

Re Rudensky

IN THE MATTER OF:

**The Rules of the Investment Industry Regulatory Organization of
Canada**

and

Andrew Paul Rudensky

2018 IIROC 28

Investment Industry Regulatory Organization of Canada
Hearing Panel (Ontario District)

Heard: May 7, 8, and 9, 2018 in Toronto, Ontario
Decision: July 23, 2018

Hearing Panel:

Paul Moore Q.C., Chair, Charles Macfarlane, and Stuart Livingston

Appearance:

Sally Kwon and Rob Delfrate, Enforcement Counsel

Kevin Richard and Martin Mendelzon, for Andrew Paul Rudensky

Andrew Paul Rudensky

DECISION ON THE MERITS

Allegations

¶ 1 By Notice of Hearing dated November 2, 2017, staff of IIROC made two allegations against the Respondent:

Allegation 1

In April 2015, the Respondent engaged in personal financial dealings with a client of his Dealer Member Firm, contrary to Dealer Member Rule 43.

Allegation 2

In April 2015, the Respondent made a false and misleading representation to his Dealer Member Firm contrary to Dealer Member Rule 29.1.

Uncontroverted facts

¶ 2 The Respondent was a registered representative with Richardson GMP Limited (“RGMP”) from November 2009 until September 8, 2015 when he resigned from RGMP.

¶ 3 On April 20, 2015, a bought deal offering by RGMP of Brookfield Asset Management Inc. (“Brookfield”) Class A Limited shares (“shares”) became what is known as a “hung bought deal” because it had not been fully subscribed and the market price for Brookfield shares had fallen below the offering price. At this point in time RGMP opened up the offering to permit “pro-eligible” accounts, including the Respondent’s trading account with RGMP, to subscribe for underwritten shares at a special (reduced) drawdown price which was below the market price for Brookfield shares.

¶ 4 On April 21, 2015, the Respondent sold short 135,000 Brookfield shares for US\$7,474,291.64 and agreed with RGMP to draw down on the new issue date of April 27, 2015 an equivalent number of Brookfield shares being underwritten by RGMP in the bought deal offering for the special drawdown price of US\$7,408,800.

¶ 5 The price the Respondent received from the short sale of the Brookfield shares was the market price for Brookfield shares. The Respondent's gross profit from these long and shorting transactions was US\$65,122.64, being the difference between the price from the short sale and the special drawdown price he paid for the underwritten shares.

¶ 6 The short sale was the largest transaction in terms of dollar value that the Respondent had ever done.

¶ 7 On April 21, 2015, the Respondent contacted RS, who was a client of RGMP, to obtain a loan because he knew that he (a) would not have sufficient funds to cover a margin call relating to the short sale that would be required by the settlement date of April 24, 2015, and (b) would not be able to cover his short position until he received his allocation of new issue underwritten shares three days later on April 27, 2015.

¶ 8 On April 24, 2015 the Respondent borrowed \$3,000,000 (the "Brookfield loan") from RS.

¶ 9 He received the borrowed funds in his personal bank account with the Bank of Montreal ("BMO") and then had them transferred to his trading account at RGMP to cover margin for his short sale position.

¶ 10 The manager of RGMP's Toronto office, Mr. King, asked the Respondent what the source of his funds was. The Respondent confirmed in an email requested by Mr. King after a conversation with the Respondent that the funds were owned as a result of a loan collateralized on his Queen St. loft (the "representation").

¶ 11 The Brookfield loan was repaid when the Respondent received his allocation of underwritten shares and satisfied his shorting obligations. He did this by transferring funds from his trading account at RGMP to his bank account at BMO and then from that account to RS. He also wrote a cheque to RS for U.S.\$44,076, being 70% of his gross profit.

¶ 12 RPMG subsequently learned that the Brookfield loan was evidenced by a promissory note which provided for interest of 70% of the profit the Respondent would be making on the purchase and shorting transactions.

¶ 13 The transactions by and accounts of the Respondent as well as the promissory note evidencing the Brookfield loan were actually by and in the name of his holding company, Dark Horse Financial Corp.

Summary of Staff's Position

¶ 14 Staff's position was that the Brookfield loan with interest tied to a percentage of the Respondent's profit from purchasing and shorting Brookfield shares was a profit sharing and loan arrangement which constituted personal financial dealings with a client of RGMP contrary to Rule 43.

¶ 15 Staff also maintained that the statement that the funds were owned as a result of a loan collateralized on the Respondent's Queen St. loft (his "condo") was false because there was no mortgage or other documentation evidencing a collateralization of the loan and misleading because it did not disclose the profit sharing arrangement with and source of the loan from RS contrary to Rule 29.1.

Summary of Respondent's Position

¶ 16 The Respondent's position was that Rule 43 did not apply because RS was not the Respondent's client. In other words, it was not enough for RS just to be a client of RGMP without also being a client of the Respondent.

¶ 17 The Respondent maintained that he had not known that RS was a client of RGMP through its Calgary office. Furthermore, he thought he was dealing with JJR, the merchant banking lending company owned and run by RS whom he had dealt with before. Rule 43 should be interpreted flexibly and applied to advance its purpose and intent. Staff was requesting that it be interpreted in a manner that would catch conduct that it was

not meant to catch.

¶ 18 Regarding whether “client” meant client of RGMP or of the Respondent, the Respondent maintained that RGMP had not trained the Respondent and that its policies and procedures were silent on this question.

¶ 19 The Respondent maintained that his oral understanding with RS amounted to a collateralization of the loan on his condo.

¶ 20 The Respondent maintained that in his conversation with Mr. King prior to the confirmatory email, he had described the loan as “non-traditional”.

¶ 21 He maintained that he had used the same term when answering Mr. King’s inquiry about the source of funds to cover a short position of \$2,651,462 in connection with an earlier hung bought deal in February 2015 for shares of Cenovus Energy Inc. (“Cenovus”) when he borrowed \$1,000,000 (the “Cenovus loan”).

¶ 22 The Respondent maintained that RGMP was satisfied with his response. They asked no follow up questions, so the Respondent’s answer must have responded to what they were interested in.

¶ 23 He maintained that RGMP had allowed a cross-guarantee (the “GS cross guarantee”) with an employee and a client, so it should not be concerned about the Brookfield loan.

¶ 24 The Respondent maintained that the representation was true and not misleading.

