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, June 11 and July 11, 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** **Yvonne Chisholm**	**For the Staff of the Ontario Securities Commission**
	Alan Lenczner **Graham King** **Eleni Maroudas** **Colin Stevenson**	**For the Respondent**

REASONS FOR DECISION

By Vice Chair Moore and Commissioner Adams

I. The Proceeding

[1] This proceeding was a hearing pursuant to sections 127(1) and 127.1 of the *Securities Act*, R.S.O., 1990, c. S.5 (the Act), in the matter of Piergiorgio Donnini, under an amended notice of hearing dated May 7, 2002, and the related amended statement of allegations of staff of the Ontario Securities Commission. At the commencement of the hearing, at the suggestion of counsel for staff and the respondent, it was agreed that the hearing would be held in two parts. The first part, which was held on May 13, 14, 15, 16 and 17, heard evidence and argument on the question of the merits. Our findings and conclusions on the merits were announced orally on June 11, 2002. The second part, which dealt with appropriate sanctions in light of our findings on the merits, was held on July 11, 2002.

II. The Allegations

[2] Staff alleged that, among other things, Donnini's conduct in connection with a second special warrants financing proposal for Kasten Chase Applied Research Limited (KCA) was contrary to the public interest and contrary to section 76(1) of the Act because, while he was in a special relationship with KCA with knowledge of a material fact with respect to KCA that had not been generally disclosed, he purchased and sold shares of KCA.

[3] In addition, staff alleged that, having regard to the foregoing, Donnini's conduct was unbecoming of a registrant and contrary to the public interest.

[4] The notice of hearing, as amended, referred to "such additional allegations as Staff may submit and the Commission may permit." In her opening statement, counsel for staff made it clear that the allegations against Donnini included the allegation that, even if there had been no violation of the Act, and in particular section 76(1), Donnini's conduct was unbecoming that of a registrant and was contrary to the public interest.

III. The Issues

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

[6] The issues were (i) whether information concerning a proposed second special warrants financing for KCA was material, (ii) whether the information constituted a fact, and (iii) whether Donnini's knowledge of the information was knowledge of a material fact.

[7] A second question was, if Donnini did not have knowledge of a material fact, was his conduct, nevertheless, unbecoming of a registrant and contrary to the public interest.

IV. Evidence

A. Facts Agreed to By Donnini

[8] The facts that Donnini agreed to in respect of the amended statement of allegations dated May 7, 2002, were as follows:

i) KCA is a corporation incorporated under the *Business Corporations Act* (Ontario). KCA develops and applies technology to provide secure remote access to computer networks. KCA was a privately held company until 1995 at which time Yorkton Securities Inc. structured the reverse take over by KCA of the reporting issuer known as Dysis Corp. KCA is a reporting issuer in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and Quebec. The common shares of KCA are listed and posted for trading on the Toronto Stock Exchange (TSE) under the symbol KCA. Since 1994, Yorkton has acted as underwriter in respect of several financings and private placements for KCA.

ii) In early February 2000, Yorkton and KCA engaged in discussions about a possible financing of KCA. On February 10, 2000, KCA sought "price protection" from the TSE for an offering of special warrants based on the $1.37 closing price of its common shares on February 9, 2000.

iii) On February 11, 2000, KCA executed an engagement agreement with Yorkton under which KCA proposed to raise $5 million by issuing 4 million special warrants priced at $1.25 each. Pursuant to subsections 619(a) and (b) and 622 of the TSE Company Manual, special warrants exchangeable into listed common shares may be issued at a discount to the closing price of the common shares on the TSE on the day before the date on which price protection is sought. Each special warrant was to entitle the holder to acquire one common share of KCA and one-half of one common share purchase warrant at an exercise price equal to $1.75 per common share.

iv) Pursuant to the engagement agreement, Yorkton was entitled to receive an underwriter's commission equal to 8% of the gross proceeds of the offering (or $400,000 in cash) and compensation options to acquire 400,000 units at an exercise price of $1.37 per unit. Each unit was to be exchangeable for one common share of KCA and one-half of one common share purchase warrant at an exercise price equal to $1.75 per common share. Yorkton did not own freely tradeable shares of KCA at this time.

v) The arrangements between Yorkton and KCA set out in the engagement agreement were confirmed in an underwriting agreement dated February 24, 2000. The financing closed on February 24, 2000.

vi) During the pre-marketing of this first special warrants offering, Yorkton's institutional clients expressed a greater demand than the proposed 4 million units available. These clients were prepared to purchase close to 6.5 million units.

vii) On February 11, 2000, Yorkton received sufficient orders to purchase the special warrants that resulted in the offering being oversubscribed.

viii) Among others, a Yorkton institutional client subscribed for 340,000 special warrants and a Yorkton retail client subscribed for 78,000 special warrants.

ix) Each subscriber was required to complete a subscription agreement and a private placement questionnaire and undertaking in a form prescribed by the TSE. Pursuant to the undertaking, each subscriber undertook to the TSE that, except with the "prior consent" of the TSE, it would not "sell or otherwise dispose of any of the said securities so purchased or any securities derived therefrom for the lesser of" six months or the date that a receipt for a final prospectus in respect of those securities was issued by the Commission.

x) The trading price of KCA common shares on the TSE increased substantially from $2.05 per KCA common share at the close of business on February 11, 2000 to $6.75 per common share by the close of business on February 28, 2000. As a result, subscribers for the special warrants enjoyed a substantial unrealized appreciation in value.

xi) Commencing in mid-February 2000, certain Yorkton salespersons spoke with some of the subscribers for the special warrants to determine their interest in realizing a profit by selling some or all of their special warrants. The clients approached were pleased to have the opportunity to sell the special warrants and realize a profit on the sale.

xii) On or about February 28, 2000, Yorkton agreed to purchase from the Yorkton institutional client, for Yorkton's own account, 80,000 of the special warrants at a price of $5.00 per warrant.

xiii) On or about February 29, 2000, Yorkton agreed to purchase from the Yorkton retail client, for Yorkton's own account, 78,000 of the special warrants at a price of $7.65 per warrant.

xiv) On or about February 29, 2000, Yorkton agreed to purchase from the Yorkton institutional client, for Yorkton's own account, 60,000 of the special warrants at a price of $7.00 per warrant and 100,000 special warrants at a price of $7.75 per warrant.

xv) On March 2, 2000, Yorkton sought and obtained the TSE's consent to these purchases of special warrants from the Yorkton institutional client and the Yorkton retail client, conditional upon, among other things, Yorkton filing a questionnaire and the undertaking in the prescribed form.

xvi) Commencing on or about February 15, 2000, with the knowledge of Paterson, who was the chairman and chief executive officer of Yorkton, Donnini began executing short sales of common shares of KCA for Yorkton's own account.

xvii) On or about February 17, 2000, Donnini, on behalf of Yorkton, began to borrow KCA common shares from various registered dealers. Between February 15, 2000 and February 28, 2000, Yorkton sold short for its own account approximately 355,000 common shares of KCA. These transactions were transparent to the market as Donnini traded from Yorkton's inventory account.

