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Citation: Solar Income Fund Inc. (Re), 2022 ONSEC 2
Date: 2022-03-28
File No. 2019-35

IN THE MATTER OF
SOLAR INCOME FUND INC., ALLAN GROSSMAN,
CHARLES MAZZACATO and KENNETH KADONOFF

REASONS AND DECISION
(Subsection 127(1) and Section 127.1 of the *Securities Act*, RSO 1990, c S.5)

Hearing:	March 1, 3, 4, 5, 24, 25, 29, 31, April 1, 6, 7, 8, 9, 21, 22; written submissions filed on June 4 and 25, and July 5, 2021	
Decision:	March 28, 2022	
Panel:	Timothy Moseley	Vice-Chair and Chair of the Panel
	Craig Hayman	Commissioner
	Frances Kordyback	Commissioner
Appearances:	Andrew Faith Ryan Lapensée	For Staff of the Commission
	James W.E. Doris Sean R. Campbell Abhishek Vaidyanathan	For Solar Income Fund Inc. and Allan Grossman
	Andrea L. Burke Chantelle Cseh	For Charles Mazzacato
	Eli Lederman Brian Kolenda Madison Robins	For Kenneth Kadonoff

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REASONS AND DECISION

I. OVERVIEW

[1] The respondent Solar Income Fund Inc. (**SIF Inc.**) was a small private company set up to develop and manage solar photovoltaic power generation installations. Staff's allegations in this case arise from SIF Inc.'s activities between 2013 and 2016. Each of the individual respondents – Allan Grossman, Charles Mazzacato and Kenneth Kadonoff – was a member of SIF Inc.'s senior management committee for part or all of that period.

[2] SIF Inc. and its principals established various funds, which paid SIF Inc. to provide consulting, development and management services. This proceeding focuses on two such funds. The first is SIF Solar Energy Income & Growth Fund, called **SIF #1**. The second, Solar Income and Growth Fund #2, is referred to as **SIF #2**.

[3] Both funds raised money from the public. In each case, investors purchased fund units through exempt market dealers based on disclosure contained in an offering memorandum and its amendments.

[4] The core of Staff's case is that the respondents used funds raised by SIF #1 in ways that were inconsistent with what was disclosed to potential and existing investors. Staff alleges breaches of two provisions of the *Securities Act*[1] (the **Act**).

[5] The first is s. 44(2) of the Act, which prohibits false or misleading representations that a reasonable investor would consider relevant in deciding whether to enter into or maintain a trading or advising relationship with the person or company making the representation.

[6] The factual matrix underlying Staff's s. 44(2) allegation is wide-ranging. It involves numerous loans by SIF #1 to related entities. Some loans were for significant amounts. The impugned transactions total up to one third of the approximately $60 million that SIF #1 raised from investors.

[7] Staff contends that by purchasing units of SIF #1, investors entered into a trading relationship with SIF Inc., and therefore any misrepresentations in the offering memorandum are a breach of s. 44(2) by SIF Inc., and possibly, by extension, one or more of the individual respondents. As we explain below, we do not accept Staff's submission that by purchasing a unit of SIF #1, an investor enters into a trading relationship with SIF Inc. Subsection 44(2) does not apply to the facts of this case, and we therefore dismiss that allegation.

[8] The second provision on which Staff relies is s. 126.1(1)(b) of the Act, which prohibits fraudulent conduct relating to securities. Unlike the wide range of conduct underlying Staff's s. 44(2) allegations, Staff's fraud allegations are limited to loans made by SIF #1 to SIF #2 for two specific purposes: (i) to pay distributions to SIF #2 investors, and (ii) to pay fees to SIF #2's exempt market dealers.

[9] The respondents submit that these loans were permissible under the terms of the SIF #1 offering memorandum. For reasons we explain below, we do not

[1] RSO 1990, c S.5

accept the respondents' interpretation of the offering memorandum, and we find that the loans were unauthorized diversions of investor funds.

[10] The respondents also submit that even if we find that the loans were unauthorized by the offering memorandum, the respondents relied on advice from the law firm of Aird & Berlis LLP, which had been SIF Inc.'s primary external legal counsel since late 2010. We explore in detail below the communications between the law firm and SIF Inc., and conclude that at no time did the lawyers opine on whether the SIF #1 offering memorandum permitted these loans. Accordingly, the defence of reasonable reliance on legal advice is unavailable to the respondents in this case.

[11] We conclude that SIF Inc. engaged in fraudulent conduct relating to securities and thereby breached s. 126.1(1)(b) of the Act. We find that each of the individual respondents caused one or more of the fraudulent diversions of investor funds, and we therefore conclude that all three individual respondents also breached s. 126.1(1)(b) of the Act.

II. FACTUAL BACKGROUND

A. General

[12] Before turning to our substantive discussion of the issues in this case, we set out some additional factual background. We begin with SIF Inc. and then speak about the individual respondents.

[13] Mr. Grossman and an individual named Paul Ghezzi founded SIF Inc., a private company, in 2009. The offering memorandum at issue in this proceeding stated that SIF Inc. was "focused on the development and management of solar photovoltaic… energy power generation installations backed by long-term Power Purchase Agreements."[2] Messrs. Grossman and Ghezzi intended that SIF Inc. would benefit from the Ontario government's "feed-in tariff" program, which, according to Mr. Grossman, could result in "very generous returns for solar projects in Ontario."[3]

[14] SIF Inc. had an informal management committee made up of the company's senior personnel. The composition of the committee changed over the period from 2013 to 2016. We specify below each individual respondent's time on the committee.

[15] Mr. Grossman described the committee as a "very close-knit group" that "met constantly" and would "discuss issues as they came up."[4] He testified that decisions were made within SIF Inc. by the whole management team acting together and unanimously. If a member of the management team did not agree with a transaction, SIF Inc. would not carry it out.

[16] Mr. Kadonoff gave a similar description, characterizing the relationship among members of the management group as "consensus-driven".[5]

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[2] Exhibit 32, Revised Exhibit A to the Affidavit of Kevin Dusseldorp affirmed February 20, 2021 (**Dusseldorp Affidavit**), Offering Memorandum dated March 6, 2013 at p 5

[3] Hearing Transcript, Solar Income Fund (Re), March 29, 2021 at p14 line 27 to p15 line 3

[4] Hearing Transcript, Solar Income Fund (Re), March 29, 2021 at 17 lines 11-14

[5] Hearing Transcript, Solar Income Fund (Re), April 1, 2021 at 111 line 11

[17] Only members of the management committee could authorize the movement of funds in and out of a SIF Inc.-related bank account. All members of the management committee had online access to the bank accounts of SIF Inc. and the entities that it managed.

B. Mr. Grossman

[18] Through a trust, Mr. Grossman's family held approximately 30% of the company.

[19] Mr. Grossman was a member of SIF Inc.'s management committee from at least March 2013 (the establishment of SIF #1) to November 2017, when SIF Inc. resigned as manager of SIF #1 and SIF #2. He was, at different times, SIF Inc.'s Chief Operating Officer, Vice-President Finance, Chief Financial Officer and Secretary. He also became a director of SIF Inc. in November 2013.

C. Mr. Mazzacato

[20] In May 2014, Mr. Ghezzi, one of the founders of SIF Inc., left the company. CPE Inc., a company run by Mr. Mazzacato and Jennifer Jackson (his then-partner) had done work for SIF Inc., and Mr. Mazzacato and Ms. Jackson were offered senior management positions by Mr. Grossman and Mr. Kadonoff. Ms. Jackson became SIF Inc.'s President and Chief Operating Officer. Mr. Mazzacato became Chief Technology Officer, VP Project Development, and a member of the management committee.

[21] In June 2014, Mr. Mazzacato became a director of SIF Inc. The following month, he and Ms. Jackson jointly acquired Mr. Ghezzi's approximately 30% share of SIF Inc., and SIF Inc. acquired 100% of CPE.

[22] During the summer of 2015, following Ms. Jackson's departure from SIF Inc., and at which time Mr. Kadonoff was interim President, Mr. Grossman and Mr. Kadonoff asked Mr. Mazzacato to become SIF Inc.'s President. Mr. Mazzacato assumed that role, and remained on the management committee to November 2017.

D. Mr. Kadonoff

[23] Mr. Kadonoff is a lawyer who began working with SIF Inc. in 2010, one year after its inception, as a part-time consultant. In 2011, after reinstating his status with the Law Society of Ontario, he signed a retainer agreement with SIF Inc. to work full-time, primarily preparing and negotiating contracts for solar acquisitions.

[24] Through a holding company, he became an indirect 30% shareholder of SIF Inc. around 2010.

[25] According to Mr. Grossman, Mr. Kadonoff was a member of SIF Inc.'s management committee:

a. along with Mr. Ghezzi and Mr. Grossman from the establishment of SIF #1 in March 2013 until May 2014;

b. along with Ms. Jackson, Mr. Mazzacato and Mr. Grossman from May 2014 until May 2015; and

c. along with Mr. Mazzacato and Mr. Grossman from May 2015 until at least the end of August 2015, at which time Mr. Kadonoff formally resigned as an officer and director of SIF Inc.

[26] Mr. Kadonoff's role after August 2015 is a matter of some dispute. He states that following his resignation as an officer and director, he "was no longer involved in management and did not have any decision-making authority."[6] He further states that he made clear to Mr. Grossman and Mr. Mazzacato that he would no longer play a role in management. He continued to hold his shares in SIF Inc., because neither Mr. Grossman nor Mr. Mazzacato would purchase them from him. He also continued to work as a consultant for SIF Inc. until February 2016, to complete financing transactions for SIF #1 and SIF #2.

[27] However, according to Mr. Grossman, Mr. Kadonoff was a member of the management committee until February 2016. Mr. Mazzacato has a similar recollection, testifying that on an ongoing basis between September 2015 and February 2016, Mr. Kadonoff participated in meetings with SIF Inc.'s management committee, and provided "opinions and direction" on SIF Inc.'s financial and legal affairs.[7] We will explore Mr. Kadonoff's role in greater detail in our analysis of Staff's fraud allegations.

III. ISSUES

A. Earlier motion about proposed expert testimony

[28] Before we identify the issues that are raised by this hearing, and before we present our analysis of those issues, a preliminary comment is in order. Earlier in this proceeding, a different panel of the Commission heard a motion about Staff's intention to call a witness at this hearing to give expert testimony.

[29] Based on the Statement of Allegations, which defines the scope of an enforcement proceeding such as this, and with the benefit of an undertaking from the respondents not to call evidence or make submissions that would have made part of the expert's proposed testimony relevant, the Commission decided[8] that the proposed testimony was not admissible.

[30] We need not review here the reasons for that decision, but it is important to note that as a result of the motion, there is no issue before us as to the commercial reasonableness of any loan made by SIF #1 to SIF #2. Our analysis is confined to the specific issues before us, which we will now address.

B. Issues raised by Staff's allegations

[31] As discussed above, Staff's case rests on two alleged breaches of the Act.

[32] The first is of s. 44(2). In general, an alleged breach of s. 44(2) presents three issues:

a. whether the respondent made a statement;

b. whether the statement was untrue or misleading in the circumstances in which it was made; and

c. whether a reasonable investor would consider the subject of the statement to be relevant in deciding whether to enter into or maintain "a

[6] Exhibit 38, Affidavit of Kenneth Kadonoff, affirmed March 30, 2021 at para 29 (**Kadonoff Affidavit**)
[7] Exhibit 35, Affidavit of Charles Mazzacato, sworn March 29, 2021 at para 18
[8] *Solar Income Fund Inc. (Re)*, 2021 ONSEC 2, (2021) 44 O.S.C.B. 557 (***Solar Income Fund Inc. (Re)* Motion Decision**)

trading or advising relationship" with the respondent who made the statement.

[33] The second alleged breach is of s. 126.1(1)(b). The two high-level issues presented by that allegation are:

a. whether the respondent directly or indirectly engaged in or participated in acts, practices or courses of conduct relating to securities; and

b. whether the respondent knew or ought reasonably to have known that the acts, practices or courses of conduct perpetrated a fraud.

[34] These two issues can be broken down into their elements. We do that below, in our introduction to the analysis of the fraud allegations. We turn now, though, to our analysis of the alleged breach of s. 44(2).

IV. ANALYSIS

A. Subsection 44(2)

1. Introduction

[35] Staff alleges that all respondents made, or caused SIF #1 to make, untrue or misleading statements to investors about SIF #1's use of funds. Staff alleges that the respondents thereby contravened s. 44(2) of the Act. We conclude that they did not.

[36] As noted above, a threshold issue raised by this allegation is whether that subsection applies at all to the relationship between any of the respondents and the investors. If the subsection applies, we must then consider whether any respondent made any statement that contravenes the subsection.

[37] Subsection 44(2) provides:

> No person or company shall make a statement about any matter that a reasonable investor would consider relevant in deciding whether to enter into or maintain a trading or advising relationship with the person or company if the statement is untrue or omits information necessary to prevent the statement from being false or misleading in the circumstances in which it is made.

[38] As we noted above, for Staff to prove a direct contravention of s. 44(2) against a respondent, Staff must establish three things, one of which is that a reasonable investor would consider the subject of the statement to be relevant in deciding whether to enter into or maintain "a trading or advising relationship" with the respondent who made the statement.

[39] Staff does not suggest that any of the respondents was in an "advising" relationship with investors. As we will explain, Staff relies on the investors' purchases of fund units, and other connections between those investors and the fund, to submit that those connections establish a "trading" relationship.

[40] We conclude below that the relationship between SIF Inc. and existing or potential investors was not a trading relationship. As a result, Staff failed to establish the third of the three elements above, and s. 44(2) does not apply here. If s. 44(2) were to apply in the circumstances of this case, then every issuer might be said to be in a trading relationship with every holder of that

issuer's securities. That cannot be the correct interpretation of s. 44(2), as we explain more fully below.

[41] Because we conclude that the third element above is not present, we need not consider the first two elements in the context of the s. 44(2) allegations. However, our assessment of some of the statements made, and the extent to which funds were used in a manner consistent with those statements, is central to our analysis of the fraud allegations, which follows below.

2. Factual background

[42] We therefore turn to a closer examination of our reasons for concluding that the relationship here between SIF Inc. and existing or potential investors was not a trading relationship. Staff cites the following facts in support of its position:

a. investors purchased SIF #1 units directly from SIF Inc.;

b. investors entered into a subscription agreement that was explicitly directed to SIF #1, and to SIF Inc. as the "Manager", and that was signed by SIF Inc. "as agent for" SIF #1;

c. SIF Inc. would determine the investor's eligibility to purchase the units;

d. SIF Inc. wrote to each purchaser to confirm details and to invite questions;

e. Raintree, the lead exempt market dealer retained to sell units, identified itself as an independent dealer and advised investors that the investors would "also be creating a relationship with [the] issuer for the ongoing care and control of [the] investment.";

f. the SIF #1 management agreement said that SIF Inc.'s role would include reporting to and liaising with investors about SIF #1;

g. SIF Inc. sent regular newsletters to unitholders;

h. units were redeemable at the unitholder's option, with the redemption price being tied to the units' market value, which was determined by SIF Inc.; and

i. SIF Inc. could cancel units at its discretion.

[43] The respondents do not dispute these facts, but assert that the facts do not create a trading relationship within the meaning of s. 44(2). We will now consider that submission.