The Evidence

¶ 25 We relied on an agreed statement of facts as to some of the facts. We relied on four compendiums of documents submitted jointly by staff and the Respondent and a compendium of documents submitted by staff. We heard testimony from staff’s three witnesses: Mr. Apostolatos, investigator for IIROC, Mr. King, manager of RGMP’s Toronto office, and Mr. Kennedy, a former employee of RGMP and colleague of the Respondent in their Toronto office. We heard testimony from the Respondent. We admitted into evidence, over the objection of staff, an affidavit of RS.

The Issues

¶ 26 We were faced with the following issues.

Allegation 1

¶ 27 In Rule 43, does “client” include a client of the RGMP who is not a client of the Respondent?

¶ 28 Was knowledge by the Respondent that RS was a client of RGMP necessary for there to be a contravention of Rule 43?

¶ 29 Did the Respondent know that RS was a client of RGMP?

¶ 30 Did it matter if the Respondent thought that the loan was with JJR?

¶ 31 If it did matter, when did RS know that the loan was with RS and not JJR?

¶ 32 Was there a conflict of interest between RS and RGMP or RS and the Respondent?

¶ 33 Was RS a sophisticated client?

¶ 34 If yes, was the purpose and intent of Rule 43 to protect RS from any conflicts of interest with the Brookfield loan? If there was a violation of Rule 43 was it a technical violation only because RS was a sophisticated client?

¶ 35 Would it be relevant to the case against the Respondent under Allegation 1 if RGMP’s policies and procedures were silent on whose clients were covered by Rule 43, or if RGMP allowed the GS cross guarantee?

¶ 36 Was it relevant to Allegation 1 that staff did not make any allegation that the Respondent’s similar conduct in connection with the Cenovus loan was in violation of Rule 43?

Allegation 2

¶ 37 Was it necessary that the answer to RGMP's inquiry as to the source of the funds be a full and complete answer for the representation not to be false and misleading, and if so, was the representation full and complete?

¶ 38 Was it relevant to the case against the Respondent that RGMP failed to ask follow up questions, or if it failed to properly do its own due diligence as to the facts surrounding the arrangement and loan?

¶ 39 What was the Respondent's intention in wording the representation as he did?

¶ 40 Were the proceeds of the Brookfield loan owned as a result of a loan collateralized on the Respondent's condo?

¶ 41 Was RGMP misled by the representation?

¶ 42 Was the representation by the Respondent false or misleading?

¶ 43 Is Allegation 2 sustainable in face of the Respondent's argument that Rule 29.1 was repealed effective September 1, 2016 (before the Notice of Hearing was issued) and the applicable Transitional Rule fails to provide any provision that would permit IIROC to proceed with an enforcement hearing which is commenced after September 1, 2016 in accordance with Rules which have been repealed and are no longer in force, such as Rule 29.1?

General

¶ 44 Where testimony from the Respondent, Mr. King, Mr. Kennedy and RS conflicted, who should we believe and why?

¶ 45 How much weight should we give to testimony in RS's affidavit?

¶ 46 Prior to Mr. Kennedy testifying, the Respondent protested that pre-hearing disclosure of Mr. King's evidence did not indicate that Mr. King would testify that the Respondent had indicated to Mr. King prior to the events in question that RS was a client of RGMP, although the Respondent had learned this at the commencement of the hearing. Staff replied that their pre-hearing disclosure did indicate what Mr. King would say. The issue we faced was whether the Respondent would be prejudiced if the Respondent was right that the proposed testimony of the fact had not been indicated in the pre-hearing disclosure and if so whether we should ignore such testimony.

The Testimony

Mr. Apostolatos

¶ 47 Mr. Apostolatos introduced the various documents reviewed by IIROC in its investigation and in preparation of the case against the Respondent. He testified about the use of the Respondent's personal cell phone and his cell business phone, the transfer of funds in and out of the Respondent's trading account through his personal bank account at BMO and then to or from RS, and about various documents referred to in the testimony of other witnesses.

Mr. King

¶ 48 Mr. King was and is currently the manager of RGMP's Toronto office. He and RGMP are the subject matter of a lawsuit by the Respondent.

¶ 49 Mr. King testified that when the \$3,000,000 transfer of funds was received into the Respondent's account with RGMP from BMO, Dan Bowering, the head of compliance, asked him to find out from the Respondent what the source of funds was. Mr. King stated that Mr. Bowering wanted Mr. King to ask because Mr. Bowering believed that the Respondent would be upset if it was Mr. Bowering who made the inquiry.

¶ 50 The Respondent told Mr. King that the funds were owned as a result of a collateralized loan on his Queen Street loft.

¶ 51 Mr. King testified that he assumed that the funds came from BMO secured by the condo. He also testified that he believed that the Respondent was well to do financially and that he came from a wealthy family.

¶ 52 Mr. King was satisfied with the Respondent's answer and asked him to set it out in an email to him. Neither Mr. King nor anyone else at RGMP made any further inquiries.

¶ 53 RGMP subsequently learned about the \$3,000,000 promissory note and the profit sharing arrangement with and the loan from RS through discussions among compliance personnel, Mr. King, the Respondent and others concerning an unrelated matter. It also learned about the Cenovus loan. Mr. King testified that he was unaware of the earlier loan at the time of the Cenovus bought deal and that he and the Respondent did not have any conversations about the Cenovus loan or the transfer into his account of the \$1,000,000 from BMO.

¶ 54 Mr. King categorically denied that the Respondent said that the Brookfield loan was a "non-traditional" loan or that it was like the Cenovus loan.

¶ 55 Mr. King stated that in the last half of 2014 the Respondent asked him to move SA from another office of RGMP in Toronto to the main Toronto office where the Respondent was and to have her desk near his desk. Mr. King said he asked the Respondent who SA was. He said the Respondent told him that she had recently moved to Toronto from the Calgary office of RGMP and that she was the girlfriend of RS. Mr. King said he asked the Respondent who RS was. He said the Respondent said RS was a client with accounts in the Calgary office and that SA was an advisor or broker with the team in Calgary looking after RS. Mr. King said that the Respondent indicated that he was interested in developing business with RS and mentioned some deals that RS had brought to the Calgary office.