xviii) The short sales carried out prior to February 28, 2000 were effected as a part of a strategy to lock in Yorkton's profits in relation to compensation options and special warrants from the first special warrants offering, which could not be freely traded.

xix) By the close of business on February 29, 2000, Donnini had sold short on February 29, 2000 for Yorkton's account approximately 579,400 common shares of KCA, of which 333,500 common shares were jitneyed through another investment dealer. [Jitney: The execution and clearing of orders by one member of a stock exchange for the account of another member. (Source: Canadian Securities Course Textbook Volume 3, September 1998, prepared and published by the Canadian Securities Institute).]

xx) On the morning of March 1, 2000, Milligan, the chief financial officer of KCA, continued to negotiate the terms of a second special warrants offering with Paterson, and by mid-day, KCA had reached an agreement in principle with Yorkton in relation to the following terms of the second special warrants offering (subject to board approval of KCA and negotiation of the engagement letter with Yorkton):

- The pricing of the second special warrants offering;
- The size of the second special warrants offering (including the common share purchase warrants and the exercise period and exercise price of the warrants);
- The commission to be paid to Yorkton in respect of the second special warrants offering, and the number, exercise price and exercise period of the compensation warrants to be issued to Yorkton in respect of the underwriting.

xxi) On March 1, 2000, KCA sought price protection from the TSE for an offering of special warrants at $6.75 per special warrant based on the $6.90 closing price of KCA's common shares on February 29, 2000.

xxii) At the close of the day on March 1, 2000, the board of directors of KCA approved the second special warrants financing.

xxiii) On March 1, 2000, Donnini sold short for Yorkton's account a further 440,200 common shares of KCA, of which over 400,000 shares were jitneyed through another investment dealer. By the close of trading on the TSE on March 1, 2000, Donnini had sold short for Yorkton's account approximately 1,019,600 common shares of KCA for the period February 29 and March 1, 2000. Paterson took no steps to restrict Donnini's trading in KCA common shares.

xxiv) Yorkton's "bought deal" committee approved Yorkton's participation in the second special warrants financing at about 8:00 a.m. on March 2, 2000. KCA and Yorkton then executed an engagement agreement pursuant to which KCA agreed to raise, and Yorkton agreed to underwrite, $10 million by issuing 1.483 million special warrants priced at $6.75 each. Each special warrant was to entitle the holder to acquire one common share of KCA and one-half of one common share purchase warrant at an exercise price equal to $7.75 per common share.

xxv) Pursuant to the engagement agreement, Yorkton was entitled to receive an underwriter's commission equal to 8% of the gross proceeds of the offering and compensation options to acquire 148,399 units at an exercise price of $6.90 per unit. Each unit was to be exchangeable for one common share of KCA and one-half of one common share purchase warrant at an exercise price equal to $7.75 per common share.

xxvi) After Yorkton's "bought deal" committee approved the financing, KCA was placed on Yorkton's "restricted list," which was distributed by e-mail shortly before markets opened on March 2, 2000.

xxvii) The arrangements between Yorkton and KCA set out in the engagement agreement were formalized in an underwriting agreement dated March 15, 2000. The financing closed on March 15, 2000.

B. Undisputed Facts From the Witnesses' Testimony Regarding February 29 and March 1, 2000

[9] The following additional undisputed facts emerged from the witnesses' testimony.

i) On the morning of February 29, 2000, Paterson telephoned KCA and left a message for Hyde or Milligan to call him back. At 9:42 a.m. Milligan called Paterson back. Paterson proposed a second financing for KCA and mentioned involvement by hedge funds. Milligan was surprised that Paterson would suggest a second financing so soon after the closing of the first special warrants financing and inquired as to what Paterson meant by the involvement of hedge funds. Paterson told Milligan to call Donnini who could explain hedge funds to him. Milligan told Paterson he would be interested in having Temple Ridge (1996) Ltd. (the senior executives' holding company, holding approximately 20% of the shares of KCA) do a secondary offering of KCA shares.

ii) At 10:30 a.m. Milligan telephoned Donnini. The conversation lasted approximately six minutes.

iii) At 12:37 p.m., Milligan called Donnini back to discuss hedge funds further.

iv) Milligan discussed matters with KCA's outside counsel, Fran Guolo, but was unable to explain what Paterson meant by involving hedge funds.

v) Paterson called Milligan back and told him there was no market interest in a secondary offering of KCA shares.

vi) Shortly before 2:24 p.m. Paterson asked McQueen to sit in on a conference call he would be having with Milligan to see how a deal is done and to follow up with a draft engagement letter.

vii) At 2:24 p.m. Paterson, McQueen and Milligan had a conference call for approximately 20 minutes. Paterson did most of the talking and pitched Milligan on a second special warrants financing.

viii) Immediately after the conference call, Paterson called Donnini into his office, and in a three-minute meeting in the presence of McQueen, asked Donnini questions about KCA.

C. Testimony of Individual Witnesses

[10] We heard evidence from six witnesses: Michael John Milligan, the Chief Financial Officer, Executive Vice President, General Counsel and Secretary of KCA at the material time; Mark McQueen, currently the Managing Director of the investment banking group of Yorkton and, at the material time, a Vice President in Yorkton's Corporate Finance group; Brian Campbell, at the material time, Director, Investment Banking, Technology group at Yorkton, and a signing officer of Yorkton; Paul Hyde, the President and Chief Executive Officer of KCA; Gordon Scott Paterson, at the material time registered as a trading officer and the Chairman and Chief Executive Officer of Yorkton; and Donnini.

[11] The following is not a comprehensive account of all the testimony, but merely sets out the testimony which we considered the most salient and influential in reaching our decision on the merits.

1. Milligan

[12] Milligan testified as to the following.

[13] In the 9:42 a.m. telephone call with Paterson on February 29, 2000, he did not say anything to give Paterson the impression that KCA was not interested in pursuing another financing. Given the nature of the condition of the market generally at that point in time, given that KCA had improved its balance sheet, and that Paterson was someone proposing a transaction that could significantly improve the condition of KCA's balance sheet again, Milligan was very interested as chief financial officer of KCA to consider the proposal very seriously. Paterson and Milligan agreed that they would continue the discussion as to whether there was some interest on the part of KCA in pursuing another financing.

[14] In his 10:30 a.m. telephone call with Donnini on February 29, 2000, Milligan mentioned to Donnini that he had had a conversation with Paterson, that Paterson had proposed a transaction involving a hedge fund, and that Paterson had suggested that Milligan should speak with Donnini so that Donnini could help Milligan understand this kind of transaction. Donnini then indicated to Milligan how this kind of transaction works. Once Milligan heard that the transaction begins with the hedge fund shorting stock of the issuer, Milligan's interest in the conversation quickly dwindled away.

[15] In the afternoon conference call, Paterson and Milligan talked about the possibility of proceeding with the second special warrants financing. There was some brief discussion about the hedge fund structure but Milligan observed that KCA really did not have an interest in doing this, and suggested "why didn't we just get on with doing another special warrants financing." Milligan testified that it would have been easy because KCA had just done one. They could use the same prospectus being prepared to qualify shares under the first special warrants financing, to qualify shares for each transaction. He believed it was just going to be neater and tidier and more efficient and effective from KCA's perspective. Milligan stated that he tried, and that he thought Paterson was amenable, to focus the discussion on a special warrants financing.

