not experience losses. Further, we disagree with section (c) of that same paragraph, that the holdings of TEA and GTV in the YA Inventory Account represented "numerically large holdings" relative to the total number of shares in the account. DeLuca testified that he required Bond to close most of his stock positions at the end of each day to avoid overnight volatility risk. As a result, the remaining shares in the Inventory Account represented Bond's trading in junior stock, which were normally held for longer periods of time. Of the other items mentioned in paragraph 41, we are not persuaded that these items raised the "red flags" necessary to spur DeLuca into taking additional supervisory steps, as argued by RS.

Analysis – DeLuca

While RS acknowledges that DeLuca had a supervisory system in place, it was their contention that "DeLuca should have done more", by giving attention to the supervision of unfilled orders which affected the closing price for securities. DeLuca clearly stated that he did not make any attempts to supervise unfilled orders.

In testimony, DeLuca made much of the fact that there was no technological tool available to the industry as a whole to monitor unfilled orders. However, he did not offer any evidence to substantiate his position. It was his view that since this was an industry-wide problem, he was under no obligation to take any additional steps to review unfilled orders. He felt it was sufficient to have reviewed the daily inventory reports and the month–end high closing report from the TSX. Although DeLuca had reviewed the

month-end high closing report for years, he failed to notice that the report did not include the TSXV, even though TSXV stocks were an important part of WDL's business.

It seems that DeLuca's concern was limited to the potential financial impact of inventory trading upon WDL's capital position. The positions that were held in the YA and YB inventory account represented a miniscule hit to WDL's bottom line, even had they gone to zero in value. His concern was too narrow. He should have also considered the integrity of the marketplace. Followers of the marketplace were being misled by the entry of artificial bids.

While there was no technological tool to assist DeLuca, for him to rely upon this fact is insufficient approach to his supervisory obligations. He acknowledged that he did have available the Removed Orders List which revealed orders that were unfilled at the end of the previous day. DeLuca explained that because this list did not show the time of order entry it was of no value to him. The panel disagrees with this conclusion. This list could have been used as a starting point for further investigation, as it would have revealed a consistent pattern by Bond of having unfilled day orders of minimum board lots. It is a regulatory requirement that unfilled orders be retained[1]. By obtaining a report of unfilled orders, he might have been able to see that Bond was engaging in a practice of entering orders so late in the day that there was no reasonable expectation that they would be filled.

Had DeLuca noted this pattern, he could have made further investigations to determine the timing of the orders. In fact, he could have discussed the matter with Bond. It appears that DeLuca did discuss these late orders with Bond, however, only after RS pointed them out to him.

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[1] Securities Act (Ontario), Regulation 1015, S.113(3) 6. and S. 113(4). See also IDA Regulations S. 200.1(g)(3) . Unfilled orders are required by *Securities Act (Ontario)* regulations to be kept for a period of 2 years.

The panel notes on page 20 of the transcript of DeLuca's interview with RS, the following answer to a question related to trades highlighted in the TOQ[2] report:

> I was concerned that RS was concerned. My big concern is that the appearance of the information in the chart would lead someone to believe that he was doing something untowards, and I did not know what he was trying to accomplish by putting these bids in at the end of the day.....It raised red flags in that he was entering the bids so late in the day, yes.

DeLuca's statement that he could not prevent a trader from entering bids and manipulating the market for whatever reason is of concern to the Panel. This attitude on behalf of DeLuca is not consistent with respect to his supervisory obligation to uphold the integrity of the marketplace. Closer vigilance would have detected the issues at an early point in time allowing him to put an effective stop to continuing violations.

CONCLUSION

Our overall impression of DeLuca is that he made an honest effort to supervise. It would have been very easy for him to tell the Panel of some efforts made to review unfilled orders, but he did not do so, and we appreciate his candor in this regard.

Our assessment of the facts as we have found them leads us to conclude, pure and simply, that DeLuca did not review unfilled orders placed by Bond and as such did not fully and properly supervise Bond. WDL's business is primarily that of principal trading. While financial adequacy is obviously important, a compliance supervisor, under his gatekeeper obligation as further outlined in Part 10.16 of the UMIR rules, must monitor for deceptive activities that affect the integrity of the marketplace. When trades are entered for other than legitimate purposes, there is an impact on the integrity of the market. When supervision is not taking place, there is opportunity, as in this case, to allow artificial bid pricing to occur.

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[2] Trades, Orders and Quotes Report originated by RS, Exhibit # 2, tabs 16-21, inclusive. These reports are compiled by RS for their own use.

We are satisfied that RS has met the onus which has been described above and accordingly find that RS has proven the allegation against DeLuca.

We request counsel to contact the Hearing Co-ordinator to arrange a date to deal with the sanctions.

Dated at Toronto, this 7th day of March, 2007.

The Hon. John B. Webber, Q.C.

Ms. Brigitte J. Geisler

Mr. Guenther W. K. Kleberg