3. Analysis

[44] Subsection 44(2) governs some relationships involving investors. The question here is whether it governs the relationship between SIF Inc. and investors in SIF #1.

[45] The term "trading relationship" is not defined in the Act. We begin our task of giving that phrase meaning by examining the context in which it appears, *i.e.*, "to enter into or maintain a trading… relationship."

[46] The plain meaning of the word "relationship", in its ordinary sense, evokes an ongoing connection involving enduring or repetitive behaviour. The word "maintain" in s. 44(2) highlights this enduring character. The alternative of

"enter into" clearly aims the provision not only at existing participants in the subject relationship, but also at potential participants.

[47] There can be no question that for as long as an investor holds a security of an issuer, the investor and issuer are in a relationship. The question is whether it is a relationship that falls within the provision. To answer that question, we must look to the fact that the nature of the enduring or repetitive behaviour is defined by the qualifier "trading".

[48] Can it fairly be said in this case that the relationship between SIF #1 unitholders and SIF Inc. meets that qualifier? Looking solely at the words of s. 44(2), we think not.

[49] To further test that proposition, we look to the rest of s. 44, to give additional context. Is there anything about any other part of s. 44 that suggests one conclusion or the other?

[50] Section 44 has only one other subsection apart from s. 44(2). Subsection 44(1) provides that a person or company may make a representation about their registration status under the Act only if that representation is true and it specifies the particular category of registration. The subsection aims to ensure that investors can know whether or not they are dealing with a registrant, and if so, the category of registrant.

[51] Subsection 44(1) of the Act does not apply to the facts of this case. However, we still find it useful in assessing the purpose of s. 44(2). While we do not place significant weight on its presence, we note that it governs registrants or others who make representations about being a registrant. This reinforces our conclusion that the "trading or advising relationship" envisaged by s. 44(2) is of a nature typically provided by registrants, *i.e.*, to act on behalf of investors to assist with their trading, and to advise investors on investment decisions they may make.

[52] SIF Inc. is not a registered dealer and none of the individual respondents is a registrant. Should the provision apply in these circumstances? Of previous decisions that deal with s. 44(2), none is determinative, but two offer some assistance.

[53] The first is *Carter*,[9] a 2010 decision of a Director of the Commission. The respondent Carter Securities Inc. was a registered exempt market dealer who marketed and sold securities of an unrelated issuer. The dealer gave investors marketing materials that were found to have contravened s. 44(2). The Director therefore suspended the dealer's registration. Staff's allegations in the proceeding were confined to the dealer and did not extend to the issuer or to any of its principals.[10] Accordingly, the relationship between the respondent dealer in *Carter* and the investors was more immediate than, and is not analogous to, the relationship here between SIF Inc. and SIF #1 investors.

[54] In the Commission's 2013 decision in *Winick*,[11] the respondent Winick directed a transfer agent to send misleading correspondence to potential investors in two issuers of which Winick was the directing mind. The Commission dismissed

[9] *Carter Securities Inc. (Re)*, (2010) 33 OSCB 8691 (***Carter***)
[10] *Carter* at paras 1, 53, 74, 87
[11] *Winick (Re)*, 2013 ONSEC 31, (2013) 36 OSCB 8202 (***Winick***)

Staff's allegation that by giving that direction, Winick breached s. 44(2). The Commission found that while the misstatements might have related to a trading relationship with the transfer agent, they did not relate to a trading relationship with Winick himself.[12]

[55] While the facts in *Winick* are distinct from those in this case, *Winick* does reinforce the importance not just of identifying who was responsible for a communication that contained untrue or misleading statements, but also of carefully identifying who the parties are in the relationship that is governed by s. 44(2), *i.e.*, a trading or advising relationship. In this case, we must look closely at the nature of the interaction between SIF Inc. and the SIF #1 investors.

[56] The respondents in this case point to other contested cases before the Commission or a Director of the Commission that featured alleged breaches of s. 44(2). As the respondents correctly submit, in none of those cases did Staff successfully establish a breach of s. 44(2) by a non-registrant,[13] other than one case in which the non-registrant was also found to have been carrying on the business of trading or advising without being properly registered.[14]

[57] In the one case in which a non-registrant was found to have contravened s. 44(2), the respondent Goddard had previously been a registrant but was no longer registered during the material time. He was the sole director, officer and directing mind of the respondent corporation. The respondents (Goddard and his corporation) issued documents to investors, pursuant to which the respondents promised those investors a return on their investment. The Commission found that:

a. the documents were themselves securities;

b. the respondents engaged in the business of trading in securities;

c. the documents were false and misleading; and

d. the documents were relevant to any investor who was deciding whether to enter into a trading relationship with the respondents.

[58] In that case, the trading relationship was clearly between the investors and the respondents. There was no intermediary. The fact that the respondents were not registered could not shield them from liability under s. 44(2), especially (but not exclusively) since the respondents were engaged in the business of trading and ought to have been registered if they were to carry on that business.

[59] Staff has cited no other decision in which a breach of s. 44(2) was found against a non-registrant. While Staff correctly submits that we ought not to read words into s. 44(2) that are not there, we must interpret, give meaning to and apply the words that are there. The subsection contains the words "a trading or advising relationship", and to us these words mean something considerably more

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[12] *Winick* at paras 157-8

[13] See *Waterview Capital Corp (Re)*, (2011) 34 OSCB 5059; *Energy Syndications Inc. (Re),* 2013 ONSEC 24, (2013) 36 OSCB 6500; *David Charles Phillips (Re)*, 2015 ONSEC 24, (2015) 38 OSCB 617 (***Phillips***)

[14] *Black Panther (Re)*, 2017 ONSEC 1, (2017) 40 OSCB 1115

than the incidental and administrative relationship between unitholder and manager of the issuer in this case.

[60] We therefore agree with the respondents' submission that to apply s. 44(2) in this case would be a departure from previous decisions.

[61] We also agree that such a departure is not warranted on policy grounds. The connection between SIF Inc. and those who purchased units of SIF #1 was a relationship between the investor and an entity to which the issuer delegated all responsibility for management and general administration (*i.e.*, SIF Inc. as manager of SIF #1). We had no evidence before us that any investor had any trading-related connection with SIF Inc. that was anything more than, once, buying units of SIF #1.

[62] We do not accept that the facts cited by Staff, referred to in paragraph [42] above, create a trading relationship with any of the respondents. In particular:

a. SIF Inc.'s administrative steps at the time of purchase were typical of those of an issuer of exempt securities, and its after-purchase steps were typical of investor relations activities conducted by many issuers;

b. even if the exempt market dealer was correct when it told investors that they would "also be creating a relationship with [the] issuer for the ongoing care and control of [the] investment", that relationship was of an administrative nature, and there would not necessarily be any trading once the initial purchase was complete; and

c. any rights of redemption or cancellation did not create a "trading" relationship.

[63] Mr. Mazzacato's own testimony supports this conclusion. As he testified, SIF Inc. had an investor relations person "who did administration work".[15] Any interaction with investors was through SIF Inc.'s exempt market dealers. Mr. Mazzacato reported that he was told that interactions with investors were not permitted.

[64] Our conclusion on this issue is unaffected by the fact that Staff alleges that the trading relationship involving the investor is with SIF Inc. instead of SIF #1. For these purposes, SIF Inc. essentially stands in the shoes of SIF #1. SIF Inc. as manager did nothing more or differently than SIF #1 would have as issuer, had there been no manager.

[65] In addition, it is noteworthy that Staff does not allege that any of the impugned statements were made orally by any of the respondents. Instead, those statements were contained in the offering memorandum and its amendments. Those documents were given to investors by the exempt market dealer, not by the respondents. As a general proposition, that kind of distinction in a given case would not necessarily absolve a respondent of responsibility for any misstatements if the respondent were found to be an author of the document. However, the fact that there was no direct communication between a respondent and an investor helps to understand the nature of the relationship between them.

[66] We do not agree with the dire consequences behind Staff's warning that if the respondents are not held to have contravened s. 44(2) in this case, "an issuer

[15] Hearing Transcript, Solar Income Fund (Re), April 8, 2021 at 98 lines 22-23

could never be held liable under s. 44(2) for making misrepresentations to investors so long as the issuer retained an EMD to sell on its behalf."[16] It is true that if there is no trading or advising relationship between the issuer and its prospective or existing securityholder, then the issuer cannot be held liable under s. 44(2). But that is because the trading or advising relationship is an essential element of s. 44(2). The issuer about which Staff is concerned can still be held liable under other provisions of Ontario securities law more relevant to issuers.

[67] If we were to find the existence of a trading relationship in this case, every issuer could face a similar finding. There is nothing about this case to meaningfully distinguish the relationship from the common event of an investor completing a single trade in a security of an issuer.

[68] In summary, we find that it would take something more than a trade, and associated administrative and information-conveying steps, to create a trading relationship. The facts of this case do not support such a conclusion.

4. Conclusion about Staff's s. 44(2) allegations

[69] We therefore dismiss the allegation that SIF Inc. breached s. 44(2).

[70] As for the individual respondents, Staff does not allege that any of them breached s. 44(2) directly; only that as officers and directors of SIF Inc. they should be found to share liability for any breaches by SIF Inc., pursuant to s. 129.2 of the Act. Having found no breach by SIF Inc., we dismiss the related allegations against the individual respondents.

[71] Having found that no reasonable investor would consider the subject of the impugned statements to be relevant in deciding whether to enter into or maintain a trading relationship with the respondent who made the statement, we decline to find, within the context of the s. 44(2) allegations, whether the statements were untrue or misleading (the second of the three elements to be proven, as referred to in paragraph [38] above). In our analysis below of Staff's fraud allegations, we will return to consider whether the respondents adhered to certain statements in the offering memorandum.

[72] We will now address Staff's allegations that all four respondents engaged in fraudulent acts.

B. Clause 126.1(1)(b)

1. Introduction

[73] In the Statement of Allegations, Staff alleges that the "offering memorandum led investors to believe that all of their invested funds would be used to buy, develop and operate physical assets that would produce a return on investment through the sale of solar energy." Staff alleges that the respondents did not live up to this promise, because they used SIF #1 funds "in a way that was contrary to the purpose and the short-term and long-term objectives of SIF #1 as provided in" the offering memorandum.[17]

[16] Written Reply Submissions of Staff of the Ontario Securities Commission dated July 5, 2021, para 40

[17] Amended Statement of Allegations dated February 18, 2021, at paras 2 and 63

[74] At the hearing, including in Staff's closing submissions, Staff limited and particularized that broad complaint of misuse of funds, alleging that the respondents caused SIF #1 to transfer funds to SIF #2 for the payment of:

a. distributions to SIF #2 investors; and

b. fees owed to SIF #2's exempt market dealers.

[75] Staff alleges that because the SIF #1 offering memorandum did not contemplate that SIF #1 would lend funds to another entity (even a related entity) for these purposes, the loans to SIF #2 were unauthorized. Further, Staff alleges, these loans caused a deprivation to SIF #1 investors, in that their funds were put at risk in a manner to which they had not agreed. As a result, says Staff, all four respondents contravened s. 126.1(1)(b) of the Act.

[76] The burden of proof for this allegation is the same as for all allegations before us. It is the balance of probabilities. In other words, is it more likely than not that a particular fact is true, or that the allegation is proven? While any conclusion we reach by applying the balance of probabilities standard must be based only on clear, cogent and compelling evidence, that requirement does not elevate the standard of proof.[18] This is so, despite the use of the words "high standard of proof" in some decisions cited by the respondents from other jurisdictions.

[77] Staff makes no allegation that an individual respondent committed a fraud independent of any of SIF Inc.'s actions. Instead, Staff submits that the individual respondents share responsibility for those actions. Accordingly, in our analysis we focus first on SIF Inc.'s actions.

[78] We then consider what are, on the facts of this case, the two ways that an individual respondent can be found liable for a fraud committed by SIF Inc. As we explain further below, we may make such a finding against an individual respondent if:

a. Staff proves all the elements of s. 126.1(1)(b) against that respondent directly, one of which is that the respondent knew or ought to have known that SIF Inc. was perpetrating a fraud; or

b. pursuant to s. 129.2, Staff proves that SIF Inc. contravened s. 126.1(1)(b), that the individual respondent was a director or officer of SIF Inc. at the time of SIF Inc.'s non-compliance, and that the respondent authorized, permitted or acquiesced in that non-compliance.

[79] In their closing written submissions, the respondents submit that Staff has "impermissibly attempted to expand the scope of the case" beyond the Statement of Allegations, including by submitting that the impugned transactions "were not commercially reasonable or prudent".[19] For the reasons set out above regarding the motion about expert testimony, we agree with the respondents that that issue, framed that way, is not relevant in this proceeding. We confine our analysis to the elements required for proof of the s. 126.1(1)(b) allegations, which require Staff to establish that:

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[18] *FH v McDougall*, [2008] 3 SCR 41 at para 46

[19] Joint Written Submissions of Solar Income Fund Inc., Allan Grossman, Charles Mazzacato, and Kenneth Kadonoff, dated June 25, 2021, at paras 6-7

a. the respondent directly or indirectly engaged in or participated in acts, practices or courses of conduct relating to securities; and

b. the respondent knew or ought reasonably to have known that the acts, practices or courses of conduct perpetrated a fraud.

[80] There is no dispute that the first of these two elements is true in this case. The transfer of funds to pay investor distributions and dealer fees, whether permissible or not, relates to securities.

[81] The second element raises the central question. Was the transfer of funds for those purposes fraudulent, and if so, did each respondent know, or ought that respondent to have known, that the transfer was fraudulent? For Staff to establish that the transfer was fraudulent, Staff must prove two things:

a. the *actus reus*, a mostly objective element (except for the subjective requirement that the act have been a voluntary act of the person alleged to have committed it,[20] a consideration not relevant here), which must consist of:

   i. a prohibited act, which may be an act of deceit, falsehood, or some other fraudulent means; and

   ii. deprivation caused by that act; and

b. the *mens rea*, or subjective or mental element, which must consist of:

   i. subjective knowledge of the act referred to above; and

   ii. subjective knowledge that the act could have as a consequence the deprivation of another.[21]

[82] A corporation cannot be described as having "knowledge" in the same way that an individual does. A s. 126.1(1)(b) allegation is established against the corporation where Staff proves that the corporation's directing minds knew or ought reasonably to have known that the corporation perpetrated a fraud.[22]

[83] We will now review these elements individually, in each case in the context of Staff's two allegations about the transfer of funds to pay distributions to SIF #2 investors and fees owed to SIF #2's exempt market dealers.

2. Did the respondents engage in an act of deceit, falsehood, or some other fraudulent means?

(a) "Other fraudulent means" includes unauthorized diversion of funds, of the type Staff alleges here

[84] We begin by considering whether SIF Inc. engaged in an act of deceit, falsehood or other fraudulent means. Staff relies on the third of those elements, "other fraudulent means".

[85] The Supreme Court of Canada, in the leading case of *Théroux*, states that whether an act falls within "other fraudulent means" must be determined objectively, with reference to what a reasonable person would consider to be a

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[20] *R v Théroux*, [1993] 2 SCR 5 at para 17 (***Théroux***)

[21] *Théroux* at para 24, cited in *Re Quadrexx Hedge Capital Management Ltd*, 2017 ONSEC 3, (2017) 40 OSCB 1308 (***Quadrexx***) at para 19

[22] *Re Al-Tar Energy Corp*, 2010 ONSEC 11, (2010) 33 OSCB 5535 at para 221

dishonest act.[23] Even where deceit or falsehood cannot be established, a situation may still be dishonest and therefore be "other fraudulent means".