[16] Although Milligan could not recall how McQueen was introduced, he testified that it was clear that McQueen was going to be fulfilling a role of shepherding the transaction and administering things that needed to be done to get any transaction that they might decide to do underway. They also discussed, and McQueen got into this part of the conversation, the size of the transaction that KCA could do given the 25% limit that the TSE places on the amount of capital that may be raised by a reporting issuer through a private placement exemption without shareholder approval. They also talked about fees, in terms of what the commission rate would be, what the percentage for broker warrants would be, and what the terms of those broker warrants might be. Milligan stated that the way the first special warrants financing was done was important in connection with the second special warrants financing. Milligan stated, "we knew that our starting point was $6.75, because that was the close on the previous day [February 28]." Milligan knew that when it came to discussing the exercise price for the warrants, it would be something up from that.

[17] Milligan testified that his sense, at the end of the conversation with Paterson and McQueen, was that there were still some issues to be negotiated, that KCA needed to do some talking on its side, and that the parties would pick up the conversation later. He observed that KCA had to determine the size of the transaction in terms of the number of units that would be issued, and that was really going to be the result of the mathematical formula based on TSE limit requirements. They had to conclude on the price of the offering. They had to conclude on the exercise price for the purchase warrants and the compensation warrants and the exercise periods.

[18] Milligan testified that on the morning of March 1, 2000, he and Paterson by telephone settled on the price of $6.75 for the units and the price of $7.75 as the exercise price of the warrants. The closing price of the KCA common shares on February 29, 2000 was $6.90. The discount price of $6.75 from $6.90 resulted in a premium much more significant than the premium in the first special warrants financing. Milligan testified that there seemed to be little flexibility about that.

[19] Milligan testified that prior to the afternoon conference call, he had spoken with Guolo, outside counsel for KCA, about how large a financing KCA could do, given that KCA had just done a special warrants financing. He and Guolo discussed the 25% limit.

[20] With respect to the size of the issue, Milligan testified that he was trying to strike a balance between raising as much money as KCA could through this financing, but being sure that KCA was well within the limit prescribed by the TSE. The parties settled on a $10 million issue.

[21] Milligan testified that he believed the second special warrants financing was a material transaction. The first transaction raised approximately $5 million. Given that KCA had something less at that point in time than $2.75 million in cash, the $5 million transaction was material at that point in time. Using the same rationale for a $10 million transaction, Milligan felt it certainly would be material. He testified that the financing was very, very important to the ongoing operations of KCA. The first special warrants financing provided KCA enough cash resources to get the company refocused. The second special warrants financing put KCA in a position where KCA had the luxury of more time and more options and the benefit of having that cash through the subsequent months and years.

[22] Milligan testified that the first special warrants financing had been presented to KCA by Yorkton with little room for negotiation. It had been agreed to within a day or two of being presented to KCA.

[23] The first special warrants financing contained a restriction on Temple Ridge from dealing with or selling any of the securities of KCA owned by it for a period of 90 days following the filing of a final prospectus, subject to the consent of Yorkton.

[24] Milligan testified that on December 10, 1999, the share price of KCA common shares was 45 cents per share. Volume was sluggish. Through the early part of 2000, and especially in early February, the share price was going up in a remarkable way, reflecting general market circumstances for technology companies at the time. It was a very hot market. It was feverish. KCA volumes were going up quite significantly.

[25] Milligan testified that he and Hyde always consulted each other on important financial matters for KCA. He remembered that he tried to get a hold of Hyde immediately after the first conversation with Paterson on February 29, 2000, and that, although he did not remember, he was quite sure that he must have got hold of Hyde by the end of the day.

2. McQueen

[26] McQueen testified as to the following.

[27] Under Paterson's tenure at Yorkton everyone reported to him in the normal course of the week-to-week business situation. Paterson was a very active and involved chief executive officer and would involve each of the persons in the corporate finance department, and have a

direct relationship with everyone, in any given month or week, on transactions, either potential or that actually occurred.

[28] McQueen testified that during the afternoon telephone conference with Milligan on February 29, he observed Paterson outlining a potential offering for KCA. The pitch was a $10 million special warrants financing at $6.75 for units that would have a common share and half a purchase warrant. The exercise price would be at a number higher than $7.00. McQueen believed that Milligan was open to the idea and undertook to go away and think about it and discuss it with his management team and also to check with his board of directors about their interest in pursuing it further. They also discussed issues involving borrowing arrangements and potential sales from Temple Ridge. McQueen confirmed that the $10 million figure was based entirely on the maximum that would be allowed to KCA under the 25% limit in the TSE private placement rules, taking into account the first special warrants financing. Paterson inquired whether or not Temple Ridge would lend to Yorkton free-trading shares of KCA through a term borrowing arrangement. There was some discussion about Temple Ridge selling stock at the same time as the special warrants financing and whether or not those two offerings could be done together.

[29] McQueen's recollection at the end of the conversation was that the parties had a short list of things to go away and pursue and consider: engagement letter to be prepared; borrowing arrangement to be researched; the size of the issue to be determined under the cap; the price of the warrants; and strike price of the purchase warrant. Milligan was going to go away and think about Temple Ridge's considerations in terms of a potential sale from their holdings as well as KCA's own potential issue, and to seek more direction, and to discuss the matter with his management team. Milligan stated that he would talk to his board about the financing on March 1, 2000.

[30] McQueen admitted that at the conclusion of the conference call with Milligan and Paterson there were four possible scenarios: 1) an issue by KCA of common shares, units or warrants; 2) no deal; 3) a Temple Ridge secondary offering of KCA shares and no treasury issue by KCA; and 4) a combination of a KCA treasury issue and a secondary offering by Temple Ridge sold to institutions as a package. McQueen stated, "from where I sat, those four outcomes were possible."

[31] McQueen testified that after the conference call with Milligan, Paterson sent him to get Donnini from his trading post and bring him into Paterson's office. Paterson reported and outlined for Donnini the discussion that Paterson and McQueen had just had with Milligan. Paterson advised Donnini of the potential size of the offering, being $10 million, that the unit price was going to be $6.75 per unit, and that there would be a purchase warrant that would be at a price north of $7.00, yet to be determined. Paterson advised Donnini that Temple Ridge was considering at the same time their own sale from their control block and how that may or may not interplay with the treasury offering by KCA itself. Paterson asked whether or not Donnini thought the treasury offering would work. According to McQueen, the gist of Donnini's response was, "Yes, it would work. It would sell. It would work." Paterson asked Donnini what his current short position was. Donnini responded that it was somewhere between half a million shares and a million shares. Paterson also asked Donnini what the average cost of the short position was. Donnini replied that it was a number that was north of $7.00, higher than $7.00.

