Re Rutledge

IN THE MATTER OF:

The Rules of the Investment Industry Regulatory Organization of Canada

and

Jeffrey Scott Rutledge aka Jeff Rutledge

2022 IIROC 36

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

Heard: October 28, 2022 via videoconference
Decision: February 11, 2023

Hearing Panel:
Catharine Esson, Chair, Nigel Potts and Brad Doney
Appearances:
Lorne Herlin, Senior Enforcement Counsel
Jeffery Scott Rutledge (present)

PENALTY DECISION

INTRODUCTION

¶ 1 This decision addresses the appropriate penalty for misappropriation and failure to cooperate with an IIROC Investigation.

¶ 2 The main issues between the parties at the penalty hearing were:

- whether Mr. Rutledge could avoid disgorgement because of an agreement that may result in him repaying some or all of the misappropriated funds or, alternatively,
- whether Mr. Rutledge should be granted additional time to repay some or all of the misappropriated funds prior to the Panel considering the issue of disgorgement.

¶ 3 The Panel delayed the issuance of its decision for over three months from the date of the penalty hearing to allow Mr. Rutledge additional time to provide evidence that he had repaid the misappropriated amount. Mr. Rutledge has not done so. The Panel has determined that it is in the public interest to issue its decision now and that it should not reduce the amount of the financial penalty based on the possibility that Mr. Rutledge may repay some or all of the misappropriated amount in the future.

PROCEDURAL BACKGROUND

¶ 4 The Notice of Hearing and Statement of Allegations against Mr. Rutledge alleges that he failed to cooperate with an IIROC investigation and that he misappropriated over two million dollars from two client accounts.

¶ 5 Mr. Rutledge did not file a Response to the Notice of Hearing or attend the initial appearance despite being served with the Notice of Hearing and being given notice of the initial appearance.

¶ 6 At the initial appearance, IIROC Enforcement Staff ("IIROC Staff") requested that the Panel accept the facts and contraventions alleged in the Statement of Allegations as proven.

¶ 7 IIROC Rules 8415(4) and 8423(12) give a panel the discretion to:

- proceed with the hearing on the merits; and
- accept as proven the facts and contraventions alleged in the Notice of Hearing and Statement of Allegations

because Mr. Rutledge did not file a Response to the Notice of Hearing and did not attend the initial appearance, despite having notice of it.

¶ 8 IIROC's Rules do not, however, provide any guidance on when a panel should exercise its discretion to make findings against a respondent who has not participated in the proceedings.

¶ 9 In this case, IIROC Staff provided affidavit evidence in support of the allegation that Mr. Rutledge failed to cooperate with IIROC Staff. Based on that evidence, the Panel determined that that allegation had been proven. The details of this finding are set out below.

¶ 10 IIROC Staff did not provide any evidence in support of the allegation that Mr. Rutledge had misappropriated funds from his clients. Instead, IIROC Staff argued that the Panel should accept the facts and contraventions alleged relating to misappropriation as proven based solely on Mr. Rutledge's failure to participate in the IIROC hearing process.

¶ 11 The Panel concluded that it would not be appropriate in this case to consider the misappropriation allegations in the absence of evidence. The seriousness of the misappropriation allegations and the complete lack of evidence to support those allegations were factors in our decision.

¶ 12 The Panel notes that in the most recent misappropriation case cited to us in which a panel proceeded in the absence of a respondent, IIROC Staff provided evidence in support of its allegations.

Re McCarthy 2021 IIROC 33, paras 3, 8-10

¶ 13 The Panel therefore declined to make any decision on the merits of the misrepresentation allegations at the initial appearance.

¶ 14 In June 2022, following the initial appearance, the parties agreed on a statement of facts and allegations in which Mr. Rutledge admitted the misappropriation allegations ("Agreed Statement of Facts and Admissions of Liability").

¶ 15 At Mr. Rutledge's request, a penalty hearing was set for October 2022; four months after the Agreed Statement of Facts and Admissions of Liability was prepared, to allow him time to take action which could affect the appropriateness of a disgorgement order being made against him.