¶ 56 Under cross-examination, Mr. King admitted that he had been copied on several communications from many persons at RGMP containing answers to questions raised by IIROC as to whether anyone knew whether the Respondent had been aware that RS had been a client of RGMP. He admitted that he had not reacted to these communications by advising anyone that he, Mr. King, knew that the Respondent had known by late 2014. He also admitted that he had not informed staff until May, 2018 of his 2014 conversation with the Respondent about RS being a client.

¶ 57 Mr. King also admitted that he had not made any notes of his various conversations with the Respondent or others relevant to the matters raised in these proceedings.

¶ 58 When asked if he was a friend of Mr. Kennedy's, Mr. King admitted that he had occasionally shared a meal or a drink with Mr. Kennedy as a colleague in the Toronto office.

Mr. Kennedy

¶ 59 Mr. Kennedy at the relevant time was a registered representative in the Toronto office of RGMP and a colleague of the Respondent sitting at a desk directly across from the Respondent. He is no longer associated with RGMP and currently is a registered representative with a different Dealer Member Firm.

¶ 60 He testified that when he first learned of the loan and profit sharing arrangement with RS he was out of the office. He said that the next day he told the Respondent that what the Respondent had done was wrong, that this was something a registered representative cannot do with a client. Under cross-examination he admitted that his concern was so not so much with whether the Respondent was dealing with a client, but rather that there was a profit sharing arrangement with a third party not registered in the securities business whether or not the person was a client.

¶ 61 Mr. Kennedy testified that in 2014 the Respondent wanted SA to be moved to the main Toronto office and to be seated near the Respondent, that the Respondent knew SA was RS's girlfriend and that SA was involved with RGMP's team in Calgary servicing RS's accounts. He stated that the Respondent knew RS was a client in 2014 because the Respondent told him this.

¶ 62 Mr. Kennedy admitted that he had occasionally had drinks or a meal with Mr. King as a colleague and did not deny that he had been friendly with him.

¶ 63 Mr. Kennedy stressed that he had no personal stake in this matter and that he could have avoided a lot of bother if he had just kept quiet about what the Respondent had told him in 2014 about RS being a client of the Calgary office, but that he believed that he had to tell the truth.

¶ 64 Mr. Kennedy confirmed that when he was with RGMP he had two cell phones, one for personal matters and one for business.

¶ 65 He testified that it was permissible for fund transfers to and from third parties to go directly to an account with a registered representative at RGMP, but that the paper work and checking by RGMP may be more extensive and less quickly processed than transfers from an account of the registered representative with a financial institution.

¶ 66 Mr. Kennedy testified about the GS cross guarantee. He stated that the cross guarantee was in place before the employee became an employee and that the cross guarantee had been disclosed to RGMP and any necessary consents or approvals had been given.

The Respondent

¶ 67 The Respondent testified that he did not know at the relevant time that RS was a client of RGMP at its Calgary office, but that he was aware that RS was a client in Calgary of GMP Securities Limited (“GMP Securities”), a sister company of RGMP, where RS had brought investment banking business for several companies.

¶ 68 The Respondent denied that he had had in 2014 any conversations with Mr. Kennedy or Mr. King about RS being a client of RGMP.

¶ 69 He denied that he had had conversations with Mr. King about moving SA to the main Toronto office and suggested that Mr. King’s conversation had been with another person at RGMP responsible for arranging office moves.

¶ 70 He testified that he had discussed with Mr. King the \$1,000,000 wire transfer of funds into his account from the Cenovus loan. However, in his September 29, 2016 interview with IIROC, when asked about the loan and whom he had talked to, he did not mention a discussion with Mr. King.

¶ 71 He admitted in cross examination that he had invested in a new investment opportunity with one of RS’s endeavours in September, 2014 when SA was sitting at a desk near him and was the broker for 5 of RS’s accounts in Calgary.

¶ 72 He stated that when Mr. King asked him about the source of the \$3,000,000 transfer of funds into his account at RGMP, he said they were owned as a result of a “non-traditional” loan collateralized on his condo but did not use this term in the confirmatory email to Mr. King.

¶ 73 The Respondent testified that his negotiations of the Cenovus loan and the Brookfield loan were with RS acting for JJR and that the terms of both loans were similar except the profit participation was 65% on the earlier loan and 70% on the second one because of the higher amount, and therefore the greater risk.

¶ 74 He stated that he thought that the Brookfield loan would be from JJR, like the Cenovus loan, and that he did not notice that the promissory note was made payable to RS and not JJR until after he had signed it. In cross-examination he was vague as to when he actually noticed that RS was the payee. It may have been shortly after he signed or later although he knew when he repaid the loan.

¶ 75 The Respondent testified that when he resigned from RGMP he was planning to transfer his registration to Beacon Securities Limited (“Beacon”). He asked RGMP if there were any outstanding issues when he resigned. He was advised that there were none. His problems about RS being a client arose after he had resigned, he stated, and he implied they were related to his litigation against RGMP.

¶ 76 The Respondent stated that he had been in discussion with Beacon from before the Brookfield hung bought deal and that he had hoped to develop RS as a client with accounts at Beacon.

¶ 77 The Respondent sent an email to Mr. Mills, a senior compliance officer of Beacon, in October, 2016 explaining the Brookfield loan in which he stated: “I received a call shortly after each deposit and was questioned by James King about the loans. I gave him *the rough outline* [emphasis added] and emphasized that I was not dealing with clients in any way. He seemed ok with my explanation and said the firm needed to inquire and confirm the source of funds since it was a large deposit. However, at the time I was never asked to disclose who the lender was. I simply referred to it as a loan and they seemed ok with this at the time.” He did not provide Beacon with a copy of the promissory note or disclose the profit sharing aspect that troubled RGMP.

¶ 78 In cross examination it became evident that when the Respondent was interviewed by IIROC in September 2016 and was asked about the wire transfer of funds into his account from the Cenovus loan to cover his short position for the Cenovus transactions, he never mentioned any conversation with Mr. King.

¶ 79 The Respondent admitted that his communications with RS about the Cenovus and Brookfield loans were on his personal phone and that wire transfers of funds into or out of his trading account at RGMP were to or from his personal bank account at BMO and then to or from RS but not directly from or to RS and his trading account. However, fund transfers for other private investments he participated in with the knowledge and /or approval of RGMP were made directly between the third party and the Respondent’s trading account.