McQueen reported that Paterson mused aloud about what the appropriate price - the differential - should be between the unit offering of $6.75 and the average price of the short price being over $7.00, and whether or not a number that was larger than 25 cents was appropriate and how that could potentially be shared with KCA.

[32] McQueen testified that when he first learned of the TSE's investigation into trading of KCA shares he was told by a Mr. McNenly, head of compliance at Yorkton, that a mistake had been made by a pro trader, which was not associated with the wholesale or institutional group, or was on a different floor at Yorkton, or in Chicago, who had traded KCA shares by mistake after it had gone on the restricted list, and that the TSE had come across this. This was the first that McQueen learned that regulators were looking into the trading of KCA shares. McQueen testified that he reported some angst to McNenly about being drawn into the investigation by the TSE, and that McNenly reflected McQueen's dissatisfaction to Paterson.

[33] Paterson called McQueen later that day to tell McQueen that there was nothing unusual about the investigation, that pro traders make these mistakes occasionally and that McQueen shouldn't be fussed. Paterson understood from McQueen's days at a bank-owned dealer that this was unusual, but that McQueen shouldn't take it as anything more than a normal course situation. McQueen testified that that message was reinforced by a Mr. Staley, a lawyer who was retained by Yorkton to do a report, when he met with McQueen regarding the investigation.

[34] McQueen testified that he inadvertently became aware of Staley's report during a Sunday board meeting in mid-September, 2001, to which he had been invited as a guest. The report was included in the materials for the board meeting and was dated May 7, 2001. McQueen testified that he was concerned that there were elements of the report that did not reflect his recollection of the events of February 29, 2000. In particular, he was concerned with the paragraph that read, "Both Donnini and Paterson have advised that they had no discussions with each other about the second KCA warrant financing until after it was announced on March 2, 2000. Donnini told the TSE that he learned of the second warrant financing when an internal announcement was made by e-mail on the morning of March 2, 2000." McQueen approached Alan Schwarz, who was then chief executive officer of Yorkton, and advised him that McQueen would be providing to the Commission later in the month different evidence under oath than had been provided in the report, and that he had witnessed the meeting between Paterson and Donnini on February 29, 2000. McQueen testified, "it was not until I discovered that there was an inaccuracy, that others had not given him [Staley] the truth, as I went on to do, that I realized there was a problem."

[35] McQueen testified with respect to a grey list. When a corporate finance officer becomes privy to material or potentially material non-public information, the person leading that file would put that security on the internal watch list, or grey list, which is for compliance purposes. This allows compliance to be able to track trading in the security. McQueen stated that the grey list is distributed to a very small group of people and does not go to the institutional sales or trading group. McQueen advised that the grey list is a tool. If someone in the corporate finance department is trading intentionally or unintentionally or just by mistake, the compliance department can take steps. McQueen testified that he was not the lead on the second special warrants financing and that he did not put KCA on the grey list. McQueen stated that Paterson, as the lead on the transaction, had the responsibility to put KCA on the grey list.

[36] McQueen testified that a restricted list is used by dealers as follows. Following the announcement of a financing, a security goes on the restricted list. The list is distributed around the wholesale institutional group so that both corporate finance officers as well as traders and certain salesmen would be aware that a stock was now restricted for the purposes of soliciting orders for trading.

[37] McQueen testified that the Yorkton bought deal committee approved the transaction on the morning of March 2, 2000 and right after this, compliance was asked to put KCA on the restricted list and an e-mail announcing the bought deal was sent to the institutional salesmen and retail brokers to sell the deal.

3. Campbell

[38] Campbell testified as to the following.

[39] In February and March 2000, his role and responsibility at Yorkton was head of the technology investment banking group and, specifically, relationship manager for many of the technology companies in Canada, including KCA. Campbell was involved in the first special warrants financing. He was not involved in the second special warrants financing until March 1, because he was out of the office the previous day. On the first special warrants financing, from the time he first contacted Hyde to propose the transaction, to the signing of the deal, there was a very rapid turnaround. He confirmed Milligan's testimony that there were no extensive negotiations as to the terms that were ultimately agreed to.

[40] On March 1, Campbell was approached by McQueen who was seeking help on an engagement letter. McQueen informed him that Paterson and Donnini had been involved in the proposal. Campbell recollected that McQueen informed him that the proposal that had been put together for KCA involved a size of approximately $10 million at a price of $6.75. Campbell signed a draft engagement letter on March 1. Campbell was vague as to the actual day on which he signed the draft engagement letter. When he was presented with documents to assist his recollection in order to place the first conversation he had had with McQueen, he replied that the documents did not really assist his recollection. He stated, however, that he could reconstruct from the documents in front of him that the conversation must have occurred late on March 1, 2000. We know, however, that the first draft of the engagement letter, signed by Campbell, was sent to Milligan at 11:22 a.m. on March 1 and must have been drafted some time before then.

4. Hyde

[41] Hyde testified as to the following.

[42] Hyde relied upon Milligan to negotiate terms of deals during their working relationship. He first heard about the proposed second special warrants financing in the late afternoon on February 29, 2000, and that it would be a $10 million offering, although there was some question as to the number of shares that would be available, because further calculations were required.

In response to the question by counsel for staff, "So, as of February 29, 2000, I take it your intention with working through Mr. Milligan was to try and complete the terms of that deal?", Hyde answered, "Yes, over the next couple of days, absolutely, that's correct."

[43] Hyde confirmed that KCA faced a serious financial situation in late 1999 and early 2000. He stated, "There would be no doubt about it. We were certainly holding on." He confirmed that in 1999 KCA reported a net loss of $11.9 million, compared to a loss of $5.3 million in 1998, and that at December 31, 1999 KCA had cash and cash equivalents of $2.8 million compared to $10.1 million as at December 31, 1998. In 1999, operations used cash of $6.5 million compared to $3.5 million in 1998. He confirmed KCA was looking for cash. Hyde also confirmed that KCA was pleased to hear there was a proposal for a second special warrants financing and that he had felt very positively towards completing the deal. Hyde admitted that the second special warrants financing represented a very significant change for KCA going forward.

[44] Hyde stated that sales from Temple Ridge of shares of KCA was something that he and Milligan were always interested in. However, he stated, "I would just hate to paint it in the picture of pre-occupation because history would show that even when our stock reached very significant levels it was never – we never took advantage of those things. This was just an opportunity that presented itself, I think would be fair to say."

[45] With respect to engaging outside counsel, Hyde confirmed that KCA's board of directors was very insistent in involving outside counsel when looking at a financing. He admitted that when KCA involved outside counsel, it was because KCA was very interested in having the matter moved forward. When informed subsequently that on February 29, 2000, Milligan had engaged outside counsel, Hyde stated, "In fact I would have considered it to be an abnormal practice if we hadn't involved her, particularly around the issue of the number of shares available for sale, something that was on the top of our mind."

5. Paterson

[46] Paterson testified as to the following.

[47] He was not involved in the first special warrants financing for KCA but he learned of it shortly after the deal was concluded. He was very aware of KCA's need for cash.