[86] That description applies to unauthorized diversions of funds[24] because they generally constitute, in the words of the Supreme Court of Canada, "the wrongful use of something in which another person has an interest, in such a manner that this other's interest is… put at risk."[25] The unauthorized nature of the diversion is the wrongful use that is at the heart of the dishonesty contemplated by "other fraudulent means". The separate question of whether a wrongful use puts one's interest at risk (as contemplated in the above quotation) is part of the analysis of deprivation. We address that question below.

[87] Staff cites several previous decisions where diversion of investor funds has been found to have been fraudulent:

a. diversion, without notice to investors, of funds raised ostensibly for a factoring scheme ("a very specific investment proposal"), to a separate unrelated company ("funds… not used in the specific manner authorized by the clients");[26]

b. without first amending the relevant offering memorandum and notifying investors of the change, diversion of new investor funds to pay dividends to existing investors;[27] and

c. without proper authority, a corporation's diversion of funds to the personal benefit of two of the corporation's principals.[28]

[88] Each of those, to a greater or lesser extent, bears some similarity to the present case. All of them reinforce the principle that a use of funds that is inconsistent with what was promised to investors and that is without notice to them is dishonest.

[89] The respondents submit that the impugned transfers of funds from SIF #1 to SIF #2 cannot be found to be fraudulent, for two reasons:

a. the funds used for the transfers were not the funds of SIF #1 investors; and

b. the risks borne by SIF #1 investors in connection with the loans from SIF #1 to SIF #2 were exactly the risks that they had bargained for.

[90] We address the second of those two objections, about the risks borne by SIF #1 investors, in our discussion of deprivation below.

[91] As for the suggestion that the funds used for the transfers were not those of SIF #1 investors, we cannot accept that submission. Staff's investigator witness provided extensive evidence of cash flows to and from investors and various entities, and transfers between accounts. In addition to cross-examining that witness, the respondents provided an extensive appendix to their closing

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[23] *Théroux* at para 14
[24] *Théroux* at para 15
[25] *R v Zlatic*, [1993] 2 SCR 29 at para 19 (***Zlatic***)
[26] *R v Currie*, [1984] OJ No 147 at para 15
[27] *Quadrexx* at para 246
[28] *Money Gate Mortgage Investment Corporation (Re)*, 2019 ONSEC 40, (2019) 43 OSCB 35 at para 307

submissions, that they say exposes gaps and limits associated with the Staff witness's evidence. One of the respondents' main submissions on this point is that the impugned payments originated from third parties who loaned funds to SIF #1 and SIF #2.

[92] The respondents' submission is misguided, because it implies a necessary tracing of a particular dollar from an investor to its ultimate use. Such a tracing would be possible where funds are segregated, *e.g.*, in trust. However, no such segregation happened here, nor was one required. SIF #1's funds were to be fungible, whether their source was investors or a lender (or, eventually, revenue). This is reflected in the use of funds table in the offering memorandum, which aggregates the $30 million (maximum) to be received from investors and the approximately $72,462,000 in long-term debt, and then indicates how that total is allocated. There is no streaming of investor funds for some purposes and debt financing for others.

[93] An investor who decided to invest in SIF #1 was entitled to assume that all of SIF #1's affairs (not just a portion represented by the funds of that investor or all investors) would be conducted in a manner consistent with that set out in the offering memorandum.

[94] Our conclusion on the tracing point does not preclude the Commission's examination, for other purposes, of the overall cash flow and general financial condition of one or more entities. For example, the fact that at a given point in time, an entity had insufficient funds to make a necessary payment, and funds were transferred to that entity that were immediately used to make that payment, may be relevant evidence in support of a conclusion about either or both of:

a. a respondent's state of mind at the time; and/or

b. the purpose of a transfer of funds.

[95] We decline to apply the tracing approach urged by the respondents in the context of this issue. We agree with Staff's submission that the unauthorized diversion of funds from SIF #1 for the impugned purposes was wrongful.

(b) As alleged, SIF #2 paid fees to exempt market dealers, and distributions to its investors

[96] Staff's investigator witness prepared an analysis of the flow of funds among various accounts. That analysis included a particular focus on transfers from SIF #1 to SIF #2 in the ten-month period from July 1, 2015, to May 5, 2016. During that time, according to the analysis:

a. approximately $5.31 million was transferred from the SIF #1 operating trust account to the SIF #2 operating trust account, being substantially all the external funds received in the SIF #2 account;

b. approximately $1.66 million went from the SIF #2 operating trust account to the SIF #2 fund account;

c. at least $223,224.04 was paid from the SIF #2 fund account to investors as distributions; and

d. $92,031 was paid from the SIF #2 fund account to exempt market dealers ($11,640) and a numbered Alberta corporation that was retained to provide marketing services to the dealers ($80,391).

[97] There is no real dispute that SIF #2 made some payments to exempt market dealers and to investors, and that the loans from SIF #1 to SIF #2 enabled SIF #2 to make these payments. This fact is evident from, among other things:

a. contemporaneous email correspondence;

b. cheques signed by Mr. Grossman and Mr. Mazzacato indicating that the funds were being paid for those purposes; and

c. Mr. Grossman's acknowledgment in his affidavit that he was aware at the time that some portion of the funds loaned by SIF #1 were used to pay SIF #2 distributions and exempt market dealer fees.

[98] Staff cites several payments out of SIF #1 as examples of the impugned transfers:

a. two payments relating to exempt market dealers and for marketing services:

i. a November 25, 2015, cheque for $15,000, signed by Mr. Grossman, from the SIF #1 operating trust to the SIF #2 operating trust, with the memo line showing: "Re Computershare annual fee+pinnacle"; and

ii. a February 4, 2016, wire transfer for $25,000, from the SIF #1 operating trust to the SIF #2 operating trust, with the memo line on the bank statement showing: "Re Geoff Lafleu", an apparent reference to Geoff Lafleur, the principal of the numbered Alberta corporation referred to in paragraph [96] above; and

b. payments to fund investor distributions:

i. a July 7, 2015, wire transfer for $35,000 from the SIF #1 operating trust to the SIF #2 operating trust, with the memo line on the bank statement showing: "MFT2JuneDist", "MFT2" being SIF #2; and

ii. a December 7, 2015, cheque for $80,000, signed by Mr. Mazzacato, from the SIF #1 operating trust to the SIF #2 operating trust, with the memo line showing: "MFT 2 Expenses & Distribution", and a cheque of the same day and in the same amount, from the SIF #2 operating trust to SIF #2, also signed by Mr. Mazzacato, and with the same memo line notation.

[99] The respondents correctly submit that the Alberta corporation providing marketing services to the exempt market dealers was not itself an exempt market dealer. The Statement of Allegations repeatedly describes the category of impugned payments as "exempt market dealer fees" or "fees owed to exempt market dealers". Staff's written submissions confirm that the fraud allegation is so limited. There are no words in the Statement of Allegations that would cover fees paid to a third party non-dealer for marketing. Accordingly, we exclude the $80,391 paid to the Alberta corporation, leaving $11,640 paid to the two exempt market dealers.

[100] The respondents also dispute the precise amount of the impugned payment from the SIF #2 fund account to investors. Staff's investigator witness arrived at the figure of $223,224.04 for distributions by a self-described conservative approach of taking the total of $261,159.38 paid for distributions during the period and deducting an adjustment of $37,935.34.

[101] Staff's investigator witness applied the adjustment on a chronological basis to reflect the fact that some funds were commingled in the SIF #2 fund account, and some or all of the $37,935.34 may have been used for various impugned purposes, including not only the payment of distributions and exempt market dealer fees, but also allegedly improper payments to SIF Inc. and CPE. While that last category of payments is not the subject of Staff's fraud allegation, the category is essential to understanding the adjustment.

[102] We accept this conservative approach as an appropriate methodology. Accordingly, for our purposes the amount transferred from SIF #1 to SIF #2 that funded distributions is not less than $223,224.04, and may be slightly higher. Using Staff's chronological approach, the opening balance adjustment referred to above was consumed by July 22, 2015, at the latest. This date is not material for the overall calculation we discuss here, but it becomes relevant when we address Mr. Kadonoff's responsibility below.

[103] Taking the $223,224.04 amount together with the dealer fees of $11,640, the total challenged amount is $234,864.04.

[104] Contrary to the respondents' submission, Staff's analysis does not demonstrate that the impugned uses of SIF #1 funds began no earlier than September 2015. Staff's analysis cannot be completely conclusive on the point, because of the commingling of funds. We accept Staff's conclusion that the use of SIF #1 funds to pay distributions and dealer and marketing fees began no later than June 2015. We are bolstered in this conclusion by Mr. Grossman's testimony that the "entire management team" in June and July of 2015 was aware that funds were being transferred at that time from SIF #1 to SIF #2 to pay distributions to SIF #2 investors.[29]

[105] The respondents describe the impugned amount as a small subset of the funds that SIF #1 advanced to SIF #2. Even accepting that characterization for the sake of argument, it is irrelevant to our analysis. If the transfer were isolated, inadvertent, and of an insignificant amount, then under certain circumstances it might justifiably be disregarded for not meeting the "dishonesty" criterion. In this case, that description does not apply. The absolute size of the amount in issue, and the ratio of the impugned amount to the total amount transferred, are meaningless in the context of this merits hearing.[30]

[106] We will now consider whether the transfer of $234,864.04 to pay distributions and dealer fees was authorized.

[29] Hearing Transcript, Solar Income Fund (Re), April 1, 2021 at 69-70
[30] *Quadrexx* at para 241

(c) Was the use of SIF #1's funds for those purposes authorized?

i. Introduction

[107] In addressing the question of whether the use of SIF #1's funds for the impugned purposes was authorized, the respondents rely not only on the SIF #1 offering memorandum, but also on the declaration of trust that established the SIF #1 operating trust. For reasons we expand on in our discussion below about legal advice given to the respondents, we focus our analysis on the language contained in the offering memorandum, since that is the investor-facing document. Further, while the two documents contain some language in common, there are significant differences as well. Nothing in the declaration of trust that is not already present in the offering memorandum affects, positively or negatively, the respondents' position in this case.

[108] We will first conduct a thorough analysis of relevant provisions in the offering memorandum, following which we will review related oral testimony.

ii. Text of the offering memorandum

[109] The offering memorandum was originally issued on March 6, 2013, in support of an intended $30 million capital raise. It contemplated that SIF #1 would create a subsidiary trust that would be the sole limited partner of one or more limited partnerships to be formed to conduct SIF #1's business. A July 3, 2013, amendment to the offering memorandum reflected the creation of the SIF #1 operating trust, which was the subsidiary trust referred to in the original offering memorandum.

[110] The offering memorandum was amended again on January 15, 2014, after approximately $25.5 million had been raised, to double the total size of the offering to $60 million. Two more amendments were made, on April 23 and June 10, 2014, respectively. Neither amendment is consequential for our purposes.

[111] The original offering memorandum describes the nature of SIF #1's business and short- and long-term objectives. According to the offering memorandum, SIF #1 "was established to invest in Subsidiaries which will in turn invest in the acquisition, development, financing and operation of solar energy power installations… and other ancillary or incidental business activities".[31] These words echo those set out in the Feb 4/13 declaration of trust by which SIF #1 was created.

[112] The word "Subsidiaries" in the above text is defined as "any company, partnership, limited partnership, trust or other entity either controlled, directly or indirectly, by the Fund or in which the Fund holds more than 50% of the outstanding equity securities."[32]

[31] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Offering Memorandum dated March 6, 2013 at p 5

[32] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Offering Memorandum dated March 6, 2013 at p 1

[113] The listed short-term objectives in the offering memorandum are specified to be "for the next 12 months" and are only two:

a. to raise capital through the offering that is the subject of the offering memorandum; and

b. to acquire and/or develop and operate solar energy installations on land or on rooftops, to generate power to be sold under long-term power purchase agreements.

[114] The description of SIF #1's long-term objective tracks the language set out in paragraph [111] above.

[115] SIF #1's purpose is to "invest in" subsidiaries, of which the SIF #1 operating trust is one. As noted above, the SIF #1 operating trust, in turn, is to invest in "the acquisition, development, financing and operation" of solar installations. The respondents contend that an "investment" by the SIF #1 operating trust can be in the form of an equity investment or a loan.

[116] As for permissible activities of the entity to which the loan is made (in this case, SIF #2), the respondents rely heavily on the word "financing" in the phrase quoted above. They submit that nothing in the offering memorandum specifies that any investment that is "financing" must occur in tandem with the acquisition, development or operation of a solar power energy installation.

[117] Staff rejects the respondents' proposed interpretation of the offering memorandum, *i.e.*, that it permitted the respondents to use investor funds to make unsecured loans to unowned third-party entities. Staff contends that even under the respondents' interpretation, the offering memorandum would not permit the impugned uses of SIF #1's funds.

[118] Staff submits that:

a. reasonably, "financing" could only have meant borrowing by SIF #1, and not SIF #1 lending to other entities; and

b. even if the respondents' proposed interpretation is correct, it would not have permitted SIF Inc. to use SIF #1's money to pay dealer fees or distributions to SIF #2 investors.

[119] In general, the word "financing" is capable of two meanings, representing two opposite directions of flow of funds. An entity that engages in financing may be raising or borrowing funds for its own purposes, as in financing one of its projects. Alternatively, an entity that engages in financing may be lending to another entity, *i.e.*, providing financing.

[120] This ambiguity is at the heart of the dispute between Staff and the respondents.

[121] Given that ambiguity, what meaning should we give the word in the description of permissible uses of funds? Does it mean, as Staff submits, that the subsidiaries in which SIF #1 will invest will not only acquire, develop and operate solar installations, but those subsidiaries will also borrow funds as necessary for those purposes? Or does it mean, as the respondents submit, that the subsidiaries in which SIF #1 will invest may acquire, develop and operate solar installations, and may also provide financing for such installations? Or can it mean both in that phrase?

[122] In order to answer those questions, we must examine the entire offering memorandum so that we can understand the context in which the word arises. Analyzing the question in this way best aligns with the fundamental purpose of an offering memorandum, and the interest at stake, *i.e.*, disclosure to investors, and how a reasonable investor would understand the offering memorandum's contents. We conduct the analysis by reviewing the relevant provisions or characteristics of the offering memorandum and assessing the effect of each.

[123] *Description of the business* – The offering memorandum defines the business of SIF #1 as being the investment by SIF #1 in subsidiaries that will in turn "invest in" the financing of solar installations, among other things.

[124] It is illogical to say that an entity would be "investing in financing" by borrowing money. The concept of investing in financing makes sense only if "financing" in this phrase means lending money. Had the intended allusion been to borrowing money in connection with the acquisition, development or operation of a solar installation, we would expect to see words such as "which will in turn invest in the acquisition, development and operation of solar installations, including by obtaining the necessary financing to do so". The wording of the phrase as it appears in the offering memorandum supports the respondents' proposed interpretation of "financing".