¶ 80 The Respondent testified that he never read the annual compliance questionnaire of RGMP for 2014 that he signed. He regarded it as an administrative detail that was completed by his administrative assistant. He was vague on whether he had read or was familiar with IIROC’s rules and policy statements concerning the duties and obligations applicable to Dealer Member Firms and their registered representatives.

RS

¶ 81 Staff objected to the admission in evidence of RS’s affidavit.

¶ 82 Staff, at our request, submitted questions it would have liked to cross examine RS on. We ourselves had many questions we would have put to RS arising out of matters testified to by him.

¶ 83 Counsel for the Respondent advised that the Respondent had not reviewed RS’s affidavit before the Respondent gave his testimony. Nevertheless, it appeared to us from the affidavit that RS was familiar with the case and the Respondent’s view of the matters in issue.

¶ 84 We decided to give little weight to RS’s testimony in his affidavit where it was in conflict with other testimony or raised unanswered question in our mind that RS likely should have been able to clarify if we had questioned him.

¶ 85 We found that his opinion was subjective on matters he was not in a strong position to judge or on which he had a reason for bias.

¶ 86 For example, he stated that the Cenovus and Brookfield loans were only ever intended to be loans, suggesting they were not aspects of a profit sharing arrangement with the Respondent.

¶ 87 For another example, he stated “*as far as I know*[emphasis added], Rudensky did not know that I had any accounts at Richardson GMP.”

¶ 88 Some of his testimony was not relevant to our consideration of the issues.

¶ 89 For example, he stated that “At no time did anyone from Richardson GMP or IIROC contact me to discuss the above two loans that were provided to Rudensky.” This was irrelevant to the case before us but was consistent with the Respondent’s argument to us that IIROC was not doing a proper job in investigating this case.

¶ 90 RS stated that he did not consider there to be any conflict of interest with respect to the loans. That was from his point of view. He did not seem to believe that he was in need of the protection of Rule 43.

¶ 91 But from RGMP’s position (RGMP might have disallowed the sale of new issue Brookfield shares to the

Respondent if it knew of the profit sharing arrangement) there was a potential conflict of interests. Furthermore, if “conflict of interest” means “differing interests”, then the interests of RGMP, the Respondent and RS were all different.

¶ 92 Some of his testimony we accepted at face value.

¶ 93 For example, he indicated that he was solely responsible for making decisions to lend on behalf of JJR and that he made the decision to fund the Brookfield loan himself and not through JJR. We also accepted that he, either himself or through JJR, was in the merchant banking and lending business. We concluded that he was a sophisticated lender familiar with lending risks, including lending to cover short positions such as that taken by the Respondent in connection with the Brookfield hung bought deal.

Facts

¶ 94 We determined the following facts regarding factual matters in issue. In doing so we considered the submissions of staff and counsel for the Respondent concerning the evidence. We weighed the evidence and relied on clear, cogent and convincing evidence that persuaded us that it was true. Where testimony was in conflict we decided what to accept as true for reasons we set out below.

RS was a client of RGMP

¶ 95 RS had been a client of RGMP since January 2014, and a client of acquired predecessor firms. Also, since 2014, he was the authorized person on four corporate accounts.

The Respondent knew RS was a client

¶ 96 We found as a fact that the Respondent knew that RS was a client of RGMP at the time of the Brookfield loan.

¶ 97 We believed Mr. Kennedy’s testimony on this. We found it clear and probable in the circumstances and not in conflict with other evidence, except for the evidence of the Respondent. He had no reason to be untruthful. His evidence was clear, cogent and convincing.

¶ 98 We also believed with some reservations Mr. King’s evidence on this. We would have been unlikely to rely on it if it stood alone or was in any way inconsistent with Mr. Kennedy’s testimony. We wondered why, when he had reviewed several communications from other persons at RGMP who stated that they had no reason to believe that the Respondent had known that RS was a client, he failed to speak up and say that he knew. We also wondered why he had not informed IIROC until May 2018 that he knew in 2014 that the Respondent knew RS was a client.

¶ 99 We determined that any late disclosure of this testimony of Mr. King’s, if it had not been disclosed in earlier pre-hearing disclosure as alleged by the Respondent but only just before the commencement of the hearing, was not prejudicial to the Respondent because the Respondent had the opportunity to cross-examine Mr. King effectively on it. We determined that we need not dismiss it from our consideration and that we could consider it as corroborative evidence. We did not believe it necessary to determine whether the earlier pre-hearing disclosure by staff adequately covered this aspect of Mr. King’s testimony, as argued by staff.

¶ 100 The Respondent admitted he knew that SA was RS’s girlfriend, that she was part of the team in Calgary that serviced RS’s accounts, that he knew RS from 2013, that he had invested in one of his companies, that he wanted SA to be moved near him, and that he was interested in developing a brokerage relationship with RS, especially in anticipation of his planned future move from RGMP to Beacon with whom he had been in discussion from before the time of the Brookfield loan. We believed that based on the evidence from the Respondent alone, his assertion that he did not know that RS was a client of RGMP was improbable and not credible.

¶ 101 Finally, we found the Respondent to be convoluted and evasive on many of his answers concerning the details of what he knew and when about SA and RS and their relationship, especially under cross examination.

The Respondent knew the Brookfield Loan was from RS

¶ 102 We found as a fact that the Respondent knew that the Brookfield loan was from RS and not JJR.

¶ 103 The promissory note he signed was payable to RS, not JJR. We did not believe the Respondent would have signed the note without reading it or understanding it. He would have seen the evidence of the wire transfer into his BMO account and would have known where the funds had come from. He knew to whom to make the payment of the loan and the cheque for the 70% of the gross profit. He may have not cared where the funds were coming from and may have been surprised when RS decided to advance the funds himself instead of through JJR as he did for the Cenovus loan, but when the promissory note was signed, and the funds advanced, he knew it was from RS.

The representation was false and misleading

¶ 104 We found as a fact that the representation was false and misleading.

¶ 105 Although RS and the Respondent may have discussed what assets the Respondent had to secure the Brookfield loan if it stayed outstanding longer than anticipated, and although the Respondent may have agreed orally that in such a situation he would be willing to place a mortgage in favour of RS on his condo, as testified to by the Respondent and RS, this loan was not what one would normally interpret as a “loan collateralized on my condo”. At most there was a promise, but only if things turned out differently than anticipated, to give a mortgage. The loan was not collateralized on the condo.