[48] On the morning of February 29, it looked like KCA was going to open a lot higher. It had closed on February 28 at $6.75. He testified, "So my thoughts were to give the company a call, and although it would be extremely unusual to do a second transaction within four days of the first transaction, that they were in a very unique position and should consider doing something. . . . I proposed he [Milligan] talk to Paul Hyde about considering a second financing, given what was happening with the stock." He stated, "I was suggesting that he consider a treasury issue. I thought in light of what was happening with the stock and the unprecedented liquidity, they should seriously consider something." Although Milligan's first reaction was one of surprise and a suggestion that rather than doing a treasury deal, Temple Ridge preferred to do a secondary offering of KCA shares, he discounted Milligan's reaction as not unusual and

instinctive in the first instant, testifying, “So his instincts were probably, this is so unusual, my initial instincts are probably to say I might not be interested.”

[49] When asked whether Paterson talked with Donnini on February 29, prior to the 2:45 p.m. meeting with McQueen and Donnini, Paterson did not say no. Rather, he carefully replied, “Not in respect of doing a deal with the company, but I was aware that Mr. Donnini was shorting [KCA] stock on our behalf. And so in that connection, we would have had discussions that day or the prior day.”

[50] Paterson testified that when he approached McQueen about helping on the transaction, he said something like, “Come on down and see how a deal can be put together.” Paterson testified, “He was a young guy and I wanted to instil a sense of how to, hopefully, take a deal from an initial conversation to fruition.”

[51] Paterson recollected that the conference call with Milligan and McQueen involved a lot of time concerning what would be the pros and cons if KCA did something on the treasury side, if they did something with Temple Ridge, if they did something together, or if they didn’t do anything at all. Paterson talked about the disadvantages of combining a control block sale and a treasury deal relative to the payment of commission and the free-tradeability of shares. Paterson’s view was that KCA was a huge beneficiary of what had happened to their stock price in liquidity. Paterson testified, “My instincts were, Paul, or pardon me, Michael, you know, part of the discussion was, there’s a whole bunch of money for the company and also sell two million shares for Temple Ridge? Well, I didn’t think the company could accomplish that. So on the one hand of the range you had a huge deal. On the other end of the range, if you totally focused on the treasury issue it was all really a function in my mind of how much stock could be borrowed by hedgers. So my instincts were about 10 million I was thinking . . . my view was they had to put the treasury interests ahead of Temple Ridge’s interests . . . What I am saying is that I felt reasonably comfortable that we could, on their behalf, complete an underwriting for about $10 million for a treasury issue.”

[52] When asked if he had any recollection as to what other terms were discussed with Milligan and McQueen, Paterson replied, “Well, my view was that the price would be in the context of the market obviously, the time we were ready to do a deal. The market at that point was 7 to 7 ¼, and my instincts, the company would probably do something, and we would feel comfortable in the 6 3/4 range where they would have to add half a warrant.”

[53] In answer to a question about the complications involved in combining a treasury issue with a sale of from the control block of Temple Ridge, Paterson testified, “If you need to do a unit deal to effectively sell a special warrant deal, you have to get the control block to package a unit for you as well. You can’t sell one person free-trading shares and another person a unit that has a hold period. So that’s exactly the kind of complication we were talking about when people tried to do both at the same time.”

[54] Paterson testified, “I think we ended the conversation by Michael saying he was going to get in touch with Paul Hyde and get back in touch with us.”

[55] Paterson testified that immediately after the conference call with Milligan he called Donnini into his office, "and we had a very brief discussion and I told Mr. Donnini what my instincts were with respect to advice I had given the company, and I asked for, solicited his opinion for the marketability or viability of doing *the* deal." [emphasis added] In answer to a question about what he said to Donnini, Paterson testified, "My recollection was, I'm thinking, you know, about this company doing a $10 million deal in the context of the market. You know, look at the market, both aware of the market, and I'm thinking 6 3/4, what's your view?" Paterson added, "I may have asked him what his short position was. I was aware that we bought back special warrants from the purchasers of the first transaction which had just closed four days earlier. And also aware that we had been, along with all the shareholders of Kasten Chase, very lucky as a firm, because part of our compensation in the first transaction, we had 8% cash fee but we also had compensation options. And on an unrealized basis, we had a very fortuitous position and had a huge unrealized gain. So I was very much behind his decision to be, try to lock in those gains and also hedging the purchases from the special warrant purchasers. So I wanted to know where he was at from that perspective." Elsewhere Paterson testified, "I called our head trader, Mr. Donnini, into my office. And we had a very brief discussion and I told Mr. Donnini what my instincts were with respect to advice I had given the company and I asked for, solicited his opinion, for the marketability or viability of doing the deal... I don't think I got into the multitude of things that we spoke to Mr. Milligan about. Could be wrong but that's not really my recollection."

[56] Paterson testified that Donnini's response was that he thought it would be highly unlikely to clear a deal at that price because he didn't think the buyers would pay up. Paterson continued, "and I immediately said, I'm thinking in terms of hedgers. He said that's probably the only way it will get done." Paterson later in his testimony observed that because Yorkton had been shorting KCA shares and the average price was greater than $7.00, Paterson was willing to pursue the transaction.

[57] In discussing the final pricing of the deal around mid-day on March 1, 2000 Paterson testified, "Well, mid-day I was trying to, you know when you talk within the context of market, as I said earlier, as everybody knows its in the context of the market, if the stock goes down you have to lower the price, if the stock goes up you try to keep it the price you were talking about for the benefit of new shareholders. And so I was still on the same kind of theme, $10 million in the 6 3/4 range."

[58] Paterson testified that Yorkton committed its capital to the deal on March 2, 2000 when its bought deal committee approved the transaction with respect to Yorkton's short position.

[59] Paterson stated that he had discussion with Donnini every day he was putting on short positions. However, at another point in his testimony, Paterson stated that he had no recollection of any conversations with Donnini on March 1, 2000.

[60] With respect to the various scenarios referred to, Paterson said that a prime motivating factor in his discussions with Milligan was to take him through the issues that would need to be addressed based on the various possible scenarios, and to educate him. Paterson testified that he did not remember what Milligan wanted to do with Temple Ridge, with respect to the exact number of shares, but stated, "They could have whatever wish list they wanted. It was going to

be a function of what we thought was accomplishable. So they certainly talked big numbers but I don't remember the numbers." In other words, the deal that would be done would be one that Yorkton could place.

[61] Paterson described where he thought buyers for the issue would come from. He testified that, "There would be limited fundamental buyers, the people that actually believed, the market capitalization at $7.50 was $300 million. It was $20 million in December. They lost $12 million in the prior year, burning $10 million a year. So hard to justify the merits of a $300 million market capitalization. The buyers were either going to come out of the woodwork by momentum, fundamental buyers thought there was a lot of momentum. Buyers that buy where there is a significant discount to the market. And that's where pricing in context of the market becomes very important. There are investors that if they see a $7.70 quote, buy at $6.75. They will take a shot because they think they've got a little bit of a buffer. And the buyers I expected to be the biggest buyers would be the hedge funds because for them if they can sell stock at $7.70, buy at 6 3/4 - short stock at $7.70, buy at 6 3/4 and have half a warrant for free, that's the business hedge funds are primarily in. So the context of the market becomes critical."