¶ 16 At the penalty hearing on October 28, 2022, Mr. Rutledge requested a three-month adjournment to allow him further time to sell a piece of property to satisfy obligations under an agreement with his former firm's insurer ("Insurer" and "Insurer Agreement"). Mr. Rutledge testified in support of this request that:

- He understands that the Insurer is the entity that is out of pocket as a result of his misappropriations.
- He entered into the Insurer Agreement on June 18, 2021, to settle a civil suit against him. He

had legal counsel to assist him in negotiating the Insurer Agreement.

- The Insurer Agreement involved the sale of a property that Mr. Rutledge had owned since 2016 ("Property"). The Property was listed for sale three to four months before the date of the penalty hearing.
- The Insurer Agreement contained a confidentiality clause which prevented him from disclosing its terms to the Panel.

¶ 17 Mr. Rutledge submitted that disgorgement will not be an appropriate remedy once the Property sells.

¶ 18 IIROC Staff opposed the adjournment application on the grounds that:

- Mr. Rutledge had already had sufficient time to repay the misappropriated amounts and there was no evidence that an additional three months will put him in a better position to do so.
- There was no evidence of the terms of the Insurer Agreement.
- Delay in holding hearings is contrary to the public interest and the purpose of administrative proceedings.
- If future events make the amount of any disgorgement order inappropriate, Mr. Rutledge could apply to the British Columbia Securities Commission to vary the disgorgement order or ask IIROC Staff not to enforce that portion of the order.

¶ 19 The Panel declined the application for an adjournment, but indicated that, if it made a disgorgement order, it would consider framing the order to allow Mr. Rutledge further time to repay some or all of his ill-gotten gains to reduce the amount to be disgorged.

¶ 20 Mr. Rutledge did not make submissions at the penalty hearing on what penalty was appropriate other than to argue that it would not be appropriate to order disgorgement because of the Insurer Agreement and to request a three-month delay of the determination regarding disgorgement to allow him more time to sell the Property.

¶ 21 During the hearing, it became apparent that Mr. Rutledge had not considered whether the cases IIROC Staff was relying on were distinguishable on the issue of whether the clients or firm had been repaid. In order to give Mr. Rutledge an additional opportunity to consider this, the Panel gave Mr. Rutledge 10 days to make further written submissions.

¶ 22 Following the hearing, Mr. Rutledge made written submissions on three points:

- Mr. Rutledge provided unsworn copies of mortgage documents that he submitted provided evidence of the existence of the Insurer Agreement;
- Mr. Rutledge provided unsworn evidence in support of an argument that he has only been able to sell the Property for about six months;
- Mr. Rutledge made submissions that some of IIROC Staff's cases were distinguishable.

¶ 23 IIROC Staff made further submissions in reply, arguing that Mr. Rutledge's submissions and evidence on the first two points outlined in paragraph 22, above, should not be considered because they were outside the bounds of the order the Panel made allowing further argument. IIROC Staff also addressed the three points Mr. Rutledge raised.

¶ 24 While IIROC Staff is correct that Mr. Rutledge's submissions on the first two points summarized in paragraph 22, above, are outside the scope of the order the Panel made, the Panel has considered the

documents Mr. Rutledge submitted and his arguments in reaching our decision.

¶ 25 The Panel delayed publication of our decision by over three months from the date of the hearing to give Mr. Rutledge further time to provide evidence that he had repaid some or all the amounts he misappropriated that are the subject matter of this hearing. In early February 2023, Mr. Rutledge advised the Panel that he had not sold the Property and repeated his argument that disgorgement was not appropriate because of the Insurer Agreement.

ANALYSIS

¶ 26 IIROC sanctions are intended to deter future wrongdoing, both by the Respondent and by other participants in the industry.

¶ 27 IIROC Rule 8210 sets out the sanctions that a hearing panel can impose to achieve this goal. These include, among other things:

- a fine not exceeding the greater of $5 million for each contravention and an amount equal to three times the profit made directly or indirectly as a result of the contravention;
- disgorgement of any amount obtained directly or indirectly as a result of the contravention;
- a permanent bar to approval in any capacity or to access to a Marketplace; and
- a permanent bar to employment in any capacity by a Regulated Person.