¶ 106 The loan was expected to be outstanding for 3 or 4 days. The promise, if things went wrong, of mortgage security for the loan, if the promise really was made, or the assurance that the Respondent had assets that would be available to pay off the loan, were not the essential feature of the loan. The profit sharing arrangement and RS as lender were the central features of the loan and this was not disclosed.

¶ 107 The Respondent hid the involvement of RS in the Brookfield loan. This was intentional.

¶ 108 He communicated with RS and RS’s assistant on the Respondent’s personal cell phone and not on his business phone. All transfers of funds to and from the Respondent’s trading account at RGMP, destined ultimately for RS, went through his BMO bank account and not directly to or from RS.

¶ 109 This may have been motivated in part to avoid delays in obtaining sign-off from RGMP if the transfers were direct from and to RS, but more likely it was motivated by the concern that RGMP would disallow the transactions if RGMP knew of them, whether because of RS’s involvement as a client or because of his involvement as a third party outsider sharing in the Respondent’s access to a strategy RS could not have had access to on his own and which was not available to any other RGMP clients.

¶ 110 There was no documentation or evidence from anyone else that the Respondent used the term “non-traditional” in his discussion with Mr. King.

¶ 111 The Respondent did not use the term in his confirmatory email to Mr. King. Mr. King denied that the Respondent used the term. The Respondent did not use the term in describing his conversation about the loan in his email of October 20, 2015 to Mr. Mills at Beacon.

¶ 112 We believe that had the Respondent used the term “non-traditional” Mr. King would have asked what was meant by such a term (similar to what he did when the Respondent said SA was the girlfriend of RS: “Who is RS?”). We concluded that the term was a *post facto* fabrication by the Respondent.

¶ 113 The representation was another step in the Respondent’s deception. It was meant to mislead RGMP. And it did mislead RGMP. Mr. King was satisfied with the Respondent’s answers. He, wrongly, assumed that the Respondent had taken out a mortgage loan with BMO secured on his condo. This was consistent with the transfer of funds from BMO.

¶ 114 The representation was not a full and complete answer to RGMP’s inquiry.

RS was a sophisticated client

¶ 115 We determined that RS was a sophisticated client.

Argument of the parties

¶ 116 Staff and the Respondent submitted written argument and staff submitted a written reply argument which were scheduled for oral argument at a hearing on July 9, 2018. We advised the parties that their submissions were clear and that we had no questions we wished to ask about their submissions. With consent of staff and the Respondent we dispensed with an oral hearing on the submissions and on July 9, 2018 began our deliberations.

Staff's Argument

¶ 117 In addition to the positions outlined under **Summary of Staff's Position** staff made the following submissions.

Rule 43

¶ 118 As articulated in IIROC Rules Notice 13-0162 which provided notice of Dealer Member Rule 43 to Members, there is no distinction between clients of the firm and clients directly serviced by an Approved Person:

“Both the Dealer Member and an individual Dealer Member Representative have obligations to the client and to that extent the client is a client of both the Dealer Member and the individual registrant. With respect to the application of the attached Proposed Rules and Guidance Note, **the client is the client of the firm. As such, an Approved Person may not accept any consideration from a client of the Dealer Member, whether or not that Approved Person is the designated Registered Representative on the client's account.** Although the real or perceived conflicts are more tangible where the advisor makes a personal loan to a friend who is directly serviced and advised by that same advisor, or by another advisor in the same branch or region, it is difficult to set out all types of situations where a lower standard may be acceptable. **Accordingly, a general prohibition is needed in order to create consistency and certainty.** [emphasis added]”

¶ 119 Dealer Member Rule 43 is consistent with a registered firm's requirement to identify and respond to conflicts of interest pursuant to National Instrument 31-103 (“NI 31-103”), Part 13, Division 2, Section 13.4 which provides:

“13.4 Identifying and responding to conflicts of interest

- (1) A registered firm must take reasonable steps to identify existing material conflicts of interest, and material conflicts of interest that the registered firm in its reasonable opinion would expect to arise, between the firm, including each individual acting on the firm's behalf, and a client.
- (2) A registered firm must respond to an existing or potential conflict of interest identified under subsection (1).
- (3) If a reasonable investor would expect to be informed of a conflict of interest identified under subsection (1), the registered firm must disclose, in a timely manner, the nature and extent of the conflict of interest to the client whose interest conflicts with the interest identified.
- (4) This section does not apply to an investment fund manager in respect of an investment fund that is subject to National Instrument 81-107 Independent Review Committee for Investment Funds.”

¶ 120 The Companion Policy to NI 31-103 explains that a conflict of interest is “any circumstance where the interests of different parties, such as the interests of a client and those of a registrant, are inconsistent or divergent”. Moreover, the Conduct and Practices Handbook Course (CPH) sets out the Canadian Securities Industry Standards of Conduct for registrants. Standard C (Professionalism) of the CPH clearly articulates that, “subject to certain exceptions, registrants **must** avoid personal financial dealings with clients, including the

lending of money to or the borrowing of money from them, paying clients' losses out of personal funds, *and sharing a financial interest in an account with a client.*" [emphasis added]

¶ 121 IIROC Dealer Member Rule 1500.1(a) requires all registrants to read the CPH and all updates to the CPH. The Respondent was obligated to conduct himself in accordance with industry standards including the CPH.

¶ 122 If the Respondent was not clear about whether RS was a client, the onus was on the Respondent to make inquiries to be certain he was not a client of RGMP, before entering into the Brookfield loan from RS.

¶ 123 Finally, the determination of whether the Respondent contravened Dealer Member Rule 43 does not require a consideration of the Respondent's actual knowledge of the status of a client. In any event, the direct evidence of Mr. King and Mr. Kennedy establishes that the Respondent knew RS was a client before entering into the profit sharing and loan arrangement.