[62] This, Paterson tried to explain to Milligan. Paterson testified, "It's a very complicated, complex issue and it's important he understood the pros and cons of doing a transaction where we expected it to be mostly hedge funds that bought it. So I believed he had certainly a knowledge at the end of the conversation where I was comfortable moving forward if he chose to move forward at a later date on behalf of the company. But I wouldn't say he completely understood hedge funding strategies."

[63] Paterson testified in the context of before, during and after the conference call with Milligan that, "I didn't believe, as I mentioned earlier, that the company should necessarily do the control block sale at the same time . . . . That's why I had him focus on a treasury deal. But I think the more important answer is, when you try to create a transaction, the same way I went down the hall and found Mark and said something along the lines 'Come and see how to do a deal,' I wanted him to see how building momentum, educating them, the temperament of when you call, how often to call, put in place the notion of let's prepare an engagement letter, let's send it to them because the written word is pretty powerful. So when you get a draft engagement letter it starts your mind turning toward that. So I always employed that type of strategy when someone was contemplating a deal; we tried to make them feel that they were going to take that to fruition. So that was behind the thinking at that point."

[64] Paterson testified that Yorkton bought 650,000 units of the transaction for its own account. That was $4.7 million out of the $10 million. Paterson testified that Yorkton's retail sales persons had received indications of interest from sophisticated retail clients in purchasing a total of 609,500 special warrants. Retail sales were allocated 431,000 of the 1.483 million special warrants that were to be distributed. Except for some hedge fund clients, Yorkton's institutional clients were not interested in purchasing KCA units in the second special warrants financing. Yorkton purchased as principal the remaining 650,000 special warrants with the result that fewer special warrants were allocated to sophisticated retail clients. Paterson explained that the reason the demand for 609,500 special warrants was cut back to 431,000 special warrants was that the syndication department had experience with a number of brokers who had padded their orders historically and on closing not delivering on behalf of the client and

that caused problems. They used their judgement unbeknownst to Paterson and determined who was going to get those shares.

6. Donnini

[65] Donnini testified as to the following.

[66] His number one role at Yorkton was to manage the firm's liability trading on a day-to-day basis. He did not have to get pre-clearance on anything he traded in the firm's liability account.

[67] Donnini testified that he thought the stock price had disconnected from the fundamentals of KCA. It was a company effectively out of cash in early February. He believed the stock price at $6.75 at the market closing on February 28 was "incredible", "unbelievable". Donnini considered that the market during the material time was in a speculative bubble. However, in answer to questions about speculating, Donnini testified that he was shorting as a risk management tool. He stated, "You are technically shorting the stock, because you cannot make good delivery in three days. But what, in effect, you are attempting to do is to make your position 'market neutral' as we refer to it, meaning your balance at the end of the day, your exposure at the end of the day, is as close to zero as you can get it. And that is all that that shorting, in this situation, was attempting to achieve. It wasn't speculating on anything actually."

[68] Donnini testified that he remembered a telephone call from Milligan at 10:30 a.m. on February 29. He had never spoken to Milligan before and the call was out of the ordinary. He stated that they talked about hedge funds, hedging and hedging strategies. He denies there was any discussion of a financing at all. He also remembered a second telephone conversation at 12:37 p.m. when Milligan called him back. Donnini said he had no idea as to why Milligan was interested in the concept of hedging and hedge funds.

[69] Donnini testified that he started using a jitney around 12:40 p.m. on February 29, 2000, shortly after he had spoken to Milligan the second time. He stated that he did this because he was concerned that Milligan might not approve of Yorkton's short selling of the stock. Donnini stated, "I again wanted to make sure I didn't have to have an investment banker come at me angry that we were selling it and having to explain it to an issuer, or me having to field that phone call."

[70] Donnini stated that he did not recall the three-minute conversation with Paterson in the presence of McQueen at 2:45 p.m. on February 29, 2000. Although Donnini said he had no recollection of the conversation, he speculated that it was because, "I would have left with no - with the thoughts there was zero possibility of anything happening or no possibility."

[71] Donnini stated that he was the fourth-largest shareholder of Yorkton Holdings Ltd., the parent company of Yorkton Securities Inc. Donnini also admitted that his relationship with Paterson was more akin to something of a partnership, as it was with all of the other major shareholders of Yorkton.

[72] Donnini admitted he had taken all of the necessary courses to inform himself of his responsibilities as a registrant and the conduct expected of him as a registrant. He also admitted that in his role as head trader, he appreciated the integrity of the capital markets depends on equal access to information by all prospective investors.

[73] Donnini admitted that he first became aware of the first special warrants financing on February 11, 2000 and that at this time he was also aware of KCA's financial difficulties. Donnini stated that the first special warrants financing saved KCA, for sure.

[74] With respect to his first conversation with Milligan, Donnini was asked about the testimony of Milligan. Milligan had stated that the gist of his self-introduction to Donnini was: "I had a conversation with Mr. Paterson; that he had proposed this kind of transaction; I simply referred to it as being a transaction involving a hedge fund and Mr. Paterson suggested that I could speak with you and you could help me understand this kind of transaction." While Donnini stated that he did not remember specifics, and elsewhere in his testimony he denied that there had been any talk of a transaction, he commented that this portion of Milligan's testimony made sense.

[75] Donnini denied that he talked with Paterson on the morning of February 29, 2000 prior to Paterson's call to Milligan, or indeed prior to the 2:45 p.m. meeting with Paterson and McQueen.

V. Submissions

A. Counsel for Staff

[76] Counsel for staff argued that Part XVIII of the Act prescribes continuous disclosure obligations for reporting issuers in Ontario. These obligations differ depending on the nature of the information. In particular, they differ whether the information constitutes a material change or a material fact. Information respecting a material change must be disclosed forthwith. That is dealt with in section 75(1) of the Act. In contrast, the Act does not require forthwith disclosure of information respecting a material fact. However, pursuant to section 76(1) of the Act, there is a prohibition on persons in a special relationship with a reporting issuer from purchasing or selling securities of the reporting issuer with knowledge of a material fact with respect to the reporting issuer that has not been generally disclosed. Counsel argued that the issue was not whether on February 29, 2000, or March 1, 2000, there had occurred a material change relative to KCA that required immediate disclosure, but rather whether on those dates there existed a material fact of which Donnini had knowledge that had not been generally disclosed which should have restricted Donnini from trading in shares of KCA.

[77] Counsel argued that there were two principal issues we had to decide. First, whether the information, based on an objective, reasonable standard, amounted to a material fact; and second, whether Donnini had knowledge of the material fact at the relevant time.

[78] Counsel argued that there are two alternative tests of materiality in the Act. The first test requires proof that the material fact significantly affects the market price of the security, commonly referred to as the market impact test. The second test requires proof that the material

fact would reasonably be expected to have a significant effect on the market price or value of a security. This latter test is based on an objective or reasonable standard as opposed to the first test. Counsel argued that it was open to the Commission, as an expert tribunal, to make a finding of whether the facts were material, based on the second, objective test.