¶ 28 IIROC Rule 8200 replaced Dealer Member Rule 20 on September 1, 2016. This is relevant in this case because one of the unauthorized wire transfers Mr. Rutledge used to misappropriate client funds occurred prior to that date. The sanction for that transaction, therefore, must be imposed under the previous rule, Rule 20.33(2).

¶ 29 The only relevant difference between the newer Rule 8200 and the previous Dealer Member Rule 20 is that the earlier rule did not refer to disgorgement. However, a panel could impose a fine that was based in whole or in part on the amount that had been misappropriated.

Re Mark Allen Dennis, 2012 ONSEC 24

FAILURE TO COOPERATE

¶ 30 At the initial appearance described above, the Panel concluded that Mr. Rutledge failed to cooperate with IIROC's investigation, contrary to Section 8104(3) of IIROC Rule 8100. In particular, in November 2020, he failed to attend an investigatory interview which had been rescheduled at his request. IIROC's investigator attested that this prevented IIROC Staff from completing its investigation.

¶ 31 The Panel agrees with the many previous hearing panels that have stressed the importance of registrants and former registrants cooperating with IIROC's investigations. It is fundamental to maintaining the integrity of the securities industry. As the hearing panel noted in *Re Trites* 2010 IIROC 48 (CanLii) at paragraphs 12 and 16(b):

> It is of vital importance to the system for regulating approved persons that approved persons cooperate with reasonable demands made on them during investigation of their conduct. This obligation does not end when an approved person ceases to be registered.
>
> …The gravamen of the misconduct is not respecting that, as a participant or former participant in a regulated industry, one must comply with the obligation to cooperate with the regulator's investigation…

¶ 32 IIROC Staff provided numerous previous decisions involving registrants failing to cooperate with IIROC's investigations. Panels typically impose a substantial fine and a permanent bar on approval in any capacity.

¶ 33 The Panel has concluded that the following penalty is appropriate in this case:

- a fine of $50,000;
- a permanent bar on approval in any capacity; and
- costs.

¶ 34 This reflects the seriousness of the infraction and the lack of mitigating circumstances. It is also in line with previous decisions in similar cases.

MISAPPROPRIATION

¶ 35 In the Agreed Statement of Facts and Admissions of Liability, Mr. Rutledge admitted that he misappropriated more than two million dollars from two client accounts. The misappropriation involved approximately 35 wire transfer instructions over a 27-month period. The details of the misappropriation are outlined in the Statement of Allegations attached to the Agreed Statement of Facts and Admissions of Liability.

¶ 36 Misappropriation of client funds is among the most serious misconduct a registrant can engage in. It goes to the very heart of the trust clients put in registrants and their firms. As such, it clearly harms the integrity and reputation of the capital markets. The Panel agrees with the sentiment expressed in *Re McCarthy*, above, at para 1:

> In an industry that has trust as its most fundamental principle, theft is a repudiation of the most basic industry value.

¶ 37 In this case, there are no mitigating circumstances that would affect the appropriate sanction.

¶ 38 Through his dishonesty, Mr. Rutledge caused very significance financial harm to his clients for his own benefit. His misconduct involved numerous transactions over an extended period of time.

¶ 39 Mr. Rutledge did not acknowledge or accept responsibility for his misconduct prior to it being detected by his firm, although he did ultimately admit his misconduct as part of the Agreed Statement of Facts and Admissions of Liability.

¶ 40 There is no evidence that Mr. Rutledge has returned any of the money he misappropriated in the four years since the misappropriation occurred. While Mr. Rutledge's former firm or the Insurer has apparently repaid the clients, Mr. Rutledge has not repaid the firm or the Insurer.

¶ 41 Mr. Rutledge's main submission was that he will repay some or all of this money when he sells the Property. He argued that the Insurer Agreement was evidence this would happen. He submitted that the Panel should take this into account in refraining from granting a disgorgement order.

¶ 42 The Insurer Agreement and the prospect that Mr. Rutledge may pay the insurer some money in the future is, as described elsewhere, potentially relevant to the issue of disgorgement and is addressed below in that context. It does not, however, affect the Panel's assessment of the seriousness of the misappropriation or the appropriate penalty to be imposed, apart from disgorgement.