Rule 29.1

¶ 124 Whether conduct could amount to conduct "unbecoming", in the investment industry, involves a determination by persons in the industry of the standards expected of persons who deal with investments. At the very least, basic honesty is required. People who work in the investment industry have occasion to control other people's money. The most fundamental expectation is that they do so honestly. [*Re Papp*, 2016 IIROC 41, at para 4]

¶ 125 The determination of whether conduct is "unbecoming" requires an objective, not subjective test. The test can be stated as "what would a reasonably informed person with knowledge of the investment industry think of the propriety of the conduct in question". [*Re Papp*, *supra*, at para 5]

¶ 126 It is a basic expectation that Approved Persons provide true and complete answers to queries from their Dealer Members; the failure to do so should be met with serious consequences. As stated by the Hearing Panel in *Re Scoten*:

"The investment industry by necessity operates in an atmosphere of trust. Trust between the Approved Person and his or her client, trust between the Approved Person and his or her employer, and trust between the Approved Person and IIROC Staff. Where an Approved Person breaches any of these trust relationships, serious consequences should follow." [*Re Scoten*, 2012 IIROC 67 at para 2]

¶ 127 Whether the Respondent intended to mislead RGMP may be inferred from the circumstantial evidence:

"A consideration of allegations of improper trading activity more often than not turns on circumstantial evidence, requiring us to draw inferences from facts. Often, simply because there has been no admission, we are asked to infer motive, intent or knowledge. In those cases we may begin by considering factual evidence as to actions and consequences, such as an unusual trading pattern or an unusual change in a reported price. We then consider whether it is reasonable to infer from those facts the requisite intent or knowledge. This approach can be seen in a number of decisions; for example, see *Re Health and Environment Technologies Inc.* (1989), 12 O.S.C.B. 3283 at 3309-10; and *Re Edward J. Mawod & Co.*, 46 SEC 865 (1977), affirmed 591 F.2d 588 (10th Cir. 1979), in which the court stated that inference is normally required because "[m]anipulators seldom publicize their intentions" (at 870, note 22).

Knowledge or intent can, therefore, be inferred from circumstantial evidence." [*Re Gouveia*, 2013 LNABASC 110 at para 94, citing *Re Podoriesz*, 2004 ASCD No 360 at paras 76-78]

¶ 128 As articulated in Section 13.4 of NI 31-103, conflicts of interest can be existing or potential. Because firms are required to address existing or potential conflicts of interest, it is essential that a registrant's answers to their queries are true and complete. This is particularly the case where a registrant solely possesses information about existing or potential conflicts of interest. The failure to provide true and complete disclosure prevents a firm from being able to fulfil its obligation to respond to existing or potential conflicts of interest,

thereby exposing the firm to potential damages.

¶ 129 By entering into the profit sharing and loan arrangement with RS, the Respondent created actual or potential conflicts of interest between:

- RS and himself – if the Respondent had not been able to pay the profit allocation or the principal, the Respondent’s and RS’s interests would have diverged.
- RS and RGMP – RS was in a position to profit and did profit by doing something indirectly that he and other RGMP clients were not entitled to do directly, *i.e.* purchase new issue shares at the drawdown price. Furthermore, if the Respondent had not been able to pay the profit allocation or the principal, RS may have sought repayment from RGMP, thereby crystalizing a conflict.

Respondent’s Argument

¶ 130 In addition to the positions outlined under **Summary of Respondent’s Position**, the Respondent made the following submissions.

Rule 43

¶ 131 Rule 43 is a principled based rule and is intended to prohibit unacceptable conflicts of interest.

¶ 132 It should be interpreted in a flexible manner rather than a narrow technical way.

¶ 133 Since the Rule provides no definition of client it is open to be applied where it should apply, *i.e.* to clients of the Respondent, not those of the firm.

¶ 134 When Rule 43 was introduced, RGMP did not provide any training or notices with respect to the Rule. RGMP’s policy and procedures manual does not mention Rule 43 nor does it contain any information that speaks to policies regarding personal financial dealings with clients. The Respondent was not provided with any guidance from RGMP as to how the Rule was to be interpreted and what steps were required in order to be in compliance.

¶ 135 No one at RGMP nor staff ever reached out to RS to ask him about the loans. Mr. King’s evidence was that in addressing conflicts of interest, RGMP would gather information from the people involved to determine if there was an actual conflict of interest. Yet no one from RGMP reached out to RS to gather any information from him in the course of RGMP’s investigation, despite the Respondent advising RGMP that RS was offering to speak with them.

¶ 136 The Respondent did not know that RS was a client of RGMP and that without such knowledge Allegation 1 should fail because he was not acting contrary to the spirit of Rule 43.

¶ 137 In this proceeding, it is important not only to examine the allegations made against the Respondent but the allegations that were not made.

¶ 138 The Cenovus and Brookfield loans were similar. The only differences were the amounts, the amount of the profit sharing percentage, and that the named lender in the first was JJR and in the second was RS. No concerns were raised by RGMP at the time of the Cenovus loan. No concerns or allegations have been brought by IIROC with respect to the Cenovus loan. If this was permitted, how could what the Respondent did regarding the Brookfield loan be wrong?

¶ 139 AK, a client of the sales group at RGMP of which the Respondent was a part, who was also an employee of GMP Securities, was permitted to have a cross guarantee from GS, a client of RGMP. AK was coded as “Pro” which entitled her to participate in hung bought deals underwritten by RGMP. This cross guarantee was allowed to remain in place and was used by AK to participate in the Cenovus and Brookfield hung bought deals. If this was permitted, how could what the Respondent did be wrong?

¶ 140 The Respondent’s evidence was credible and should be preferred where there was any conflict with the testimony of Mr. King or Mr. Kennedy.

¶ 141 RS’s testimony in his affidavit should be given due regard. Staff never reached out during its investigation to RS for his views of events although he had been willing and able to speak with them. It never took the opportunity to question RS during its investigation and should not now object that it could not question him on his affidavit.

Rule 29.1

¶ 142 Rule 29.1 was repealed as of September 1, 2016. The repeal was part of the implementation of IIROC’s Consolidated Enforcement, Examination and Approval Rules (the “Consolidated Rules”) which were to be effective as of September 1, 2016. As part of this implementation, Schedule C.1 to Transition Rule No. 1 was implemented (the “Transition Rule”). The Transition Rule provides that

“The Consolidated Rules primarily effect non-substantive changes to existing Rules and practices. However, to the extent that any particular Consolidated Rule is found to create a substantive change in the rights or duties of an IIROC Regulated Person, such Rule shall only apply to conduct that occurred on or after September 1, 2016.”

