IN THE MATTER OF
THE SECURITIES ACT
R.S.O. 1990, c. S. 5, AS AMENDED

AND

IN THE MATTER OF
PIERGIORGIO DONNINI

HEARING PURSUANT TO SECTION 127(1) AND 127.1 OF THE SECURITIES ACT

Hearing: May 13, 14, 15, 16 and 17, 2002

Panel:
Paul M. Moore, Q.C. - Vice-Chair (Chair of the Panel)
Kerry D. Adams, FCA - Commissioner
Harold P. Hands - Commissioner

Counsel:
Johanna Superina - For the Staff of the Ontario
Yvonne Chisholm Securities Commission

Alan Lenczner - For the Respondent
Graham King
Eleni Maroudas
Colin Stevenson

The following excerpt has been prepared for purposes of publication in the Ontario Securities Commission Bulletin. It is based on the transcript of the hearing at which the decision as to liability was given in the matter of Piergiorgio Donnini. The transcript has been edited, supplemented and approved by the panel for the purpose of providing a public record of the panel's decision in the matter.

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We have had five days of hearings in this matter pursuant to an amended Notice of Hearing dated May 7, 2002 concerning allegations of staff of the Ontario Securities Commission as to the trading by Piergiorgio Donnini ("Donnini") in shares of Kasten Chase Applied Research Limited ("KCA") on February 29, 2000 and March 1, 2000.

At the beginning of the hearing, the Commission ruled that it would hear evidence and argument as to appropriate sanctions, if any, after it came to a decision on liability.

DECISION

1. The question in this case is whether Piergiorgio Donnini had knowledge of a material fact that had not been generally disclosed when he sold shares of KCA after 2:45 p.m. on February 29 and on March 1, 2000.

2. Commissioners Moore and Adams have decided that Donnini did have knowledge of a material fact when he sold shares of KCA after 2:45 p.m. on February 29 and on March 1. Commissioner Hands, without deciding that Donnini had knowledge of a material fact, has decided that Donnini acted contrary to the public interest when he continued to trade KCA shares without ascertaining through further inquiry that the information he had was clearly not a material fact concerning KCA. Consequently, we have decided that it is in order for us to hear any additional argument and evidence that counsel may wish to lead as to appropriate sanctions under section 127.

3. We will issue reasons for our decision after we have made a decision as to appropriate sanctions.

4. In order to give counsel guidance in presenting evidence, if any, and argument as to appropriate sanctions, we will now give a brief outline of our principal findings and conclusions.

5. We find that:

1) KCA was in strained financial straits prior to the first special warrant financing. For its longer-term viability, it was still in need of a cash infusion when a second financing was proposed by Gordon Scott Paterson ("Paterson") to Michael John Milligan ("Milligan") at 9:42 a.m. on February 29, 2000: the second financing would open up options and possibilities for KCA and provide a cushion against running out of cash before the end of the year 2000.

2) The technology market bubble presented a unique market opportunity for the second financing.

3) Donnini found out from Milligan at 10:30 a.m. on February 29, 2000, that Paterson had proposed to Milligan a second financing for KCA. Milligan identified himself to Donnini as the CFO of KCA. It was the first time Donnini knew of Milligan, a fact which was noted by Donnini.

4) Donnini spoke with Milligan by telephone on a subsequent occasion that same day prior to Donnini's conference with Paterson in Mark McQueen's ("McQueen") presence.

5) Donnini knew the fundamentals of KCA from, at least, February 11, 2000, when the first financing was announced.

6) Donnini was actively buying and selling shares of KCA from at least February 15 through March 1.

7) Donnini shorted shares of KCA on ten days between and including February 15 and March 1.

8) Donnini spoke with Paterson on a daily basis when he was putting on shorts, although he says he did not talk to Paterson on March 1.

9) Paterson talked with Donnini on February 28 or before the market opening on February 29 about Yorkton Securities Inc.'s ("Yorkton") short position in KCA.

10) Paterson knew that KCA closed at $6.75 on February 28 and believed that KCA would open on the 29th at a higher price.

11) At 2:45 p.m. on February 29, Donnini knew that Paterson had just spoken to Milligan and proposed a second financing to Milligan, that Paterson believed that the second special warrant financing could be done, that Paterson was thinking of a size of $10 million and a price at a discount from market, and that $6.75 was likely the price.