[125] *Use of funds under the original offering memorandum* – The maximum amount of the initial offering was $30 million. SIF #1 also intended to obtain long-term debt financing under a term loan of $72,462,000. After the deduction of selling commissions and fees, and offering and marketing costs (all of which totaled approximately $4 million), approximately 90% of the remaining $98,670,775 was to be used for hard costs to develop or acquire solar installations. The other 10% was to be used for: (i) cash to be held in trust in respect of the long-term debt; (ii) a development fee, or management fee, of $1.62 million payable to SIF Inc.; (iii) an electricity grid connection fee; (iv) bank, legal and other professional fees; and (v) a reserve to fund distributions to SIF #1 unitholders.

[126] Of the above list, the only use of funds that was directly attributable to a solar installation was the hard costs "to develop or acquire" solar installations. No portion of the funds raised under the offering memorandum explicitly mentioned providing financing. The word "acquire" cannot imply the provision of financing. The respondents' best argument is that the "development" of a solar installation could include the provision of financing. In our view, that would be a strained interpretation that would be unlikely to alert a reasonable investor to that possible use of the invested funds. The description of use of funds supports Staff's proposed interpretation of "financing".

[127] *Timeline for deployment of funds under the original offering memorandum* – The offering memorandum states that all of the raised funds will be deployed within 12 months for "acquisition and/or development and operation" of solar installations.[33] Again, no mention is made of using funds to provide financing. Further, the timeline for the deployment of any funds would be inconsistent with any lending by SIF #1 for a term exceeding 12 months. These provisions support Staff's proposed interpretation of "financing".

[33] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Offering Memorandum dated March 6, 2013 at p 11

[128] *Services covered by the development or management fee* – SIF #1 was to pay SIF Inc. a $1.62 million development fee pursuant to a management agreement. The offering memorandum sets out a long list of the "consulting, development and administrative services" to be provided by SIF Inc. to SIF #1.[34] Fourteen of the services on the list are in connection with solar installations that were not then currently operating. Of those fourteen, thirteen are clearly preparatory steps toward allowing the solar installation to begin operating or to sustain operation in its early days (*e.g.*, securing regulatory approvals, arranging a construction contract to build the installation).

[129] Only one of the fourteen items, when read on its own, does not definitively fall into that category: "negotiating and managing long-term debt financing". That phrase suffers from the same ambiguity that we seek to resolve. However, the item is followed immediately by: "preparing all technical and legal requirements required to receive approvals for long-term debt financing". Read together, these two items clearly contemplate SIF #1 receiving financing as opposed to providing it.

[130] None of the other items in the broader list of all services to be provided by SIF Inc. to SIF #1, including the eight relating to installations that will be acquired and that are currently operating, could conceivably oblige SIF Inc. to provide consultative, development or administrative services in respect of SIF #1 lending money. Such an obligation would not necessarily have to exist in the management agreement, so we attribute less weight to its absence than we do to the earlier-mentioned provisions. Nevertheless, its absence does support Staff's proposed interpretation of "financing".

[131] *Other uses of the word "financing" in the offering memorandum* – The word "financing" is used elsewhere in the offering memorandum, apart from the ambiguous phrase "the acquisition, development, financing and operation of Installations". For example, the offering memorandum contains a warning that "alternative financing" may be necessary to accomplish all SIF #1's objectives if the offering does not raise sufficient funds.[35]

[132] Mr. Grossman was asked on cross-examination to identify any occurrences of the word in the offering memorandum that could mean lending as opposed to borrowing. He was given several days to locate any occurrences but could not. This fact supports Staff's proposed interpretation of the word.

[133] *No reference in the offering memorandum to interest income* – In all the discussion of the inflow and outflow of funds, there is no reference to a projected contribution to be made by interest income on funds loaned. If funds were to be deployed by providing financing, one would expect to see the benefit of doing so, likely in the form of interest income. The absence of any such reference supports Staff's proposed interpretation of "financing".

[134] *No risk factors related to lending money* – The offering memorandum lists 25 "Risk Factors", each of which is a category of risks associated with SIF #1's business in general or the offering in particular. Some risk factors relate to solar

[34] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Offering Memorandum dated March 6, 2013 at pp 16-18

[35] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Offering Memorandum dated March 6, 2013 at p 11

installations, *e.g.*, seasonality and solar panel degradation. Others relate to unitholder rights, reliance on the manufacturer and installer, and on management, and other types of risk.

[135] Certain of the risks relate to financial concerns, including limited availability of working capital (because most of the proceeds would be used "to develop and operate" the installations), risks associated with tax consequences and currency exchange rates, and, significantly, risks associated with borrowing (*e.g.*, the availability of construction or term loans on acceptable terms).

[136] Enumerated risks relating to the lending of money are conspicuous by their absence. Many such risks exist for any lender, especially where, as here, the parties are related, funds are lent without collateral, and terms are indefinite. We would expect any issuer whose business is, in part, the lending of funds, to disclose these risks, among others. The fact that the SIF #1 offering memorandum does not strongly compels the conclusion that Staff's proposed interpretation of "financing" is correct.

[137] *General disclaimers* – The respondents also point to language in the offering memorandum that advises investors that:

a. "operations" may "differ materially from the forward looking statements in this Offering Memorandum"; and

b. the "risks and uncertainties" to which investors are exposed "include risks associated with the solar energy power generation business, financing, environmental and tax related risks."[36]

[138] These words are contained in the largely boilerplate language about forward looking statements generally, and the unpredictability of external factors. Permitting any issuer to depart from the use of funds described in an offering memorandum simply in reliance on language like this would be to open the door wide to unfettered changes without notice to investors. That approach is fundamentally at odds with the requirement of investor protection and the purpose of an offering memorandum. We reject it.

[139] *Financial statements* – A note to SIF #1's financial statements as at February 4, 2013 (a month prior to issuance of the offering memorandum), which are appended to the offering memorandum, describes the nature of SIF #1's operations. The note says that SIF #1 was formed "for the purpose of acquiring, developing and managing solar energy power generation installations." The note goes on to say that the "purpose of [SIF #1] is to invest in subsidiaries which will in turn invest in the acquisition, development, financing and operation of solar energy power installations."[37]

[140] These two parts of the note are almost entirely duplicative, except that: (i) the first part says it is SIF #1 will do the acquiring, developing and managing, while the second part says SIF #1's subsidiaries will do those things; and (ii) the second part mentions "financing" while the first part does not. Given that the financial statements are prepared by SIF #1's independent auditors, not SIF #1

[36] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Offering Memorandum dated March 6, 2013 at p 3

[37] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Offering Memorandum dated March 6, 2013 at p 44 of PDF

or its counsel, it appears that these largely duplicative descriptions are drawn from other documents already referred to above. We attribute no weight to this note in the financial statements.

[141] *The Whitewater loan* – The respondents highlight a reference in the "Recent Developments" section of the second amendment to a particular unsecured loan to be made by SIF #1. The respondents submit that the reference makes clear that lending money had been and was part of SIF #1's business. Careful scrutiny of this submission is warranted, and requires a review of transactions that led up to the loan:

a. in 2012, SIF Capital Inc., a corporation controlled by SIF Inc., began an offering of 10.75% debentures;

b. in October 2013, by which time SIF Capital Inc. had raised almost $8 million under the offering, SIF Capital Inc. sent a notice of redemption to the debenture holders, advising of its intention to redeem the entire principal amount of the debentures, plus accrued but unpaid interest, on January 15, 2014;

c. when Mr. Grossman signed the redemption notice, he knew that SIF Capital did not have the cash to do the redemption on its own;

d. Mr. Kadonoff also knew that SIF Capital had financial difficulty, in that it required funds in order to continue to pay its distributions;

e. in November 2013, Whitewater entered into an agreement with a contractor, by which the Whitewater project would be expanded;

f. by December 19, 2013, SIF #1 had agreed to:

   i. effective January 15, 2014, refinance SIF Capital's 10.75% debentures in exchange for a 9% debenture, in order for SIF Capital to "meet its distributions in the future"[38] in the absence of available third party lenders and, as Mr. Grossman agreed, to "ease the burden on SIF Capital"[39]; and

   ii. lend $900,000 to Whitewater, an operating solar facility and joint venture owned 80% by SIF Capital to expand production capacity of that project, an expansion made necessary (according to Mr. Kadonoff) in order to produce additional revenue to allow the joint venture to meet the new 9% debenture obligations;

g. on January 13, 2014, SIF #1 issued the second amendment to the offering memorandum, which amendment referred to SIF #1's intention to make the $900,000 loan;

h. despite the language in the second amendment about the intention to make the loan, by January 13, 2014, SIF #1 had already transferred to Whitewater $600,000 of what would by December 23, 2014, total $965,000

[38] Exhibit 2, Memorandum to File dated December 19, 2013 at p 4-5
[39] Hearing Transcript, Solar Income Fund (Re), March 31, 2021 at 51 lines 22-23

i. on January 15, 2014, SIF #1 loaned $8 million to SIF Capital to redeem the debentures, with the rate set at 9%.

[142] We review this series of events not because the propriety of any of the transactions is at issue, but in order to put into context the respondents' submission that by the time of the second amendment, it was apparent to investors that SIF #1 was engaged in financing in the form of lending funds. It is clear that SIF #1 funds were used to come to SIF Capital's rescue, and that commitments to do so had been made even before the second amendment was issued.

[143] In our view, the fact that the respondents chose at the time to adopt an interpretation of "financing" that allowed them to effect this rescue is neutral on the question of how the word should be interpreted in the operative provisions of the offering memorandum.

[144] Further, by the time SIF #1 acquired a 20% interest in Whitewater, SIF #1 had advanced $750,000 to Whitewater. Therefore, at the time of those advances, Whitewater was not a subsidiary of SIF #1, contrary to the limiting provision in the offering memorandum's description of SIF #1's business.

[145] *Summary* – We summarize the relevant provisions of the offering memorandum as follows:

a. the only provision that supports the respondents' proposed interpretation of "financing" is the reference to SIF #1 investing in subsidiaries that would in turn "invest in… financing"; and

b. the promised use of funds, the timeline for deployment of funds raised and borrowed, the silence of the management agreement about any lending by SIF #1, and particularly the absence of any risk factors related to lending or any mention in the offering memorandum of interest income (two notable absences on which we place great weight), all support Staff's proposed interpretation.

iii. Testimony

[146] Having concluded our analysis of relevant provisions of the offering memorandum, we turn to consider testimony at the hearing that relates to this issue.

[147] Margaret Nelligan, one of the two Aird & Berlis partners principally responsible for providing legal services to SIF Inc., testified that when the phrase "acquisition, development, financing and operation of solar power installations" was drafted as part of the offering memorandum, SIF Inc. management and Aird & Berlis did not discuss "this".[40] It is unclear from Ms. Nelligan's answer whether the "this" to which she referred was the phrase itself or a possible desire by SIF Inc. management to be able to lend money directly to "third party corporations".

[148] When asked whether SIF Inc. management told Aird & Berlis at the time that management would like to be able to lend money to limited partnerships "that they didn't own", Ms. Nelligan confirmed that management did not do so.

[40] Hearing Transcript, Solar Income Fund (Re), April 22, 2021 at 69-70

[149] Staff describes these answers as a concession by Ms. Nelligan that when SIF #1 was formed, "no one specifically contemplated that it would lend funds as part of its business."[41]

[150] Similarly, Staff cites an answer that Mr. Grossman gave while being cross-examined about instructions that he gave Aird & Berlis around the time the offering memorandum was being prepared. Staff asked Mr. Grossman whether he gave Aird & Berlis any reason to believe that he wanted to be able to "lend money to other unowned entities with no collateral". Mr. Grossman's response was: "I don't think we said that specifically. But I said we wanted to have the ability to invest and finance the solar projects."[42]

[151] Staff says that this answer, like Ms. Nelligan's, was a concession by Mr. Grossman that when SIF #1 was formed, "no one specifically contemplated that it would lend funds as part of its business."

[152] We do not read either Ms. Nelligan's or Mr. Grossman's answers as supporting that broad statement.

[153] Ms. Nelligan's answers were about loans to "third party corporations" and limited partnerships that "they didn't own".[43] It is unclear that these questions as phrased would include SIF #2 (which is not a corporation that "they" owned, depending on who "they" is). The answers certainly do not go so far as to support a statement that no one contemplated that SIF #1 would do any lending.

[154] The question to Mr. Grossman that drew his answer was limited to lending money to unowned entities, and with no collateral. Mr. Grossman confirmed that those specific instructions were not given. He maintained that the SIF Inc. management group's desire was to be able "to invest and finance the solar projects." Again, this answer does not support Staff's characterization.

[155] To summarize our review of the relevant oral testimony, we heard nothing in the above that persuades us one way or the other about any of the respondents' understanding at the time the offering memorandum was being drafted as to whether the word "financing" permitted loans from SIF #1 to SIF #2 for the purpose of paying dealer fees or SIF #2 distributions.

[156] While we heard no oral testimony that influences our view on this specific issue, Mr. Grossman did, in his affidavit, shed some light on what SIF Inc. contemplated at the time the offering memorandum was prepared. He states that "[b]eginning in the summer of 2014" (more than a year after the issuance of the offering memorandum), SIF Inc. sought Aird & Berlis's advice about whether SIF #1 could lend funds to other entities managed by SIF Inc. "to finance solar projects". Mr. Grossman explains that this happened because SIF #1 had a surplus of cash and was seeking higher returns than it had been obtaining.[44]

[157] What was in SIF Inc.'s corporate "mind" at the time the offering memorandum was prepared (or one year later) is not determinative of how a reasonable

[41] Written Submissions of Staff of the Ontario Securities Commission dated June 4, 2021, para 371
[42] Hearing Transcript, Solar Income Fund (Re), March 29, 2021 at 88 lines 21-23
[43] Hearing Transcript, Solar Income Fund (Re), April 22, 2021 at 70 lines 2-12
[44] Exhibit 35, Affidavit of Allan Grossman, affirmed March 26, 2021 at para 77

investor would read that document. However, Mr. Grossman's explanation corroborates Ms. Nelligan's testimony and reinforces the inference that even SIF Inc.'s principals did not originally consider that the SIF #1 offering memorandum contemplated SIF #1 lending money to other SIF Inc.-managed entities.

iv. Concession by Mr. Grossman

[158] In his cross-examination, Mr. Grossman agreed that loans "from SIF #1 to SIF #2 to make distributions to SIF #2 investors is not financing a solar installation".[45] This was truly a concession, not necessarily that such loans were unauthorized, but that the word "financing" in the offering memorandum could not be relied on to support them.

[159] We believe that this admission against interest accurately reflects Mr. Grossman's true state of mind. We accord it significant weight, despite:

a. the respondents' joint submission that SIF #2's payments of distributions to its investors and fees to its exempt market dealers were permitted by the SIF #2 offering memorandum (as opposed to the SIF #1 offering memorandum) and were legitimate business purposes of SIF #2, a question that is not before us and that is distinct from the question of whether the transfers from SIF #1 to SIF #2 for these purposes were authorized;

b. Mr. Grossman's submission that funds transferred by SIF #1 for the impugned purposes "were not diverted to a purpose unrelated to a business in the solar industry or otherwise used to enrich any of the Respondents personally", a factual assertion that even if true does not reflect the test for whether the diversion was authorized, given the language of the offering memorandum; and

c. the respondents' unfounded attempt to minimize the admission's importance by distinguishing the factual background of this case from that of other cases.[46]

v. Conclusion on the question of whether the impugned uses of SIF #1's funds were authorized

[160] We conclude our analysis by noting the obvious; that the ambiguity in the pivotal language of the offering memorandum is unfortunate. However, the only reason we have found to justify interpreting "financing" in favour of the respondents (the words "invest in… financing") is overwhelmed by the many reasons not to. Viewed from the perspective of a reasonable investor reading the offering memorandum, the respondents' position cannot be sustained.