B. Counsel for the Respondent

[79] Counsel for the respondent submitted that we should not make new policy in this hearing. It was a hearing into the conduct of Donnini. While not disputing the fact that we may address matters of public interest, he submitted that we should limit ourselves to applying existing law and policy to the facts of this case and not wander into the area of declaring new policies or procedures through this hearing to the detriment of the respondent.

[80] He argued that although counsel for staff need not prove use as an essential element of the offence under section 76(1), use is important in determining the question of knowledge.

[81] Counsel for the respondent argued that the burden of proof that Donnini violated section 76(1) of the Act was on staff and not the respondent. He also stated that if there is any suggestion of limiting a license of a professional to practice, or revoking a license to practice, or interfering with the opportunity of a person to gain a livelihood, staff has a high burden of proof. He did not suggest it was a criminal burden, which is beyond a reasonable doubt, but it is more than a civil burden, which is beyond a balance of probabilities. He referred us to *Re Rosen* (1991), 14 O.S.C.B. 1091 at 1093 (*Rosen*), where the Commission cited the statement in *Re Coates et al. and Registrar of Motor Vehicle Dealers and Salesmen* (1988), 65 O.R. (2d) 526 at 536 (*Coates*), that, "Nothing short of clear and convincing proof based upon cogent evidence will satisfy at an administrative tribunal in revoking a license to practice medicine or to gain a livelihood in business."

[82] Counsel for the respondent argued that the purpose of section 76(1) of the Act is to punish clear violations where it can be shown that there was a well-established material fact and that the person impugned knew about it. This section is not intended to apply, he argued, where there is a debate about whether the facts are established and where two or more versions of possible events might pertain.

[83] Counsel for the respondent argued that section 76(1) of the Act, while it applies to employees of a person in a special relationship with a reporting issuer, is not aimed principally at such a person. He argued that the level of proof and the level of involvement when you get down to an employee has to be a little greater than when we are dealing with officers or directors.

[84] Counsel for the respondent submitted that Donnini's conduct, at worst, constituted reasonable mistake on his part.

VI. Considerations

[85] In weighing the evidence and assessing the submissions of counsel we considered as follows.

[86] McQueen was very careful in his testimony to distinguish between matters he recollected and matters he did not recollect. McQueen had specific recollection that during the conference call among Paterson, Milligan and McQueen, they talked about pricing of the transaction and specific dollar terms. Milligan's testimony was that there was discussion in terms of discounts to the market, although McQueen did not recollect that. McQueen admitted, however, that it might have been discussed. Milligan had a recollection of a discussion about fees. McQueen had no such recollection. Again, however, he was careful to state that he did not say that fees were not discussed. He admitted only that he did not have a recollection of a discussion about fees. There were other matters that Milligan had a recollection of, such as what percentage Yorkton would get for broker warrants, that McQueen did not recollect. Milligan had a recollection of a discussion of hedging. McQueen stated, "If the phrase 'hedge' was used on that call, I do not recall it. I am not saying it did not happen. It may very well have happened. It was over two years ago."

[87] In September 2001, McQueen inadvertently learned of Staley's report that included details of Yorkton's participation in the second special warrants financing. Some elements of that report conflicted with McQueen's recollection of the events of February 29, 2000 and McQueen so advised Schwartz, Yorkton's chief executive officer at that time. In particular, the original report stated that Paterson and Donnini had advised that they had had no discussions with each other about the second special warrants financing until after it was announced on March 2, 2000. That inaccurate assertion, although subsequently corrected after McQueen came forward, suggested that the participants knew the significance of the meeting at 2:45 p.m. on February 29, 2000.

[88] In agreeing to step forward to testify, McQueen was courageous and did the right thing. We can imagine that he must have experienced many difficult moments as a result of his honourable stance. McQueen has been a great assistance to the Commission.

[89] We found that both McQueen and Milligan were credible witnesses. Each appeared to us to attempt honestly and to the best of his ability to reflect only what he could recollect and not to build on supposition and speculation. For example, Milligan stated that he must have talked to Hyde on February 29 about the proposed transaction. He admitted, however, that he could not recollect specifically speaking with Hyde on that date. Hyde, of course, confirmed that Milligan had spoken with him on that date. We found McQueen to be not only credible but also meticulously careful in giving his answers. While there may have been apparent minor inconsistencies in the testimony of Milligan and McQueen with respect to the conference call on February 29, both McQueen and Milligan were telling what happened as they recollected it. Each remembered points that appeared important to them at the time. Each led us to the conclusion that serious negotiations were then well underway for a proposed transaction for a second special warrants financing of approximately $10 million at a discount to market at approximately $6.75 but that further negotiation would be necessary to come to a definitive deal.

[90] We found Campbell's recollections not to be strong. In addition, Campbell did not answer questions with the same care that Milligan and McQueen showed in their answers. Accordingly, we did not give much weight to specific answers of Campbell where those answers may have suggested different interpretations of events from those evidenced by the documents or other witnesses.

[91] Paterson testified on his feet, addressing his answers with intensity and conviction directly to the Commission. We got a glimpse of how charismatic and persuasive Paterson could be. We were uncomfortable about how serious Paterson viewed the conduct of Donnini, Yorkton and Paterson. Yet we had no reason to believe that Paterson was not being truthful in testifying as to the events of February 29 and March 1, 2000 and as to his insight, instincts and modus operandi at the time. Indeed, we did not find the testimony of Milligan, McQueen or Paterson to be fragile or suspect.

[92] McQueen testified that the kind of question Paterson asked Donnini was, "What would the market appetite be if we did a deal for Kasten Chase?" In view of McQueen's fastidious precision in giving his testimony, it is likely that Paterson used those words, among others. The question is, what else, if anything, went with those words to communicate to Donnini that there was a proposal under serious negotiation for a second special warrants financing.

[93] We accepted Hyde's testimony without difficulty.

[94] We did not have confidence that Donnini was being truthful in all of his testimony. He appeared eager to fill in holes by speculating (for example, as to reasons why he would not have put much stock in what Paterson would have told him had he recollected the conversation, with respect to the probability of a transaction occurring).

[95] Milligan testified that he mentioned to Donnini that he had been talking with Paterson about a potential transaction. It involved hedging or was a hedge transaction. Donnini testified that the discussion with Milligan was about a hedging transaction and was conceptual and not specific to KCA. Milligan confirmed that the discussion was conceptual. Donnini, however, testified that although Milligan had called him out of the blue on the morning of February 29, Donnini had no idea where Milligan got Donnini's name. This contradicts Milligan's testimony that he mentioned to Donnini that he had been speaking with Paterson about a transaction. We accept Milligan's version of the telephone conversation with Donnini.