12) Donnini was a long standing colleague of Paterson. Donnini and Paterson spoke almost every day. Paterson appears to be cocksure and a wunderkind. Donnini knew how Paterson operated.

13) The first financing was negotiated in a very short period of time. Most of the terms of the first financing were set by Yorkton and KCA did not have much flexibility in setting the terms.

14) Donnini had knowledge of the facts referred to in subsections 1) to 12) of this item 5.

15) Donnini was the head liability trader and the head institutional trader at Yorkton.

16) On February 29, 2000, Donnini was of the opinion that a second special warrant financing at $10 million for $6.75 per share could be done.

17) With respect to the four scenarios referred to by Mr. Lenczner as being available after the telephone conference among Milligan, Paterson and McQueen:

    a) The possibility that Temple Ridge (1996) Ltd. "(Temple Ridge") might do a secondary offering had been taken off the table by Paterson by mid-day on February 29, 2000: in a discreet telephone call to Milligan prior to the telephone conference, Paterson made it clear that there was no interest for a secondary offering. Besides, such an offering could not take place without Yorkton's consent. Furthermore, Paterson advised Milligan in the telephone conference that KCA directors should put the interests of shareholders in doing a treasury issue ahead of the interests of Temple Ridge in doing a secondary offering. A secondary offering was something that was always on the minds of Milligan and Hyde, but they were not preoccupied with it.

    b) Since a secondary offering by Temple Ridge was not really on the table, a combination of

a second special warrant financing and a secondary offering by Temple Ridge was not a realistic option.

c) The proposed second special warrant financing was the principal scenario. KCA needed the cash: it would make KCA's longer-term viability more certain and would open options to it. Market conditions were unbelievably favourable. The underwriter proposing the transaction believed it could be done in spite of the fundamentals of KCA that under normal market conditions would not permit KCA to do such a financing. Given the nature or condition of the markets generally at that point in time; given that KCA had improved its balance sheet by the first transaction; and that it was Paterson who was proposing a transaction that could significantly improve the balance sheet of KCA again, Milligan, as chief financial officer of KCA, was very interested in Paterson's proposal and was considering it very seriously even before the conference telephone call. Finally, none of the other options discussed, nor Paterson's desire to borrow shares from Temple Ridge, was a pre-requisite to a second special warrant financing. On the conference call among Paterson, Milligan and McQueen, they talked size, pricing, fees and a similar kind of structure to the first special warrant financing. There was little flexibility by Yorkton on the discussion point of compensation. Milligan's sense at the end of the conversation, which we accept, was that there were still some issues to be negotiated, that KCA needed to do some talking, and that the parties would pick up the conversation later. In other words, negotiations were seriously underway.

d) There was the possibility of no deal at all. This, we find, was the most remote possibility. It would only be reasonable to believe it would occur if, prior to concluding a deal, an unanticipated event occurred, such as a drastic reversal in the market.

18) There were conversations on February 29 in which Paterson seemed to suggest to Milligan that the borrowing by Yorkton of KCA shares owned by Temple Ridge be connected with a second special warrant financing. This was not a precondition of Paterson to do the second special warrant financing. Furthermore, Milligan made it clear in the conference call with Paterson, Milligan and McQueen that he wanted to concentrate on a straight second special warrant financing without a borrowing, and Paterson was amendable to focussing the discussion on a second special warrant financing.

19) On February 29, 2000, prior to the conference call with Milligan, Paterson asked McQueen to listen in on the negotiations with Milligan, with instructions to draw up an engagement letter afterwards. After the call, McQueen began preparation of an engagement letter for the second financing and engaged Yorkton's outside legal counsel.

20) Prior to the conference call with Paterson and McQueen, Milligan had engaged outside legal counsel to assist in the transaction. During the call, Milligan indicated that he would take the deal to his board on March 1, 2000.

21) After the conference call, Paterson was quite succinct with Donnini. Donnini was not told by Paterson about the multitude of things that Paterson had spoken to Milligan about.