[161] The offering memorandum paints a clear overall picture of an entity that is not only raising funds, but borrowing significant funds as well; in fact, a multiple of the funds to be raised through the offering. It was doing so in order to acquire, develop and operate solar installations.

[162] A suggestion that SIF #1 would also be engaged in lending money comes only after microscopic scrutiny of one phrase in the entire offering memorandum. The

[45] Hearing Transcript, Solar Income Fund (Re), April 1, 2021 at 72 lines 19-22
[46] *Zlatic; Hibbert (Re)*, 2012 ONSEC 11, (2012) 35 OSCB 8583

explanation that the phrase permits lending, without any of the ancillary language one would reasonably expect to see in the offering memorandum, is decidedly inferior to the more reasonable explanation, that lending is not contemplated. Instead, an inartful and aberrant phrase is used, intended to mean, but not saying clearly, that SIF #1 may need to obtain financing to support the acquisition, development and operation of solar installations.

[163] In our view, that conclusion is compelling. It was unreasonable for the respondents to rely on that language for the purposes of paying dealer fees and distributions of another fund. Even if "financing" in the offering memorandum included lending, which we have concluded it did not, neither of those two purposes could reasonably be said to be closely related to acquisition, development and operation of a solar installation. The offering memorandum did not authorize a loan, or diversion of funds, for either purpose.

[164] Before leaving this topic, we repeat our earlier comment that we reach all our conclusions in this case without reference to the commercial reasonableness of any of the transactions, including the prospect of repayment of any loan.

[165] Repeating that caution is necessary because Staff, in its reply submissions, asserts that the prospect of repayment is directly relevant to whether a loan could properly be considered "financing". While Staff's submission is not framed in terms of "commercial reasonableness", the two are inextricable. Staff essentially submits that the farther the terms of a loan are from what would be considered commercially reasonable, the less likely the loan would be considered by a reasonable investor to be financing. Such an allegation would have to have been particularized in the Statement of Allegations. It would be improper for us to consider this submission, given:

a. the absence of any allegation in the Statement of Allegations tying the prospect of repayment to "financing";

b. the Commission's previous decision in this proceeding about Staff's proposed expert; and

c. the respondents' undertaking not to lead or elicit evidence, or make any submission, about the soundness of any allocation of funds.

3. Was there a deprivation caused by the dishonest act, *i.e.*, the unauthorized diversion of funds?

[166] We have found the diversion of funds to pay dealer fees and distributions to have been unauthorized and therefore dishonest. We turn now to consider whether that diversion caused a deprivation.

[167] We begin by reviewing the specific allegation in the Statement of Allegations. At paragraph 10, Staff alleges that "by causing SIF #2 to pay exempt market dealer fees and distributions to SIF #2 investors using SIF #1 funds, Grossman, Mazzacato and SIF Inc. engaged in conduct that they knew or ought to have known perpetrated a fraud, and deprived SIF #1 investors of their capital and/or put their capital at risk."

[168] We have two comments about this allegation. First, while it excludes Mr. Kadonoff, the exclusion is inconsequential, since the allegation is essentially repeated in paragraph 65(c) of the Statement of Allegations. In that allegation, Mr. Kadonoff is included.

[169] Second, the respondents submit that for the fraud allegation, there is an important distinction between SIF #1's own capital and the SIF #1 investors' capital. While there clearly is a difference between the two, we do not accept that anything flows from that difference in this case. Staff's allegation is that the respondents, by their conduct, deprived SIF #1 investors of their capital and/or put their capital at risk.

[170] The respondents submit that there was no evidence that the loans to SIF #2 increased the risk to SIF #1 investors to a level greater than if the funds had been similarly deployed within SIF #1.

[171] The respondents are correct in their statement that we heard no such evidence. However, there was no need to. As the respondents acknowledge in their submissions, a risk of prejudice to economic interests causes a deprivation,[47] and that risk of prejudice can be established where investors are induced, by dishonest means, to purchase or hold an investment, even if doing so causes no actual economic loss.[48] Accordingly, we are not required to engage in an assessment of the relative risks of the authorized use of funds and the unauthorized use of funds.

[172] There is a causal link between a diversion of invested funds like the one that occurred in this case, and a risk of prejudice to those funds. In these circumstances, the investors unwittingly took on risks they did not bargain for.

[173] We do not accept the respondents' contention that the risks borne by the SIF #1 investors following the impugned transfers were precisely those they had already bargained for. The respondents base that submission on their characterization of those risks as "those related to the ability to earn a return on solar projects". That description is generic and superficial, it fails to take account of the many different risks that contribute to a return, and it fails to take account of the significance of risks that may be different in degree, not only in kind.

[174] Whether those different risks would ultimately turn out to be neutral, or to the investors' benefit or their detriment, is not determinative. It should have been for the investors, not the respondents, to evaluate the relative merits of the promised uses of the funds and uses other than those promised.[49]

[175] We therefore conclude that the unauthorized diversion of funds resulted in a deprivation of the SIF #1 investors' funds, by causing a risk of prejudice to those funds and to the investors' interests.

[176] Because of the causal link between the diversion and a risk of prejudice, and because Staff relies here on "other fraudulent means" (*e.g.*, unauthorized diversion of funds) as opposed to falsehood or deceit, Staff need not prove that investors actually relied on the act that proved to be dishonest.[50] Staff has proven the dishonest act undertaken voluntarily by the respondents, and a deprivation caused by that dishonest act. Staff has therefore established the *actus reus* elements of its fraud allegations.

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[47] *Théroux* at para 13
[48] *Quadrexx* at para 21
[49] *Re Borealis International Inc.,* 2011 ONSEC 2, (2011) 34 OSCB 777 at para 108
[50] *R v Riesberry*, 2015 SCC 65 at para 26

4. Subject to their defence of reasonable reliance on legal advice, did each respondent have subjective knowledge of the fraudulent act?

(a) Introduction

[177] We turn to consider the mental element of the fraud allegations, which is established where: one is subjectively aware that (i) they are undertaking a prohibited act; and (ii) the prohibited act could cause deprivation.[51]

[178] Staff need not show that a respondent regarded the act as dishonest. In the case of a dishonest means (*e.g.*, unauthorized diversion of funds), subjective awareness of the prohibited act is proven where the person knowingly undertook the act. It is not necessary to prove that they knew that the act was prohibited.[52]

[179] We begin our analysis of the mental element with the first of the two elements mentioned above, *i.e.*, whether the respondent was subjectively aware that they were undertaking a prohibited act. We will review the circumstances relevant to each respondent and then, before concluding on this first component, consider whether the legal advice provided by Aird & Berlis to the respondents affects our conclusions.

[180] As we consider each respondent individually, we bear in mind that subjective awareness may be established by showing recklessness.[53] If one is aware that there is danger that their conduct could bring about the prohibited result, but persists despite the risk, that person is reckless and that subjective element is proved.[54]

[181] We also highlight the words "reasonably ought to know" in s. 126.1(1). This constructive knowledge principle makes clear that Staff may prove the element of knowledge of the fraudulent act by establishing that the respondent reasonably ought to have known that the impugned act, practice or course of conduct perpetrates a fraud. The Commission has previously[55] adopted the reasoning of the British Columbia Court of Appeal, which held in the context of the corresponding provision in the British Columbia statute that the words "reasonably ought to know" bring within the provision those who engage in a course of conduct and ought reasonably to know that a fraud is being perpetrated by others.[56]

[182] Staff and the respondents approach the import of those words differently. The respondents note that the *Natural Bee Works* decision of the Commission, on which Staff relies, applies the "reasonably ought to have known" standard to those who participate in the same "scheme" as an individual found to have perpetrated a fraud. The respondents imply, without saying as much, that the word "scheme" carries a more pejorative meaning and requires a greater degree of co-operation in the fraud than would be the case without that word. Whether

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[51] *Théroux* at para 21
[52] *Théroux* at para 22
[53] *Théroux* at para 25
[54] *Sansregret v The Queen*, [1985] 1 SCR 570
[55] *Re Bradon Technologies Ltd*, 2015 ONSEC 26, (2015) 38 OSCB 6763 at para 232 (***Bradon***); Re Natural Bee Works Apiaries, 2019 ONSEC 23, (2019) 42 O.S.C.B. 5905 at para 104 (***Natural Bee Works***)
[56] *Anderson v. British Columbia Securities Commission*, 2004 BCCA 7

or not that is a fair interpretation of the word "scheme", that submission does not assist the respondents. While *Natural Bee Works* happened to involve a "scheme" (as described by the Commission in its decision), we reject the respondents' submission that in that case the Commission noted that the constructive knowledge element applies only where there is a 'scheme'. We read nothing in the decision as limiting the application of the constructive knowledge standard to where a "scheme" exists.

[183] Neither the words of s. 126.1(1)(b) nor the words of the British Columbia Court of Appeal referred to above support the respondents' suggestion. Nor do those words undermine the principle, correctly submitted by the respondents, that Staff must prove a mental element for each participant in the fraud. The point is that under s. 126.1(1)(b), Staff need not prove that the particular respondent actually knew that the course of conduct was fraudulent; rather, Staff may prove the mental element by showing that the respondent reasonably ought to have known that the course of conduct in which the respondent is participating amounts to a fraud being perpetrated by one of the other participants.

[184] Finally, by way of introduction, we repeat the limits of Staff's fraud allegations. In its written submissions, Staff addresses in detail each respondent's knowledge of and involvement in the loans of funds from SIF #1 to SIF #2. Many of these submissions relate to the s. 44(2) allegations. In analyzing the fraud allegations, we confine ourselves to those payments relating to the payment of dealer fees and investor distributions, without reference to loans made for other purposes.

(b) Mr. Grossman

[185] With those principles in mind, we begin with Mr. Grossman.

[186] Mr. Grossman was SIF Inc.'s Chief Operating Officer from December 18, 2009, to May 15, 2014, its Chief Financial Officer from November 25, 2013, to June 10, 2014, and its Vice President Finance from May 15, 2014, onwards. He became a director of SIF Inc. on November 25, 2013. He was the only person who was a director and/or officer of SIF Inc. for the entire period of March 2013 to December 2016.

[187] Mr. Grossman agreed that an investor reading the offering memorandum would conclude that he was a directing mind of SIF Inc., and that there was nothing in the offering memorandum to suggest otherwise. We find that he was a directing mind of SIF Inc. throughout the period of March 2013 to December 2016.

[188] Mr. Grossman testified that the management committee authorized all of the transfers from SIF #1 to SIF #2, whether individually or as one or more groups of transactions. As a general matter, transfers were made from SIF #1 to SIF #2 whenever the need for money arose in SIF #2.

[189] Mr. Grossman admitted that he authorized the use of SIF #1 funds to pay SIF #2's dealer fees and distributions, and he did so to maintain the confidence of the SIF #2 investors and exempt market dealers. However, he explained that based on his own interpretation of the offering memorandum and advice he had earlier received from Aird & Berlis, he believed this was an authorized use of funds.

[190] We discuss the Aird & Berlis legal advice below. Mr. Grossman's mistaken interpretation of the offering memorandum is of no assistance to him. He is

bound by what the offering memorandum said and what it actually meant, not his interpretation at the time, an interpretation he now concedes was incorrect.

[191] Mr. Grossman authorized the transfers of funds for the unauthorized purposes, and knew that by doing so, SIF #1's funds (and by extension the funds of SIF #1 investors) were being subjected to risks not previously applicable to those funds. Staff has therefore proven, subject to the legal advice defence, that Mr. Grossman was subjectively aware of the fraudulent act.

[192] Because Mr. Grossman was a directing mind of SIF Inc., the company is deemed to have had subjective knowledge of the fraudulent act, subject to the legal advice defence.

(c) Mr. Mazzacato

[193] Staff submits that it is uncontroverted that Mr. Mazzacato was an owner and director of SIF Inc., a member of the management team, and a directing mind for all the impugned fraudulent transactions. Indeed, Mr. Mazzacato does not dispute this assertion in his submissions. He acknowledges that he became a member of SIF Inc.'s management team upon joining the company in May 2014, even though at the time he joined, he knew little to nothing about SIF #1 or how it worked (although he was aware that SIF Inc. was SIF #1's manager), but as time went on, he came to understand what SIF #1 and the offering memorandum were.

[194] Mr. Mazzacato also emphasizes that he had no prior experience with respect to the exempt market. He testified that he relied on Mr. Grossman and Mr. Kadonoff to advise him of the contents of the offering memorandum. Mr. Mazzacato took no independent steps to understand what the document contained.

[195] He testified that in the late summer of 2015, when Mr. Grossman and Mr. Kadonoff asked him to become SIF Inc.'s President, he was reluctant to take on the role because of his lack of education or expertise in financing, accounting or legal matters, and his lack of knowledge about the financial and legal aspects of SIF Inc.'s business. He states that Mr. Grossman and Mr. Kadonoff assured him that he could rely on them for those matters and continue to focus on project origination and the technical aspects of the business.

[196] From Mr. Mazzacato's perspective, he had no responsibilities beyond those. During the hearing, Mr. Mazzacato took pains to confine the subject areas over which he exercised oversight while he was President. However, he agreed that he had "ultimate responsibility" for ensuring that SIF #1 didn't do anything that was contrary to its offering memorandum.[57]

[197] Mr. Mazzacato signed many cheques transferring funds from SIF #1 to SIF #2. Two are relevant – one in December 2015 (referred to in paragraph [98] above) and one in February 2016, both on the operating trust account of SIF #1. The two cheques were payable to the SIF #2 operating trust and clearly showed that the payments were to cover SIF #2 distributions. However, he testified that he chose not to scrutinize the reasons for the funds transfers being effected by cheques he signed, because he relied on others.

[57] Hearing Transcript, Solar Income Fund (Re), April 8, 2021 at p91 line 25 to p92 line 2

[198] Similarly, he never reviewed detailed bank statements for any of the SIF Inc. entities, nor did he monitor the amounts that were flowing into the various bank accounts. On August 21, 2015, when he signed the amended and restated management agreement between SIF Inc. and SIF #1, he did not carefully review the three-page schedule that specified the services that SIF Inc. was to provide to SIF #1. Once more, he relied on Mr. Grossman and Mr. Kadonoff to advise him of anything he needed to know of a legal or financial nature.

[199] Mr. Mazzacato submits that he should benefit from the same consideration given to two of the respondents in the Commission's decision in *YBM Magnex International Inc*.[58] Like Mr. Mazzacato, those two respondents (Messrs. Antes and Greenwald, who were retired scientists) were not experienced in securities law or public financing. They were involved with the company because of their scientific expertise, experience and connections. Under the circumstances present in that case, the Commission found that it was reasonable for the two respondents to rely on counsel.[59]

[200] While Mr. Mazzacato's circumstances have some commonality with those of the two *YBM Magnex* respondents, the differences easily outweigh those similarities. Messrs. Antes and Greenwald were directors only, and not officers of the company, and the context of their reliance was the actions of a special committee of the board, a committee of which neither respondent was a member. In stark contrast, Mr. Mazzacato was an officer of SIF Inc. throughout his time with the company, a member of the senior management group that made decisions by consensus, president of the company for part of his tenure, and by his own admission ultimately responsible for SIF #1's compliance with the offering memorandum during that time.