PENALTY FOR MISAPPROPRIATION

¶ 43 The facts relating to the misappropriation underscore that Mr. Rutledge cannot be trusted to participate in the industry in the future. The Panel has already concluded that Mr. Rutledge should be

permanently barred from participation in regulated activities because of his failure to cooperate with the investigation. Were that not the case, it would impose a permanent bar as a result of the misappropriation allegations alone.

¶ 44 To deter future misconduct by industry participants, it is important that Mr. Rutledge also receive a financial penalty that substantially exceeds the amount of the ill-gotten gains he has retained. This conclusion is consistent with numerous previous decisions involving misappropriation where the penalty has included permanent removal from the industry, disgorgement, and a substantial additional financial penalty.

Re McCarthy 2021 IIROC 33

Re Scerbo 2017 IIROC 57

¶ 45 The Panel has concluded that the fine should exceed the amount of the ill-gotten gains Mr. Rutledge has retained by $300,000. Of this, $250,000 relates to the clients RS and SS and $50,000 relates to the client SB. The Panel considers this fine to be appropriate given the extent of the misappropriation, including the number and value of the dishonest transactions and the length of time over which they occurred, as well as the lack of mitigating circumstances. The amount of the fine is consistent with penalties imposed in previous similar cases provided to the Panel.

¶ 46 Mr. Rutledge argued that he should not be required to pay any amount on account of the ill-gotten gains he has retained because of the Insurer Agreement. He argued that this made his case similar to *Re Kumar* 2015 IIROC 33. In *Kumar*, supra, the hearing panel accepted a settlement agreement in a misappropriation case which did not include a disgorgement order. However, Mr. Kumar had already returned all the monies taken from his clients, with a return on the funds. Disgorgement would no longer have been appropriate in that circumstance. In contrast, Mr. Rutledge has not repaid his clients or any party that has compensated his clients. He has only raised the possibility that he may do so in the future.

¶ 47 The related question is whether the Panel should take into account that Mr. Rutledge may repay his ill-gotten gains in the future.

¶ 48 In considering this question, the Panel has taken into account that funds paid to IIROC pursuant to a disgorgement order remain with IIROC, they are not used to repay the party who is out of pocket as a result of the misappropriation. As a result, there is a risk that a respondent who is subject to both IIROC and civil proceedings could, in effect, be required to repay ill-gotten gains twice, once to satisfy an IIROC disgorgement order and once to compensate the injured party in a civil claim.

¶ 49 This is a concern. For that reason, the Panel delayed its decision to give Mr. Rutledge the time he requested to provide evidence that he has repaid the Insurer.

¶ 50 Mr. Rutledge has not established that he has repaid any amount to the Insurer related to the misappropriations these proceedings are based on, or that he is legally obligated to do so when the Property sells. He has provided evidence that there is an agreement with the Insurer but not what his obligations are under that agreement.

¶ 51 The documentary evidence does not clarify his obligations. One of the documents Mr. Rutledge provided states that the principal amount of the mortgage the Insurer has placed on the Property is $1.5 million. This is substantially less than the list price of the Property and the amount Mr. Rutledge has admitted he misappropriated.

¶ 52 Mr. Rutledge testified that he was unable to provide a full explanation of the Insurer Agreement because of a confidentiality clause in the Insurer Agreement. The Panel does not know whether Mr. Rutledge could have avoided this problem by negotiating a different confidentiality provision. Regardless, without more

detail about the background to and terms of the Insurer Agreement, the Panel cannot determine whether or to what extent Mr. Rutledge is obligated to repay the Insurer for amounts paid to compensate his clients for the losses which are the subject of this hearing.

¶ 53 In the absence of evidence that Mr. Rutledge will be required to repay the ill-gotten gains twice, the Panel must weigh the risk described above against the public interest in having this matter concluded in a timely manner.

¶ 54 Having delayed the issuance of this decision once to allow Mr. Rutledge the additional time he requested in his adjournment application to sell the Property, it is not in the public interest to further delay the issuance of the decision in the hope that Mr. Rutledge may one day provide the necessary evidence.