¶ 143 The Transition Rule also provides:

“Any Enforcement Hearing commenced by IIROC in accordance with IIROC Rules prior to September 1, 2016 shall proceed in accordance with the Rules and Practice and Procedure in effect and applicable to such Enforcement Hearing at the time it was commenced.”

¶ 144 What the Transition Rule fails to provide is any provisions which would permit IIROC to proceed with an enforcement hearing, which is commenced after September 1, 2016, in accordance with Rules which have been repealed and are no longer in force, such as Rule 29.1.

¶ 145 As Rule 29.1 was repealed, and as a result of IIROC’s failure to create any Rule that would permit Rule 29.1 to be relied upon in a hearing such as this, Rule 29.1 cannot be relied upon in this hearing.

¶ 146 As found by the Ontario Court of Appeal, IIROC’s jurisdiction comes from its contract with its members and their registered representatives. [*Investment Dealers Assn. of Canada v. Taub*, 2009 ONCA 628, paras. 38-46] Therefore, staff’s ability to commence proceedings must be examined in light of the wording of this contractual relationship, which can be found in the Rules.

¶ 147 Pursuant to the wording of the Transition Rule, Staff should be precluded from advancing allegations pursuant to Rule 29.1 as the hearing was not commenced until November 2, 2017.

Staff’s Reply Argument

¶ 148 Staff made submissions in reply to the Respondent’s submission concerning the failure of IIROC to allege misconduct concerning the Cenovus loan and the fact that RGMP allowed the GS cross guarantee (“staff’s prosecutorial submission”) and concerning the repeal of Rule 29.1 (“staff’s repeal submission”). We agreed with and adopted staff’s prosecutorial and repeal submissions in our **Analysis** below.

The Law

Rule 43

¶ 149 Rule 43 provides in part:

“43.1 An employee or Approved Person of a Dealer Member Firm must not, directly or indirectly, engage in any personal financial dealings with clients.

43.2 Personal Financial Dealings include, but are not limited to, the following types of dealings:

(3) Borrowing money or receiving a guarantee in relation to borrowing money, securities or any other asset from a client, unless:

(i) (a) The client is a financial institution whose business includes lending money to the

public and the borrowing is in the normal course of business of the institution's business;"

¶ 150 Rule 29.1 read in part as follows:

"29.1 Dealer Members and each ...Registered Representative... of a Dealer Member (i) shall observe high standards of ethics and conduct in the transaction of their business, and (ii) shall not engage in any business conduct or practice which is unbecoming or detrimental to the public interest, and (iii) shall be of such character and business repute and have such experience and training as is consistent with the standards described in clauses (i) and (iii) or as may be prescribed by the Board.

For the purposes of disciplinary proceedings pursuant to the Rules, each Dealer Member shall be responsible for all acts and omissions of each...Registered Representative...of a Dealer Member; and each [Registered Representative] shall comply with all Rules required to be complied with by the Dealer Member."

Decision on the Merits

¶ 151 On a balance of probabilities, based on facts we found from clear, cogent, and convincing evidence staff has proved Allegations 1 and 2.

Analysis

Allegation 1

¶ 152 RS was a client of RGMP, as alleged.

¶ 153 In Rule 43 "client" includes clients of a Dealer Member who are not clients of a Registered Representative. In this we agree with and adopt the argument of staff outlined under **Staff's Argument** on Rule 43.

¶ 154 Under IIROC's Rules and policies referred to in staff's argument, the Member is responsible to every one of its clients to ensure that the Member does not permit unjustified conflicts of interest to occur. If a Registered Representative puts a client of the Member who was not his or her client in an unjustified conflict of interest position with the Member, regardless of the representative's knowledge, the Member would be in contravention of its duty and obligations to that client.

¶ 155 The Rules and policies of IIROC make the Member responsible for ensuring compliance with the Rules by its Registered Representatives. However, they also make Registered Representatives responsible for complying with all Rules required to be complied with by the Member. See in this regard the last paragraph of Rule 29.1 set out above.

¶ 156 This would not be effective if "client" in Rule 43 was limited to clients of a Registered Representative.

¶ 157 Actual knowledge that a person is a client of the Member is not necessary for there to be a violation of the Rule.

¶ 158 Ignorance is not bliss. This is why Members have a compliance obligation and a compliance department to ascertain facts and ensure compliance. A Registered Representative has a compliance obligation as well. He has a duty to inquire when he is uncertain of relevant facts and may call upon the Member's compliance department to assist and inform him of facts. The compliance department should not be viewed as an impediment to a Registered Representative doing business, but as a friend and a facility to help him or her perform his or her own due diligence.

¶ 159 If a Member does not properly perform its due diligence obligation to ensure compliance with its conflict of interest obligations, that does not relieve a Registered Representative of his or her own failure to make due diligence inquiries.

¶ 160 Furthermore, if the Respondent had made himself familiar with IIROC Rules and policies as he was obligated to do, he would have understood that “client” included clients of RGMP.

¶ 161 In conclusion, RS was a client of RGMP. It would not have mattered for there to have been a violation if the Respondent had not known this. But he did know this. It would not have mattered if he thought he was not borrowing from RS, but from JJR. But he did know he was borrowing from RS. The Brookfield loan created a conflict of interest with RGMP and with the Respondent and was personal financial dealings of the Respondent with a client of RGMP contrary to Rule 43.

¶ 162 However, RS was a sophisticated client not needing the protection of Rule 43. Therefore, the breach of Rule 43 was technical only.

¶ 163 The prohibition on personal financial dealings with clients in Rule 43 is inclusive and not limited to borrowing or lending. But it is limited to and focused on clients and controlling or preventing conflicts of interest with clients. It does not deal with ethical conduct or conduct unbecoming a registrant not necessarily related to conflicts of interest with clients.

¶ 164 It may be that entering into a profit sharing and loan arrangement like the Brookfield loan if done with a third party, whether or not a client, not registered in the securities industry would be just plain wrong (conduct unbecoming the Respondent?) as suggested by Mr. Kennedy to the Respondent, and be conduct contrary to Rule 29.1. Then the misconduct would be more than a technical violation. But this was not alleged against the Respondent and therefore was not part of our consideration under Allegation 1.

Allegation 2

¶ 165 In order to fulfill the Respondent’s compliance obligation and his duty to RGMP, his answer to Mr. King’s question should have been full and complete in order for the representation not to be false and misleading. Even a “rough outline” of the Brookfield loan, as the Respondent in his email to Mr. Mill’s said he gave to RGMP, should have outlined the profit sharing aspect of the loan and its source as RS.