[201] Further, the Commission in *YBM Magnex* found that the two respondent directors "took their duties as directors seriously".[60] They made efforts to engage with the areas, unfamiliar to them, that formed part of their responsibilities as directors. The Commission acknowledged the position that the two individuals found themselves in, including their lack of experience in the capital markets.

[202] Despite this, the Commission concluded that Mr. Antes (who was more involved in the company's affairs than Mr. Greenwald was, and who was an active member of the Audit Committee) ought to have challenged legal advice given about potential disclosure of a material change.[61] In other words, the position of director (or officer) brings with it certain responsibilities that cannot be escaped by asserting a limited expertise and experience.

[203] Mr. Mazzacato did not demonstrate any interest in going beyond his area of expertise, even when he was president of the company. He was content to stick to what he knew and to rely on others for everything else, despite the fact that he was ultimately responsible.

[204] Mr. Mazzacato states that in early 2016, he was generally aware that SIF #1 was lending money to SIF #2, including for development of one particular project. However, Mr. Mazzacato says that because he did not have day-to-day

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[58] (2003) 26 OSCB 5285 (***YBM Magnex***)
[59] *YBM Magnex* at paras 326, 332
[60] *YBM Magnex* at para 327
[61] *YBM Magnex* at paras 329, 551

responsibility for, or oversight of, financial matters at SIF Inc., SIF #1 or SIF #2, he was not aware of all circumstances relating to the loans.

[205] Mr. Mazzacato, in his affidavit, describes his understanding that SIF #1 was entitled to lend to SIF #2, and that SIF #2 was entitled to use those funds in accordance with the SIF #2 OM, which permitted the payment of dealer fees and investor distributions. Mr. Mazzacato explains that his understanding arose in the context of the decision to lend funds to SIF #2 in order to develop the project referred to in the preceding paragraph. Mr. Mazzacato says that he relied on assurances from Mr. Grossman and Mr. Kadonoff that SIF #1 could make these loans, and that they had obtained advice from Aird & Berlis regarding "all important matters".

[206] In his written submissions, Mr. Mazzacato challenges Staff's submission that he provided no support for his understanding as to the effect of the SIF #1 and SIF #2 offering memoranda. Mr. Mazzacato contends that Staff's submission is improper, because Staff did not cross-examine him on the point. We reject Mr. Mazzacato's submission, because Staff merely observes the absence of anything to corroborate his own testimony. In any event, though, nothing turns on it. Such a belief on Mr. Mazzacato's part would not constitute a defence to the allegation.

[207] With respect to exempt market dealers, Mr. Mazzacato states that he knew that SIF #2 had engaged various dealers, but he was not aware at the time that any fees were paid from any of the funds that SIF #1 loaned to SIF #2, although as stated above he believed such payments were permitted.

[208] Staff submits that this understanding is inconsistent with the SIF #1 offering memorandum and the purported advice received from Aird & Berlis.

[209] Staff asks us to reject Mr. Mazzacato's testimony about his lack of understanding and oversight, and participation in the decisions being made about the transfer of funds, because:

a. Mr. Mazzacato was an evasive witness who sought to minimize his involvement in the affairs of SIF Inc.;

b. Mr. Grossman testified that everyone on the management team authorized all transfers of cash from SIF #1 to SIF #2, and Mr. Grossman was not cross-examined on this point;

c. in a December 2017 written response to Staff's request for documents supporting authorization of transfers in 2013 to 2016, SIF Inc. described the management team as a "closed knit [*sic*] group" that had *ad hoc* meetings (without formal minutes) "all the time to make decisions", and stated that "the Board of Directors at the time was the group who authorized the transactions."[62]

[210] We do not accept Staff's characterization of Mr. Mazzacato as "evasive". Mr. Mazzacato answered questions directly. He did, however, consistently seek to minimize his involvement in SIF Inc.'s affairs.

[62] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Letter from Solar Income Fund enclosing response to November 10, 2017 Summons at p 3

[211] We weigh his testimony against the documentary evidence (including emails and cheques) and the testimony of the other principals. We conclude that it is more likely than not that Mr. Mazzacato sought then, as he does now, to limit his day-to-day activities to the areas in which he felt comfortable, *i.e.*, project origination and technical matters. Having said that, we also conclude that it is more likely than not that: (i) Mr. Mazzacato was present for, and participated in, discussions and decisions to a greater extent than he describes; and (ii) he had a greater understanding of the overall financial picture than his testimony would suggest.

[212] We have no doubt that at least in some measure, he deferred to Mr. Grossman and Mr. Kadonoff. But we do not accept that his deference excluded him from the decision-making process. It is apparent that he did not then, and does not now, fully appreciate the obligations that come with being a director and officer of a company that, through the related entities that it managed, raised funds from the public.

[213] Mr. Mazzacato was a directing mind of SIF Inc. from the time he joined the company in 2014. He is correct in saying that he had ultimate responsibility.

[214] It was not sufficient for him to abdicate that responsibility. One need not be expert in legal or financial matters to question whether it is appropriate to use the money raised from the public in one fund to pay distributions to investors in another fund, at a time when, to everyone's knowledge, the latter fund had insufficient cash to pay those distributions. We accept that someone with Mr. Mazzacato's background would not have a deep understanding of the competing principles at play, but the situation ought to have been a red flag for Mr. Mazzacato. As President with ultimate responsibility, the red flag should have prompted him to exercise some independent oversight regarding the legal advice that he says he understood had been obtained. Mr. Mazzacato took no such steps.

[215] Given his position, even if Mr. Mazzacato did not know that the transfer of funds for the impugned purposes was unauthorized, he was reckless about that, and he reasonably ought to have known. Staff has therefore successfully established that mental element, subject to the legal advice defence.

(d) Mr. Kadonoff

[216] During the summer of 2015, at the beginning of the ten-month period that is the subject of Staff's financial analysis in support of the fraud allegation (see paragraph [96] above), Mr. Kadonoff was the interim President of SIF Inc. He had previously been Vice President and General Counsel and had become a registered director and officer on June 10, 2014. This step did not significantly change his role at SIF Inc., although he states that while he "had a voice before", these new responsibilities gave him "a different voice", and he was "definitely involved in decision-making… from that point on."[63]

[217] Mr. Kadonoff testifies that Mr. Grossman was generally responsible for the financial aspects of SIF Inc. and the entities under SIF Inc.'s management. We accept that characterization. Mr. Kadonoff does concede, though, that when he

[63] Exhibit 38, Kadonoff Affidavit at para 24; Hearing Transcript, Solar Income Fund (Re), April 1, 2021 at 110 lines 22-25

became interim President in May 2015, his level of involvement in management increased. We have no difficulty concluding that Mr. Kadonoff was a directing mind of SIF Inc. from at least May 2015.

[218] While he testified that he did not focus on the source of funds used to pay the distributions, he states his belief that none of the funds used for distributions came from SIF #1 investor funds.

[219] Mr. Kadonoff described his involvement in SIF Inc.'s financial affairs as "extremely limited". He testified that he did not pay attention to the financial statements unless there was a problem or concern with them. He testified that he was "quite excluded" from the financial aspects at SIF Inc., but we interpret the word "excluded" to mean that he chose not to participate, as opposed to having his efforts to participate rebuffed. As Mr. Kadonoff himself explained:

> I didn't have an interest in it… both Paul [Ghezzi] and Allan [Grossman] were chartered accountants. There was, frankly, nothing I could add that – no value I could add to any of the conversations they were having on analysis, financial analysis, financial statements, any of that stuff. I trusted, I trusted them both in terms of taking care of the financial aspects of the business.[64]

[220] Whatever the extent of Mr. Kadonoff's obligation to familiarize himself with financial matters may be, it is clear that he chose not to do so. Further, the fact that Mr. Grossman was primarily responsible for financial matters does not preclude involvement by others or, more importantly, an obligation on others to have some degree of familiarity, especially when a management decision is made to effect a transaction.

[221] Staff submits that despite Mr. Kadonoff's denials, he must have known that the SIF #2 distribution payments in June, July and August 2015 were funded by loans from SIF #1:

a. on June 2/15 he signed a SIF #1 cheque for $530,000 payable to SIF #2; and

b. he knew that SIF #2:

   i. had stopped raising funds from investors in the spring of 2015 and did not resume that summer;

   ii. had not yet obtained any loans that could be used for distribution payments; and

   iii. was not generating any revenue because the project referred to above, SIF #2's only project, was under development and not yet operating.

[222] Staff does not allege that the $530,000 cheque signed by Mr. Kadonoff was specifically targeted for the payment of SIF #2 distributions. Indeed, Mr. Kadonoff submits that this amount did not pass through the SIF #2 account from which distributions were being paid. In reply, Staff did not contest this submission. Instead, Staff cites this payment in support of the proposition that

[64] Hearing Transcript, Solar Income Fund (Re), April 1, 2021 at 104 lines 21-28

Mr. Kadonoff was generally aware of SIF #2's financial situation (for the reasons listed above), and that money was being lent by SIF #1 to SIF #2 during that period.

[223] Mr. Kadonoff also testified that Mr. Grossman told him that the necessary funds originated in a loan that had been made from CPE Inc. to SIF #2. Staff asks us to reject this explanation, given Mr. Kadonoff's concession that he did not know at the time precisely when the loan was made or how much CPE Inc. was advancing. In fact, the CPE Inc. loan was for $51,500, which was a small fraction of the total amount transferred from SIF #1 to SIF #2 that summer, and less than one quarter of the total distributions paid to SIF #2 investors during that period.

[224] Mr. Kadonoff resigned on August 31, 2015, but continued some limited involvement in SIF Inc., partly because he retained signing authority on the bank account, and that authority had not yet been transferred to someone else.

[225] On September 1, 2015, Mr. Kadonoff wrote an email to a number of people, including Mr. Mazzacato and Mr. Grossman. In that email, Mr. Kadonoff relayed concerns from SIF Inc.'s then-CFO that SIF #2 did "not have the cash to pay distributions." Mr. Kadonoff said that he was "not comfortable borrowing funds from [SIF #1] for this purpose." He recommended that SIF #2 unitholders be advised that distributions could not be paid until additional funds were raised.[65]

[226] Soon after sending that email, and despite his concerns, Mr. Kadonoff signed a cheque for August distributions. Mr. Kadonoff says that he must have had discussions with one or more of Mr. Grossman, the CFO, the controller or others in accounting, in which he received comfort that there were sufficient funds. He also relied on a discussion he had with one of the Aird & Berlis lawyers (who had been copied on his September 1 email) about his concerns. Mr. Kadonoff says that in that discussion, he heard no advice that it would be improper to use loaned funds to pay distributions.

[227] Mr. Kadonoff submits that with respect to the impugned transactions in July and August of 2015, while he was an officer and director, and before he began objecting to the transfers, Staff has not proven that he approved the transactions or knew that they were occurring or inappropriate.

[228] In response, Staff emphasizes that by his own admission, Mr. Kadonoff failed to focus on or to investigate the source of funds used to make distributions. Staff relies on these concessions in support of its submission that Mr. Kadonoff was reckless or wilfully blind. Staff also cites a portion of Mr. Kadonoff's testimony in which he described his involvement in the financial areas of the firm as being "extremely limited", and "if they didn't bring up a question, I wasn't asking."[66] However, that answer specifically relates to the time period before June 2014, more than one year prior to the period during which Staff alleges that Mr. Kadonoff was complicit in using SIF #1 funds to pay SIF #2 distributions. We reject Staff's invitation to link the two.

[229] Staff also points out that Mr. Kadonoff did not ask questions about the fact that SIF #2 was making payments for marketing services in July and August of 2015.

[65] Exhibit 38, Kadonoff Affidavit, Tab 69
[66] Hearing Transcript, Solar Income Fund (Re), April 1, 2021 at 105 lines 16-18

As we concluded above, the payments for marketing services are not properly the subject of Staff's fraud allegations. However, Mr. Kadonoff's inaction with respect to them reinforces his own contention that he paid little attention to financial matters at the firm.

[230] There is a troublesome similarity between Mr. Kadonoff's characterization of his obligations as President and that of Mr. Mazzacato. SIF Inc. was a small company with just a few members of senior management. We find it implausible that Mr. Grossman was left to manage, on his own, the financial affairs of SIF Inc. and entities it managed, and that two Presidents in a row chose to ignore even high-level indicators of the financial health of the business.

[231] We find that it is more likely than not that Mr. Kadonoff understood the overall financial picture, and that he knew funds were being transferred from SIF #1 to SIF #2 to pay whatever obligations SIF #2 had. As Staff correctly observes, during the summer of 2015, SIF #2 was no longer raising funds, had not obtained any loans that could be used to fund distributions, and was not earning any revenue.

[232] SIF #2's suspension of the capital raise was caused by Ms. Jackson identifying concerns about SIF Inc.'s accounting and record-keeping. Mr. Kadonoff supported Ms. Jackson's request that SIF Inc. retain a forensic accounting firm to conduct a preliminary investigation. The investigation resulted in no findings of negligence or misconduct, but SIF #2's situation caused significant turmoil, including the temporary exclusion of Mr. Grossman and some accounting staff from SIF Inc.'s office. There can be no doubt that SIF #2's need for funds was prominent for all of the individual respondents.

[233] After his resignation, Mr. Kadonoff briefly retained signing authority, until that was fully transferred to Mr. Mazzacato. Mr. Kadonoff continued to work as a consultant for SIF Inc. until February 16, 2016, so that he could complete financing transactions for SIF #1 and SIF #2. His relationship with SIF Inc. during this period was governed by the original retainer agreement entered into in mid-2011, although Mr. Kadonoff drafted a revised consulting agreement reflecting his narrow responsibilities, an agreement that Mr. Mazzacato refused to sign.

[234] In early October 2015, Mr. Kadonoff met with Mr. Grossman and Mr. Mazzacato to discuss, among other things, Mr. Kadonoff's view that unitholder distributions to SIF #2 investors should stop until SIF #2 could resume fundraising. Mr. Grossman and Mr. Mazzacato rejected this advice and advised that distributions would continue.

[235] Mr. Kadonoff wrote to Mr. Mazzacato and Mr. Grossman to express his opposition, stating that in his view "the distribution should not be made".[67]

[236] Mr. Kadonoff submits that he was clearly not part of any consensus decision-making after August 31, 2015. His involvement with SIF Inc. continued only until he could close a SIF #1 loan from a third-party lender in November 2015 and could help secure additional financing from that lender for SIF #2 in January 2016. Mr. Kadonoff's services were terminated in mid-February 2016.

[67] Exhibit 38, Kadonoff Affidavit, para 127, footnote 72

[237] Mr. Kadonoff was right to raise concerns in September 2015 about SIF #1 lending funds to SIF #2 to pay distributions, although it is unclear precisely what motivated him to raise those concerns, and it is troubling that he signed the cheque for August distributions. Mr. Kadonoff is vague about comfort that he might have obtained to support his decision. Because a reasonable inquiry would have revealed that exactly what Mr. Kadonoff had feared was indeed happening, we cannot accept his wishful assertion that he relied on others to justify his signing the cheque.

[238] We find that Mr. Kadonoff was a directing mind of SIF Inc. until September 14, 2015, the date on which he authorized the cheque to pay the August distributions. We therefore conclude that Mr. Kadonoff was at least reckless, if not aware of, the fraudulent act. Staff has established that mental element, subject to the legal advice defence, to which we now turn.