6. We conclude that, although the final size, price and other terms were not finalized until mid-day on March 1, 2000, the second special warrant financing discussions between senior representatives of KCA and Yorkton were sufficiently advanced by 2:45 p.m. on February 29, 2000 that these discussions were a material fact at that point in time, having regard to the probability of the financing proceeding and the magnitude of the proposed offering. Specifically, we conclude:

1) Donnini knew the probable size of $10 million and probable price of $6.75. Without concluding whether it was necessary that Donnini also have some knowledge of the probability of the second special warrant financing for him to have had the requisite knowledge for a breach by him of section 76(1) of the Act, Commissioners Moore and Adams find that, at least after the conference with Paterson and McQueen, Donnini did in fact have sufficient knowledge of the probability of the second special warrant financing, including its probable size and price, that he had knowledge of a material fact relating to KCA that had not been generally disclosed when he sold shares of KCA after 2:45 p.m. on February 29, 2000 and on March 1, 2000. Those share sales were in contravention of section 76(1) of the Act. Commissioners Moore and Adams are also of the view that once Donnini learned from Milligan in the 10:30 a.m. phone call that Paterson had proposed a

financing for KCA, the better course of action for Donnini, in light of his duty and obligations to the marketplace as a registrant authorized to trade for the account of Yorkton, would have been to cease from that time trading in shares of KCA, until he could satisfy himself that discussions between Yorkton and KCA concerning a possible financing would not continue, or, if they were to continue, until after an announcement of a transaction, ultimately, had been made.

2) While Commissioner Hands has not concluded that Donnini had sufficient knowledge of the probability that the second special warrant financing would proceed and, therefore, that the information he had was a material fact, he is satisfied that the information Donnini possessed at the end of his discussion with Paterson in the presence of McQueen, raised sufficient red flags that the information might well be a material fact. Accordingly, as a registrant who was the senior liability trader and head institutional trader at Yorkton, Donnini had a duty to be vigilant not to buy or sell shares of KCA until he had inquired about the importance of the non-public information that he had learned about KCA. Information in connection with a possible financing of KCA, where Donnini knew that Paterson had been speaking to the chief financial officer of KCA, should not have been assumed by Donnini not to be material merely because no one warned Donnini that the information was material or that Donnini should not continue to trade. Donnini, who had two conversations with the chief financial officer of KCA on February 29, and a conversation later that day with the chief executive officer and senior corporate finance deal-maker at Yorkton in the context of a possible financing had a positive duty to refrain from trading when he became aware of the information he had until he had satisfied himself definitely and without doubt, after reasonable inquiry and further reflection, that the information was not a material fact. His failure to exercise due diligence to avoid a possible breach of section 76(1) was contrary to the public interest.

3) We accept for the most part the evidence of Paterson and McQueen with respect to the conversation between Paterson and Donnini in the presence of McQueen. In judging Donnini's conduct under the circumstances, none of us is prepared to give Donnini the benefit of sheltering behind his own inaction or his inability (whether real or feigned) to recollect. It is fundamental to the integrity of the capital markets that registrants adhere to the highest standards when dealing with confidential information that could be, or could become, material. As a registrant, Donnini had a duty to adhere to a standard of conduct, consistent with the policy reflected in Ontario Securities Commission Policy 33-601, designed to assure the investing public that it may have confidence in a fair marketplace. This policy, it should be noted, deals not only with probable, but also possible, transactions that could be material. It is, among other reasons, to prevent their traders generally from being frozen from trading that investment dealers erect Chinese walls and take other precautions to prevent persons outside their corporate finance departments from advertently or inadvertently finding out about potentially material transactions.

4) Donnini was not a credible witness. He has been unrepentant and unwilling to acknowledge that his conduct was unbecoming a registrant and contrary to the public interest.

5) Although Donnini was not an officer or director of Yorkton, he was the fourth largest shareholder, the senior liability trader and the senior institutional trader of Yorkton. He was a colleague of Paterson. He was more a chief lieutenant than a common foot-soldier.

7. In presenting evidence and argument as to sanctions, we would like counsel to address at least the following questions:

1) What relevance should we give to the sanctions imposed under the Yorkton and Paterson settlements? Specifically:

a) What relevance should we give to the fact that Yorkton and Paterson settled while Donnini did not?

b) We do not have authority to impose a fine. In comparing sanctions under the Yorkton and Paterson settlements with sanctions we may impose, what proxy value, if any, should we give to the voluntary payments paid by Yorkton and Paterson under their settlements?

2) In addition to considering the sanctions imposed pursuant to the Yorkton and Paterson settlements, should we look at sanctions imposed after other contested hearings and pursuant to other settlements?

3) What emphasis should we give to the effect that sanctions will have on confidence in the capital markets? In particular, what weight should we give to proportionality of sanctions as measured by precedent compared to the impact of sanctions in this case on confidence in the capital markets?