¶ 166 By failing to give a full and complete answer to Mr. King’s question, the Respondent not only failed to perform his compliance obligation, but also misled RGMP.

¶ 167 Whether RGMP failed in performing its own compliance obligations by not asking follow up questions or taking other steps is not an issue in this case. We are concerned with the Respondent’s conduct, not RGMP’s or any one else’s.

¶ 168 The Respondent’s use of his personal cell phone for communications with RS, and not doing direct transfers of funds with RS, and the misrepresentation were all evidence of the Respondent’s evasive approach to keep RGMP management in the dark about RS’s involvement in the Respondent’s business.

¶ 169 The representation was false and misleading in the circumstances of this case and constituted a failure by the Respondent to observe high standards of ethics and conduct in the transaction of business and constituted business conduct and practice which was unbecoming or detrimental to the public interest contrary to Rule 29.1.

Prosecutorial Discretion

¶ 170 Prosecutorial discretion refers to decisions regarding the nature and extent of the prosecution. It is erroneous to interpret the exercise of staff’s prosecutorial discretion as condoning any conduct that is not contained within the Statement of Allegations. As stated by the Ontario Securities Commission in *Re Proprietary Industries Inc.* [*Re Proprietary Industries Inc.*, [2005] ASCD No. 1045 at para 105]:

“We agree with Staff on this issue. The procedural fairness to which a respondent is entitled is meant to ensure that a respondent has a fair hearing. The hearing is distinct from the investigation, whether or not the investigation is completed first or continues alongside the hearing. *As Staff suggest, it is their task to determine, in the exercise of prosecutorial discretion, what case to bring to a hearing, how to prepare that case (including who to interview) and how to present that case to the hearing panel (including the choice of witnesses, if any).*” [emphasis added]

¶ 171 Previous IIROC Hearing Panels have recognized that their task is not to “[question] or [second-guess] how Staff investigated this case or exercised its prosecutorial discretion in setting out allegations of fact in the Notice of Hearing”[*Re Gottfred*, 2016 IIROC 22 at para 70]:

“It should not be construed from these observations that we are questioning or second-guessing how Staff investigated this case or exercised its prosecutorial discretion in setting out allegations of fact in the Notice of Hearing. Undertaking disciplinary actions is by its nature, as is all enforcement work, subject to competing priorities, limited resources and any manner of practical impediments; and we are mindful that this is a case in which the individual with the most relevant information refused to cooperate with the investigation. We refer to the scarcity of facts only because the intelligibility of our sanction determination requires it.” [emphasis added]

¶ 172 We determined that the fact that IIROC did not allege misconduct in relation to the Cenovus loan, or did not interview RS, or the fact that RGMP allowed the AK guarantee were not relevant to our considerations in this proceeding.

The GS guarantee

¶ 173 We determined that whether the GS guarantee was something that RGMP permitted, or should not have permitted, or was something worthy of prosecution by IIROC was not relevant to our considerations in these proceedings. Just because RGMP may have allowed someone else to get away with conduct purportedly similar to that of the Respondent’s should not and did not concern us.

¶ 174 Although we did not consider the issue relevant, we did note the following explanation from staff’s reply submission.

¶ 175 AK and GS were clients of RGMP. AK was an employee of GMP Securities, not RGMP. GMP Securities and RGMP are two different Dealer Members. Therefore, Rule 43 does not apply. In any event, Dealer Member Rule 100.15 governs the requirements relating to cross- guarantees.

¶ 176 Further, the evidence with respect to the cross-guarantee between AK and GS was significantly different from the facts with respect to the Brookfield loan from RS. The cross- guarantee was disclosed to RGMP and GMP Securities and was approved. It was in place prior to AK becoming an employee of GMP Securities. It was not related to any specific transaction or transactions, and there is no evidence that the guarantee entailed any sharing of profits or other remuneration to GS. It was between two clients, AK being an Approved Person at GMP Securities, a different Dealer Member from RGMP. Lastly, the relationship between AK and GS was much more personal than the relationship between the Respondent and RS. As stated by Mr. Kennedy, AK was “a long- time friend” and was “like a pseudo-daughter” to GS and his wife.

Repeal of Rule 29.1

¶ 177 The Respondent’s submission that Rule 29.1 cannot be relied upon is based on an incorrect interpretation of the Transition Rules.

¶ 178 The subsections of Section 1.3 of the Transition Rule must be read together, not selectively. When 1.3(1) is read together with 1.3(2), it is obvious that the provisions reference procedural, not substantive, aspects of hearings:

“(1) Any Enforcement Hearing commenced by IIROC in accordance with IIROC Rules prior to September 1, 2016 shall proceed in accordance with the Rules and Practice and Procedure in effect and applicable to such Enforcement Hearing at the time it was commenced.

(2) Any Enforcement Hearing commenced on or after September 1, 2016 shall be undertaken and proceed in accordance with the Consolidated Procedural Rules, irrespective of when the conduct which is the subject of the Enforcement Hearing occurred.”

¶ 179 Pursuant to the Definitions contained in Section 1.1 of the Transition Rule, “ ‘Consolidated Procedural Rules’ refers to Consolidated Rules 8200 through 8400, other than sections 8206, 8209, 8210, 8214, and 8216.”

¶ 180 Furthermore, the repeal of Rule 29.1 does not destroy the Respondent’s obligations under 29.1, nor does it forgive any contravention of Rule 29.1. As explained in *Sullivan and Driedger on the Construction of Statutes* [Sullivan, Ruth, *Sullivan and Driedger on the Construction of Statutes*, 4th ed (Lexis Nexis Butterworths: 2009) at pp. 565-566]:

“In other words, the repeal of an enactment does not destroy any right, privilege, obligation, or liability arising under the repealed enactment, nor does it forgive any contravention of the repealed law. Investigations and proceedings relating to pre- repeal events may be begun and continued under the old enactment despite its repeal. And the remedies and punishments provided for under the old enactment still apply as if the repeal had not occurred. In short, the repealed law continues to apply to pre-repeal facts for most purposes as if it were still good law.”

Dated at Toronto, Ontario this 23rd day of July 2018.

Paul Moore

Charles Macfarlane

Stuart Livingston

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