5. Is the defence of reasonable reliance on legal advice available to the respondents on the facts of this case?

(a) Introduction

[239] We will now review the defence of reasonable reliance on legal advice and consider whether it is available to the respondents on the facts of this case.

[240] The defence is available in a Commission proceeding in respect of an allegation that requires Staff to establish an intentional or wilful act.[68] An allegation of fraud contrary to the Act falls into that category. The defence is therefore available, subject to a respondent satisfying the criteria for its use.

[241] Subsection 126.1(1) of the Act does not provide for a due diligence defence, and under these circumstances none is available. Instead, a respondent who asserts the defence must establish that:

a. the lawyer had sufficient knowledge of the facts on which to base the advice;

b. the lawyer was qualified to give the advice;

c. the advice was credible given the circumstances under which it was given; and

d. the respondent made sufficient enquiries and relied on the advice.[69]

[242] The last of these four components has a due diligence aspect to it, and even though the defence in this context is not a true due diligence defence, diligence on the part of the respondent asserting the defence may play a role both in the assessment of the mental element at the merits stage and as a potential mitigating factor at the sanctions stage (if any) of a proceeding.[70]

[243] In order to show actual reliance on the advice, as is required by the fourth criterion, the respondent must show that the advice was sufficiently clear, specific and connected to the impugned act, by addressing the question raised

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[68] *Re Crown Hill Capital Corp*, 2013 ONSEC 32, (2013) 36 OSCB 8721 at para 150, aff'd *Pushka v Ontario (Securities Commission)*, 2016 ONSC 3041 (***Crown Hill***)

[69] *Phillips* at para 212; *Re Mega-C Power Corp*, 2010 ONSEC 19, (2010) 33 OSCB 8290 at para 261 (***Mega-C***)

[70] *Re Aitkens*, 2018 ABASC 27 at para 72

by that impugned act.[71] The advice need not necessarily be in contemplation of a single instance or transaction, but on the other hand it cannot be so broad or vague as to preclude reasonable reliance.

[244] With that legal background, we now consider whether the facts of this case support the availability of the defence for the respondents. We will then review the involvement of each individual respondent in the subject communications.

(b) Overall characterization of the advice given

[245] Aird & Berlis's client was SIF Inc., not the individual respondents. As a result, we focus on advice that Aird & Berlis provided to SIF Inc., no matter to which individual or individuals it was communicated.

[246] Staff and the respondents adopt starkly different characterizations of the legal advice that the respondents obtained from Aird & Berlis. Staff submits that the respondents and their counsel all conceded that the respondents never received specific legal advice on the permissibility of the various impugned transactions in this case. The respondents submit that Ms. Nelligan's evidence was that the respondents "sought and received advice on the very issue at the heart of the case – whether it was permissible for SIF1 to lend money to related or third party entities."[72]

[247] The apparent contradiction between Staff's assertion that the respondents conceded the point and the respondents' assertion that the evidence shows they received advice on the central issue can be explained by noting the difference in the way the parties describe the issue about which advice was sought. This difference is critical as we analyze the availability of the defence.

[248] Staff and the respondents agree that the advice related to the permissibility of SIF #1 lending money to SIF #2. However, in their characterization of the issue, the respondents stop there. In so doing, they fail to embrace the pivotal element of Staff's fraud allegations – whether the loans were made for permissible purposes.

[249] We agree with Staff's framing of the issue. The Statement of Allegations does not allege that no loans from SIF #1 to SIF #2 would be permissible. The allegation is that loans made for the purpose of paying dealer fees or distributions to SIF #2 investors would be impermissible. Staff submits that if advice was not received about this narrower issue, the defence of reliance on legal advice is unavailable, because the respondents cannot demonstrate that they fully complied with the fourth criterion above, *i.e.*, that they reasonably relied on advice that squarely addressed the issue presented.

[250] A close examination of the advice given is therefore required.

(c) Evidence about the advice sought and received

[251] In testifying about the advice she gave, Ms. Nelligan of Aird & Berlis distinguished between SIF #1's offering memorandum and the declaration of trust. She emphasized that in giving advice about what SIF #1 was permitted to

[71] *Crown Hill* at para 606; *Re CTC Crown Technologies* (1998), 8 ASCS 1940 at p8

[72] Joint Written Submissions of Solar Income Fund Inc., Allan Grossman, Charles Mazzacato, and Kenneth Kadonoff, dated June 25, 2021 at para 17

do, she would refer to the declaration of trust (and not the offering memorandum), since the declaration of trust is the constating document.

[252] Ms. Nelligan testified that the offering memorandum summarizes the declaration of trust, but that it also contains elements not present in the declaration of trust, specifically a description of the short- and long-term goals of the SIF #1 trusts. She further testified that in assessing the propriety of proposed payments by SIF #1 for proposed investments, she would do so with reference to two components: (i) mutual fund trust rules; and (ii) the declaration of trust, and related considerations under general trust law.

[253] It is noteworthy that neither component refers to the offering memorandum or to Ontario securities law.

[254] In the summer of 2014, Mr. Kadonoff corresponded with Anne Miatello, the other partner at Aird & Berlis who was principally responsible for providing legal services to SIF Inc. (and who was then known as Anne Markle; we will refer to her throughout as Ms. Miatello). On June 25, Mr. Kadonoff wrote to her, saying that based on his reading of a provision of the SIF #1 offering memorandum, SIF #1 could "lend money for financing third party solar deals (including other SIF LPs) as an ancillary activity without acquiring the asset." He then asked whether she agreed with his conclusion that "acting as a short term lender (i.e. less than 1 year) is permitted."[73]

[255] On July 3, Ms. Miatello replied. The entire relevant portion of her email said: "I've looked at both declarations of trust. The operating trust can lend funds for financing solar deals to the LPs or unrelated entities. The MFT should not lend the money."[74]

[256] Ms. Nelligan testified that Ms. Miatello brought the question to her when Mr. Kadonoff asked it, that they discussed how to respond, and that Ms. Nelligan reviewed the reply before Ms. Miatello sent it.

[257] Ms. Nelligan explained that the reply's distinction between the operating trust and the mutual fund trust was to ensure compliance with the federal *Income Tax Act*.[75] She explicitly confirmed that Aird & Berlis did not consider the offering memorandum in giving the advice.

[258] Again, it is noteworthy that Ms. Miatello's reply does not refer to the offering memorandum, despite the fact that Mr. Kadonoff's question of Ms. Miatello referred to the offering memorandum and not the declarations of trust. We return below to this important misalignment of question and answer.

[259] The individual respondents rely heavily on the Aird & Berlis reply:

a. In his affidavit, Mr. Kadonoff describes Ms. Miatello's reply as having advised that SIF #1's operating trust could lend funds to other entities for solar deals (the acquisition, development, operation or financing of solar projects). In his oral testimony, Mr. Kadonoff's description was less limiting – he said that Ms. Miatello was opining that SIF #1 could make

[73] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Emails between Allan Grossman, Ken Kadonoff, Jennifer Jackson, Charles Mazzacato and Anne Markle Re: MFT as a lender at p 1

[74] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Emails between Allan Grossman, Ken Kadonoff, Jennifer Jackson, Charles Mazzacato and Anne Markle Re: MFT as a lender at p 2

[75] RSC, 1985, c 1 (5th Supp)

loans "really unconditionally" and without restriction as to the identity of the borrower, as long as the money came out of the operating trust.[76]

Mr. Kadonoff further reports his second-hand understanding that in the fall of 2014, Aird & Berlis specifically confirmed the permissibility of short-term loans from SIF #1 to SIF #2 that were associated with the financing of solar projects.

b. In his affidavit, Mr. Mazzacato sets out his similar understanding. He also states that in September 2014, Mr. Kadonoff sought and obtained advice from Aird & Berlis about a proposed loan by SIF #1 to a related limited partnership for purposes of financing a solar project. Aird & Berlis gave advice and provided draft language setting out the terms.

c. On direct examination by his counsel, Mr. Grossman described the reply from Aird & Berlis as having given "carte blanche on lending funds". When cross-examined, Mr. Grossman apologized for that choice of words, but agreed with the suggestion that he believed that the Aird & Berlis reply confirmed an unlimited opportunity to lend money from SIF #1 to other entities, as long as that was done through the operating trust.

[260] The respondents' description of the Aird & Berlis advice as being unrestricted permission, subject only to the funds coming out of the operating trust as opposed to the mutual fund trust, is at odds with the text of Ms. Miatello's email, for two reasons.

[261] First, that text clearly states that loans must be "for financing solar deals", and that the advice is based on her review of the declarations of trust. We note Ms. Nelligan's testimony that Aird & Berlis was never asked for, and never provided, advice about whether that phrase could encompass any specific kinds of transactions. In particular, Aird & Berlis did not provide advice about whether loans to permit payment of distributions, or loans to permit payment of dealer fees, would constitute financing of a solar deal. Given that the ordinary meaning of the words "financing solar deals" would not include the payment of distributions at least, if not exempt market dealer fees as well, it was incumbent on those claiming to have received legal advice to have ensured that they truly were receiving an answer to a question they now say they asked.

[262] Second, since Mr. Kadonoff's email to Ms. Nelligan asking for the advice was limited to loans of less than one year, her advice must be taken to apply to such loans. We can neither conclude that the advice would apply equally to longer-term loans, nor can we exclude that possibility. What is clear is that in the context of the exchange of emails, no advice was given about loans of more than one year. Accordingly, Staff submits that the respondents cannot rely on the legal advice contained in this email as a defence in respect of the SIF #2 loans, which were advanced over more than 20 months.

[263] The respondents also seek comfort from Aird & Berlis's letter of April 24, 2015, about a credit agreement of the same day involving a loan from a third-party lender to Solar Income Fund LP (#5), an LP unrelated to the issues before us. In the relevant part of that opinion, Aird & Berlis opines that the various agreements making up the transaction did not and would not breach or

[76] Hearing Transcript, Solar Income Fund (Re), April 6, 2021 at 17 -18

constitute a default under "to our knowledge, any of the terms, provisions or conditions of any agreement, indenture, instrument or other document to which SIF or SIF Trust is party or by which SIF or SIF Trust or any of their respective property or assets is or may be bound or subject."[77]

[264] We reject the respondents' submission that this letter is of any assistance. It is a transaction-related opinion addressed to third parties, with no reference to the offering memorandum or to Ontario securities law. The cited passage has neither the specificity nor the relevance to entitle a respondent to rely on it as part of a legal advice defence.

[265] We pause our review of the evidence to emphasize that reviewing declarations of trust to determine what is permissible according to trust law is significantly different from reviewing an offering memorandum to determine whether an intended use of investor funds conforms to investors' reasonable expectations. The two questions arise in different contexts, and each requires its own lens.

[266] The reasonable expectations of investors who receive an offering memorandum inform the answer to the pivotal question of whether a use of SIF #1 funds was authorized or not. For a respondent to rely on legal advice in respect of the allegations in this proceeding, that advice must be viewed not only in the context of securities law (as opposed to trust law), but also in the context of the relationship between legal counsel and their client.

[267] Ms. Nelligan testified that as far as she could recall, only once in the course of the relationship with SIF Inc. was Aird & Berlis asked to give advice about the permissibility of a specific use of funds loaned from SIF #1 to SIF #2. The request for advice was about a short-term loan to pay deposits in connection with the purchase of a particular project.

[268] Mr. Grossman suggests that there was at least one other occasion on which the question was asked of Aird & Berlis. He cites the September 1, 2015, email from Mr. Kadonoff to Mr. Mazzacato and him, as well as the Aird & Berlis lawyers, in which Mr. Kadonoff asks Aird & Berlis to opine on various issues relating to SIF #2 (discussed at paragraph [225] above). That email contains Mr. Kadonoff's concern about SIF #2 borrowing funds from SIF #1 to pay distributions to SIF #2 investors.

[269] The respondents rely in part on a handwritten note in the Aird & Berlis file, most of which is redacted in our record. The visible portions record the date (September 1, 2015), the subject "MFT #2 raise", and a list of issues, only one of which is unredacted. The text relating to that issue is limited to the question "suspending distributions?", to which the notes in apparent response are "OK → at Manager's discretion" and "what about DRIP?". There is one marginal note "o/s issue" with an arrow pointing to one or both of those last two lines.[78] This note confirms the respondents' contention that one of the topics of the call was distributions. Nothing in the note suggests that the question of whether loans could be made from SIF #1 to SIF #2 to pay distributions was mentioned in the call.

[77] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Letter from Aird & Berlis to Sprott Bridging Income Fund LP c/o Bridging Finance Inc. and Dale & Lessmann LLP at p 7

[78] Exhibit 38, Kadonoff Affidavit, Tab 70

[270] Further, Ms. Nelligan testified that she understood Mr. Kadonoff's concern to be whether he might have been personally liable in the same way that a director of a corporation would.

[271] In conversations leading up to November 25, 2014, and in an email of that date to Mr. Grossman confirming those conversations, Aird & Berlis listed a number of concerns that should be addressed. These included considerations about the method by which the deposits would be paid, the time horizon and risks of the loan, costs and benefits to each of SIF #1 and SIF #2, and SIF Inc.'s policy for allocating opportunities between funds.

[272] The subject matter and form of this email stand in stark contrast to the advice on which the respondents say they should be able to rely. First, the payments that are the subject of the email relate directly and immediately to the acquisition of a solar project (unlike distributions and dealer fees). Second, the email carefully documents concerns that Aird & Berlis raised in earlier conversations.

[273] We accept Ms. Nelligan's testimony that this was the only occasion on which Aird & Berlis gave advice about a specific use of funds loaned from SIF #1 to SIF #2. The only evidence that might suggest a contrary conclusion is that relating to the July 3, 2014, email from Ms. Miatello (which we have already discussed) and Mr. Kadonoff's testimony about a telephone call he had with Ms. Nelligan on October 8, 2015.

[274] In his affidavit, Mr. Kadonoff states that he sought Ms. Nelligan's advice on, among other things, the propriety of continuing distributions to SIF #2 unitholders in light of SIF #2's lack of cash, and of using a loan from SIF #1 to SIF #2 to fund the distributions.

[275] Mr. Kadonoff's description of his call with Ms. Nelligan is carefully worded. He does not actually state that Ms. Nelligan expressly gave any advice; rather, Mr. Kadonoff inferred the propriety of a loan because Ms. Nelligan raised no concerns. Mr. Kadonoff states that:

a. he "believes" that he "fully disclosed [his] understanding that advances for that purpose would be required if distributions continued" and that he raised concerns about the permissibility of such a loan;

b. he "believes" that he and Ms. Nelligan discussed the fact that he was seeking legal advice from Aird & Berlis "about the use of loaned funds for distributions in light of the cash flow issues"; and

c. he raised the issue "on several occasions and… was never advised by [any of the Aird & Berlis lawyers] that distributions to SIF #2 investors should not or could not be made".[79]

[276] Mr. Kadonoff also points to Ms. Nelligan's handwritten note of the conversation. That note is one half-page, most of which was redacted (for solicitor-client privilege) in the version tendered to us. The unredacted portion consists, in its entirety, of the date of the call, the fact that it was a call from Mr. Kadonoff, a hand-drawn diagram of overlapping ovals with two instances of the word "trustee", and one line saying "- distributions may be made".