¶ 55 In coming to this conclusion, the Panel notes that Mr. Rutledge has had over four years to repay his ill-gotten gains. He has not repaid any amount during that time.

¶ 56 Mr. Rutledge argued that he was prevented from repaying his clients for most of that time because the owners of one of the accounts that is the subject of this proceeding had filed a Certificate of Pending Litigation and Injunction against the Property, preventing it from being sold. There is, however, no evidence that he has not, over the last four years, had other means to repay at least some of the amount he misappropriated, or that he could not have dealt with the Certificate of Pending Litigation and Injunction earlier by agreeing to repay his clients (or the Insurer) out of the proceeds of sale of the Property.

¶ 57 IIROC Staff submitted that, if Mr. Rutledge repays the Insurer at some time in the future, he could apply to the British Columbia Securities Commission ("BCSC") to change the amount he is required to pay IIROC. If IIROC has not already executed on its order, this may be possible. Similarly, the Panel expects that, if Mr. Rutledge provided evidence satisfactory to the IIROC Staff that he has repaid relevant amounts to the Insurer, IIROC Staff would take this into account in determining how it enforced the order from Mr. Rutledge.

¶ 58 In his February, 2023 submission, Mr. Rutledge said that the Property is the only asset he has available to provide repayment. If this is the case, it is unlikely that IIROC could enforce any monetary penalty before the Insurer takes action on the mortgage. While this does not completely remove the risk of Mr. Rutledge being required to repay ill-gotten gains twice, it makes it unlikely that this would occur without him having an opportunity to seek recourse from the BCSC or IIROC.

¶ 59 The Panel has, therefore, concluded that it is appropriate to order a financial penalty that includes the amount of Mr. Rutledge's ill-gotten gains that have not been repaid, without regard for the possibility he may make some repayment in the future.

¶ 60 IIROC Staff suggested that the entire financial penalty be characterized as a "fine", rather than making separate orders for fine and disgorgement. This is to simplify the procedural complication that would otherwise result from the fact that IIROC's Rules did not allow for disgorgement at the time of the first wire transfer, as described in paragraph 29, above.

¶ 61 The Panel is satisfied that, under both the Rules that existed at the time of the first wire transfer and the Rules as they were amended, it has the jurisdiction to order a fine that includes the amount that could otherwise be the subject of a disgorgement order. Doing so in this case simplifies the form of the order without changing the substance of the penalty.

PREVIOUS DISCIPLINARY HISTORY

¶ 62 Mr. Rutledge was disciplined in 2007 by Market Regulation Services Inc, after entering into a settlement agreement. He was fined $35,000 at that time. While a previous disciplinary history is generally an aggravating factor, in this case it has not influenced the Panel's conclusion about the appropriate sanction.

The previous discipline was 15 years ago and does not appear to have included an admission or finding of dishonesty or of failing to cooperate with IIROC. While unfortunate, it pales in comparison to the facts of this case.

COSTS

¶ 63 IIROC Rule 8214(1) allows a panel to order that a respondent pay costs incurred by or on behalf of IIROC Staff in connection with a hearing and investigation related to the hearing, including the cost of Staff time. IIROC Staff sought costs of $10,000. It provided a Bill of Costs setting out actual costs for time spent by its investigator and counsel of $22,500; based on hourly rates of $174 for the investigator and $230 for counsel. The Panel has concluded that the amount sought by IIROC Staff of $10,000 is appropriate and orders that Mr. Rutledge pay this amount for costs.

CONCLUSION

¶ 64 For the reasons above, the Panel orders that Mr. Rutledge:

- pay a fine of $2,468,974, calculated as follows:
  - $2,192,784 (including $1,942,784 in lieu of disgorgement) for the misappropriation from the joint accounts of his clients RS and SS;
  - $226,190 (including $176,190 in lieu of disgorgement) for the misappropriation from the account of client SB; and
  - $50,000 for failing to cooperate with IIROC Staff;
- be permanently barred from approval in any capacity;
- be permanently barred from employment in any capacity by a Regulated Person; and
- pay costs in the amount of $10,000.

Dated at Vancouver, BC, this 11 day of February 2023.

Catharine Esson

Nigel Potts

Brad Doney

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