[79] Exhibit 38, Kadonoff Affidavit at paras 128-129

[277] In his affidavit, Mr. Kadonoff states that this last element "is consistent with what" he believes the two discussed.[80] However, to the extent Mr. Kadonoff seeks to rely on this note as part of a legal advice defence, that reliance is misplaced, for many reasons:

a. as is quite often the case with notes of this kind, the note is, to use Mr. Kadonoff's own description of it, "cryptic" to anyone but the author;

b. on its face, the phrase "distributions may be made" is entirely ambiguous as to whether it reflects Mr. Kadonoff telling Ms. Nelligan that distributions might be made in the future (a possible interpretation that Mr. Kadonoff does not contradict), or Ms. Nelligan giving advice that distributions are permissible;

c. we are not persuaded by Mr. Kadonoff's attempt under direct examination to enhance the value of the phrase, when he testified that it "is really consistent with what I believe I heard";[81]

d. even if the phrase does reflect Ms. Nelligan's advice, it says only that distributions may be made – it makes no reference to a loan from SIF #1 to SIF #2 for the purpose; indeed, on cross-examination, Mr. Kadonoff conceded that he did not recall Ms. Nelligan giving advice about that issue, although he "didn't hear any objection to it being done";[82] and

e. Ms. Nelligan acknowledged that information about distributions may have been imparted to her, but she testified that to her knowledge, no one raised with Aird & Berlis a concern about using SIF #1 loan funds to pay SIF #2 distributions, and Aird & Berlis never gave advice on that issue.

[278] We reach the same conclusion about the Aird & Berlis note of a call on October 21, 2015, that included Mr. Kadonoff, Mr. Mazzacato and Mr. Grossman. The unredacted part of the note reflects that SIF #1 had been and was continuing to fund SIF #2 to "keep #2 going", and that both were still paying distributions. The full context of the note is unclear, but Ms. Nelligan repeats her earlier assertion that Aird & Berlis was not asked if it had any concerns, and Aird & Berlis did not raise any concerns.

[279] We conclude our review of the advice sought and received by finding that to the extent Ms. Nelligan's testimony differs from Mr. Kadonoff's or that of either of the other individual respondents, we prefer hers. She was candid about her ability to recall events, her testimony was internally consistent about the scope of questions asked and advice given, her testimony was consistent with the documentary record, and her explanations were reasonable. Her distinction between the questions on which Aird & Berlis gave advice and questions that were not asked was consistent with the documentary record and with the practice that would be expected from any professional giving advice.

[280] Any attempts by the respondents to undermine or embellish her testimony are, in our view, the product of after-the-fact mischaracterizations of documents in

[80] Exhibit 38, Kadonoff Affidavit at para 129
[81] Hearing Transcript, Solar Income Fund (Re), April 6, 2021 at 52 lines 27-28
[82] Hearing Transcript, Solar Income Fund (Re), April 6, 2021 at 52 lines 5-7

the record, and wishful (at best) recollections of conversations that occurred more than five years before the respondents testified about them in this hearing.

(d) Involvement of the individual respondents in receiving the legal advice

[281] SIF Inc. used the law firm of Aird & Berlis for much of its legal work. Mr. Grossman recounted interviewing two law firms to do SIF Inc.'s legal work and choosing Aird & Berlis.

[282] The individual respondents were, to varying extents, involved in some way in communication with Aird & Berlis. While Mr. Grossman and Mr. Kadonoff had more frequent communication with Aird & Berlis than Mr. Mazzacato did, all three were included on most or all of the material written communications.

[283] The most pivotal communication, according to the respondents, serves as an example. When Mr. Kadonoff received the July 3, 2014, response from Aird & Berlis noting that Ms. Miatello had "looked at both declarations of trust" and had concluded that the "operating trust can lend funds for financing solar deals to the LPs or unrelated entities", Mr. Kadonoff forwarded the email minutes later to Mr. Grossman and Mr. Mazzacato.[83]

[284] Mr. Mazzacato testified that he did not believe he saw the email at the time, that he was focused at the time on origination and technical matters, and that he relied on others to tell him that SIF Inc. had received the necessary legal advice. He submits that because Staff did not question him about his understanding of the legal advice or the reasonableness of his belief about that advice, Staff is precluded from arguing to the contrary.

[285] We disagree. As Staff correctly submits, the burden is on Mr. Mazzacato to establish reasonable reliance on legal advice. Mr. Mazzacato failed to do so. Staff is entitled to rely, as it has, on all of the relevant evidence regarding the steps Mr. Mazzacato took and did not take with respect to the legal advice. Further, it was abundantly clear at least from the beginning of the hearing, if not earlier in the proceeding, that Staff sought to challenge the reasonableness of the respondents' reliance on legal advice. The principle protected by *Browne v Dunn*, *i.e.*, affording a respondent a fair opportunity to address the case against them, suffered no damage whatsoever.

[286] We conclude from the fact that the individual respondents are shown on the material communications, together with the ongoing discussions among the small management committee, that there is no reason to differentiate among the individual respondents with respect to the benefit any of them might derive from Aird & Berlis's advice.

(e) Conclusion about legal advice

[287] None of the respondents' assertions about advice received approaches the level necessary to establish the defence of reasonable reliance on legal advice. Even if Mr. Kadonoff's recollection of the discussion set out beginning at paragraph [285] above is correct (a determination we need not make and decline to make), silence from one's lawyer is insufficient to establish reasonable reliance on a

[83] Exhibit 32, Revised Exhibit A to the Dusseldorp Affidavit, Emails between Allan Grossman, Ken Kadonoff, Jennifer Jackson, Charles Mazzacato and Anne Markle Re: MFT as a lender

question as central and as specific as this, *i.e.*, does the offering memorandum permit loans from SIF #1 to SIF #2 for these two purposes?

[288] In concluding that silence is insufficient, we need not resort to the American jurisprudence that Staff submitted as part of its reply submissions. The test set out in *Phillips* and in *Mega-C* (see paragraph [239] above) necessarily presumes that the client received advice. This is not the defence of reliance on passive acquiescence.

[289] The respondents refer to a number of communications between SIF Inc. and Aird & Berlis where some sort of concerns were raised, and some answer was given. In none of these communications was there sufficient precision in either the questions (which were generally not focused on one particular concern) or more importantly the answers, for us to conclude that the respondents received the legal advice they now submit they did receive.

[290] As the respondents have correctly submitted that we must do, we have considered the nature of the communications between SIF Inc. and Aird & Berlis in the context of the overall solicitor-client relationship. We have used the many communications in evidence before us as a standard against which to measure the advice that the respondents say SIF Inc. received on the question of whether loans to pay distributions and dealer fees were permitted. We agree with the respondents' submission that Aird & Berlis's silence on the point is "significant". However, we reach the opposite conclusion from this than the respondents suggest when they say that the silence "was something that the Respondents could reasonably rely upon".

[291] The evidence demonstrates that all respondents were included on communications on which they now rely. It was open to each one of them, whether legally trained or not, at least to read carefully the advice on the important question, and to form an independent view and to ask questions if necessary. None of them did.

[292] Before we leave our discussion of the defence of reliance on legal advice, we wish to address Staff's request that we draw an adverse inference against the respondents, due to their decision not to call Ms. Miatello, author of the two emails sent in July and November, 2014. We decline to draw such an inference in this case. The emails speak for themselves, and having Ms. Miatello explain what she intended by their content would not assist us in determining their value to the respondents.

[293] We do not accept Staff's reply submission that the respondents' decision not to call Ms. Miatello precludes Staff from testing the respondents' understanding of her advice and whether it was reasonable in the circumstances. We have found no advice from Ms. Miatello that could operate as a defence to the two fraud allegations in this case, so there is no need to consider the respondents' understanding of any other advice she gave.

[294] In conclusion, there is no clear evidence whatsoever that Aird & Berlis actually gave any advice regarding the question at issue, *i.e.*, whether the offering memorandum permitted SIF #1 to use its funds to lend to SIF #2 for the purpose of paying dealer fees and SIF #2 investor distributions. Therefore, none of the four respondents has available the defence of reliance upon legal advice.

6. Did each respondent have subjective knowledge that the fraudulent act could have as a consequence the deprivation of another?

[295] The final element Staff must prove as part of its fraud allegations is that each respondent subjectively knew that the impugned act could have as a consequence the deprivation of another.

[296] As we have discussed above, the deprivation at issue in this case arises because the investors' funds were subjected to risks that the investors had not bargained for and that were not disclosed to them.

[297] We have found that all individual respondents were aware or reasonably ought to have been aware that the purpose of the impugned transactions was to pay SIF #2 investor distributions and dealer fees. It follows inexorably from the unauthorized diversion of funds that those funds are exposed to different risks, and therefore that deprivation is a consequence. Staff having proved the first part of the mental element need not prove anything further, given the circumstances of this case where the deprivation is an automatic result of the fraudulent act. It is sufficient to infer, as we do, subjective awareness from the act itself.[84]

7. Conclusion regarding fraud

[298] For the reasons we have set out above, SIF Inc. effected an unauthorized and wrongful transfer of funds from SIF #1 to SIF #2 for improper purposes, and thereby deprived SIF #1 investors. The *actus reus* has been established.

[299] SIF Inc. is deemed to have had subjective knowledge of the fraudulent act, since all three of its directing minds knew or ought reasonably to have known of the fraudulent act.

[300] We find that by causing SIF #1 to make loans to SIF #2 that were improper to the extent of the investor distributions and dealer fees (*i.e.*, $234,864.04; see paragraph [103] above for the calculation of that amount), SIF Inc. contravened s. 126.1(1)(b) of the Act.

[301] As for the individual respondents, each attempted to limit his own responsibility, including by professing near-total reliance on others. We found that to be remarkable, particularly for Mr. Mazzacato and Mr. Kadonoff, each of whom was President of SIF Inc. for part of the period during which the impugned transfers were made.

[302] The individual respondents' submissions are inconsistent with the obligations that come with being one of three or four members of senior management of an entity that raises funds from the public. This is particularly so, given the overwhelming preponderance of evidence, which we accept, that the management team met regularly and made decisions by consensus. We recognize that each member of a corporation's management will inevitably adopt a unique focus, often based in large part on previous experience and expertise. This reality does not, however, relieve a corporation's officers from their legal obligations. These three officers, under these circumstances, suggest an

[84] *Théroux* at para 20

approach to corporate governance that is inappropriate for a public issuer and that undermines investor protection and the integrity of the capital markets.

[303] Mr. Grossman conceded that he knew the purpose of the transfers. If Mr. Mazzacato and Mr. Kadonoff did not know, they were reckless about that.

[304] As for any legal advice that was obtained, we conclude that it is more likely than not that the respondents were not focused at that time on whether the offering memorandum permitted the loans. Their concerns about the propriety of the loans arose from other considerations, including tax law, trust law, and personal liability. Had the respondents asked the right question of their lawyers, as they ought to have done, they would likely have received a direct answer. They could then have acted with the benefit of that advice.

[305] Instead, the respondents did not afford Aird & Berlis an opportunity to answer the direct question that was not asked. The diversion of funds they caused was an unauthorized one, and they knew or ought to have known that the funds were being diverted for those purposes.

[306] We therefore find that since Staff has established the necessary elements as against all three individual respondents, each of them contravened s. 126.1(1)(b) of the Act. We must now calculate the amount of the fraud for which each individual respondent is responsible.

[307] Because Mr. Grossman and Mr. Mazzacato were directing minds of SIF Inc. throughout the ten-month period of July 1, 2015, to May 5, 2016 that Staff used for its calculations, they are responsible for the full amount of $234,864.04, being the total of $223,224.04 for distributions and $11,640.00 for dealer fees. We repeat our note above that we accept Staff's conservative analysis of the use of funds available in the SIF #2 fund account, and specifically Staff's application of a $37,935.34 reduction to reflect the use of an opening balance in that account. That reduction is reflected in the total of $234,864.04.

[308] Mr. Kadonoff's responsibility spans only a portion of the ten-month period that is the subject of Staff's analysis. For Mr. Kadonoff, the relevant sub-period runs from July 1, 2015 (the beginning of Staff's ten-month period) to September 14, 2015 (the date on which he authorized payment of SIF #2 distributions using funds loaned from SIF #1). In that shorter period, three months' worth of distributions were paid -- $25,680.67 in the first half of July, and the same amount in each of the first half of August and the first half of September.

[309] As we mentioned above in paragraph [102], Staff's adjustment was applied on a chronological basis as impugned payments were made, and was fully consumed by those payments by July 22, 2015. We give Mr. Kadonoff the benefit of that conservative approach and exclude the June 2015 distributions paid in the first half of July. That leaves a total of $51,721.34 that Mr. Kadonoff shares responsibility for, being the two $25,860.67 payments in August and September. In the relevant period, no dealer fees were paid until September 22, 2015, by which time Mr. Kadonoff had resigned and was no longer signing cheques.

C. Are any of the individual respondents to be held liable under s. 129.2 of the Act?

[310] Section 129.2 of the Act attaches liability to an individual for non-compliance by a corporation, in certain circumstances. For s. 129.2 to apply, the individual

must have been a director or officer of the company that failed to comply with Ontario securities law. The individual director or officer must also have "authorized, permitted or acquiesced in" the company's non-compliance.

[311] Having found that each of the individual respondents directly contravened s. 126.1(1)(b) of the Act to the full extent of SIF Inc.'s non-compliance during the period relevant to each respondent, it is unnecessary for us to consider separately any potential liability under s. 129.2. We decline to do so.

D. Conduct contrary to the public interest

[312] The Statement of Allegations includes an allegation that the respondents engaged in conduct "contrary to the public interest". The Statement of Allegations contains no particulars of that allegation.

[313] As the Commission found on the earlier motion in this proceeding, referred to above, a submission that the Commission ought to make an order under s. 127 of the Act absent a contravention of Ontario securities law must be supported by sufficient particulars and submissions.[85] Staff offered no particulars or submissions on this point, other than a bald suggestion that the respondents' conduct was contrary to the public interest.

[314] Accordingly, Staff's allegation is dismissed.

V. CONCLUSION

[315] We dismiss Staff's allegations that the respondents contravened s. 44(2) of the Act, because we conclude that statements made by the respondents to investors (including in the offering memorandum) were not ones that a reasonable investor would consider relevant in deciding whether to enter into or maintain a trading relationship with SIF Inc.

[316] With respect to the allegations that the respondents contravened s. 126.1(1)(b) by causing SIF #1 to divert funds for purposes unauthorized by the offering memorandum, we find each of them to have contravened s. 126.1(1)(b), to the following extents:

a. $234,864.04 for SIF Inc., Mr. Grossman and Mr. Mazzacato; and

b. $51,721.34 for Mr. Kadonoff.

[317] The parties shall contact the Registrar by 4:30pm on April 14, 2022, to arrange an attendance in respect of a hearing regarding sanctions and costs. The attendance is to take place on a date that is mutually convenient, that is fixed by the Secretary and that is no later than April 29, 2022.

[318] If the parties are unable to present a mutually convenient date to the Registrar, then each party may submit to the Registrar, for consideration by a panel of the

[85] *Solar Income Fund Inc. (Re)* Motion Decision at paras 70-76

Commission, one-page written submissions regarding a date for the attendance. Any such submissions shall be submitted by 4:30pm on April 14, 2022.

Dated at Toronto this 28th day of March, 2022.

"*Timothy Moseley*"
Timothy Moseley

"*Frances Kordyback*"
Frances Kordyback

"*Craig Hayman*"
Craig Hayman