[96] Counsel for the respondent suggested in his written argument that Donnini did not have the benefit of the 20-minute conversation between Paterson, McQueen and Milligan and that Donnini was not told that there had been such a conversation. However, McQueen testified concerning the three-minute meeting between Paterson and Donnini as follows, "It was about three minutes in length. Mr. Paterson reported - outlined the discussion that we had had with Mr. Milligan.... Mr. Paterson advised Mr. Donnini that Temple Ridge was considering at the same time their own sale from their control block and how that may or may not interplay with the treasury offering by Kasten Chase itself; and he asked whether or not - he asked Mr. Donnini whether or not the treasury offering would work." In addition, Paterson testified concerning his conversation with Donnini, "I called our head trader, Mr. Donnini, into my office. And we had a very brief discussion and I told Mr. Donnini what my instincts were with respect to advice I had

given the company and I asked for, solicited his opinion, for the marketability or viability of doing the deal... I don't think I got into the multitude of things that we spoke to Mr. Milligan about. Could be wrong but that's not really my recollection."

[97] McQueen's and Paterson's versions of the conversation that Paterson had with Donnini are consistent, although there are different nuances. McQueen made it clear that Donnini's response was that the transaction would sell. Paterson stated that Donnini's response was that he thought it would be highly unlikely to clear a deal at $6.75 because Donnini did not think the buyers would pay up. Paterson then suggested that he was thinking in terms of hedgers, and, according to Paterson, Donnini said that that's probably the only way it would get done. Donnini did not recollect the meeting at all, although he speculated that if he had been spoken to by Paterson at 2:45 p.m. on February 29 he would not have concluded that a deal was probable. Furthermore, even if we had determined that Donnini's speculation as to how he would have reacted amounted to conflicting testimony, we would not have accepted it over Paterson's and McQueen's. His speculation was self-serving and not reasonable. He knew Paterson made things happen and was a determined visionary who enjoyed having his market instincts lead to a deal, where his sense of the market indicated it could be done.

[98] With respect to the four scenarios available after the telephone conference among Milligan, Paterson and McQueen:

a) The possibility that Temple Ridge might do a secondary offering had, reading between the lines, 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 warrants financing and a secondary offering by Temple Ridge was not a realistic option.

c) The proposed second special warrants financing was the principal scenario and by far the most probable. The deal that would be done would be the one that Yorkton could place. Milligan confirmed this in his testimony that there was little room for negotiation. 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 afternoon telephone conference call. 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. 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 warrants financing. During the conference call among Paterson, Milligan and McQueen, they talked size, pricing, fees and a similar kind of structure to the first special warrants financing. There was little flexibility from Yorkton on the discussion point of compensation. Milligan's sense at the end of the conversation, which we accepted, 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 with a high probability that they would soon lead to an approved deal.

d) There was the possibility of no deal at all. This, we found, 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.

[99] 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 warrants financing. This was not a precondition of Paterson to do the second special warrants financing. Furthermore, Milligan made it clear in the conference call involving Paterson, Milligan and McQueen that he wanted to concentrate on a straight second special warrants financing, and Paterson was amenable to focussing the discussion on a second special warrants financing.

VII. Analysis

A. Standard of Proof

[100] Counsel for the respondent referred us to *Re Seal* (1996), 19 O.S.C.B. 1529 at 1535-1536 (*Seal*), where the Commission stated:

> Mr. Peters reminded us that in a proceeding of this sort, where the licensing or registration of a person or company is at stake, although the required standard of proof is the civil one - i.e. the balance of probabilities, and not the criminal one, the degree of proof required is that the proof must be clear and convincing and based upon cogent evidence which is accepted by the tribunal. He referred us to the decision of the Divisional Court in *Re Bernstein and College of Physicians and Surgeons of Ontario* (1977), 15 O.R. (2d) 447. In that case, O'Leary, J. (with whom Steele, J. concurred) said the following at page 470:

> "The important thing to remember is that in civil cases there is no precise formula as to the standard of proof required to establish a fact.
>
> In all cases, before reaching a conclusion of fact, the tribunal must be reasonably satisfied that the fact occurred, and whether the tribunal is so satisfied will depend on the totality of the circumstances including the nature and consequences of the fact or facts to be proved, the seriousness of an allegation made, and the gravity of the consequences that will flow from a particular finding.
>
> The grave charge against Dr. Bernstein could not be established to the reasonable satisfaction of the Committee by fragile or suspect testimony. The evidence to establish the charge had to be of such quality and quantity as to lead the Committee acting with care and caution to the fair and reasonable conclusion that he was guilty of the charge. In this case where Dr. Bernstein, a man of good reputation swore that no impropriety occurred between himself and Jo-Anne Johnston it would take very strong evidence to destroy his defence of his reputation."

At page 485, Garrett, J. said the following:

> "I hold that the degree of proof required in disciplinary matters of this kind is that the proof must be clear and convincing and based upon cogent evidence which is accepted by the tribunal. I agree with Mr. Justice Schroeder that the burden of proof is to establish the guilt of the doctor charged by a fair and reasonable preponderance of credible testimony, the tribunal of fact being entitled to act upon the balance of probabilities. I think, however, that the seriousness of the charge is to be considered by the tribunal in its approach to the care it must take in deciding a case which might in fact amount to a sentence of professional death against a doctor."

In *Re Coates et al and Register of Motor Vehicle Dealers and Salesmen*, (1988), 65 O.R. (2d) 526, the Divisional Court again dealt with the matter, and Reid, J., speaking for the court, adopted the *Bernstein* standard. After referring to the passages from *Bernstein* quoted above, he said the following, at page 536:

> "This message is clear and has been consistently adopted by this court. Nothing short of clear and convincing proof based upon cogent evidence will justify an administrative

tribunal in revoking a licence to practice medicine or to gain a livelihood in business.

The concept that the standard of proof rises with the gravity of the allegation and the seriousness of the consequences has been reaffirmed in the recent decision of the Supreme Court of Canada in *R.* v. *Oakes* (1986), 26 D.L.R. (4th) 200, 24 C.C.C. (3d) 321, [1986] 1 S.C.R. 103, 53 O.R. (2d) 719*n*. There Chief Justice Dickson said, at p. 226 D.L.R., p. 137 S.C.R.:

> "Within the broad category of the civil standard, there exist different degrees of probability depending on the nature of the case: see Sopinka and Lederman, *The Law of Evidence in Civil Cases* (Toronto, 1974), at p. 385. As Lord Denning explained in *Bater* v. *Bater*, [1950] 2 All E.R. 458 at p. 459(C.A.):
>
> > "The case may be proved by a preponderance of probability, but there may be degrees of probability within that standard. The degree depends on the subject-matter. A civil court, when considering a charge of fraud, will naturally require a higher degree of probability than that which it would require if considering whether negligence were established. It does not adopt so high a degree as a criminal court, even when it is considering a charge of a criminal nature, but still it does require a degree of probability which is commensurate with the occasion."
>
> This passage was cited with approval in *Hanes* v. *Wawanesa Mutual Ins. Co.*, [1963] 1 C.C.C. 321 at p. 339, 36 D.L.R. (2d) 718 at p. 733, [1963] S.C.R. 154 at p. 161. A similar approach was put forward by Cartwright J. in *Smith* v. *Smith*, [1952] 3 D.L.R. 449 at p. 463, [1952] 2 S.C.R. 312 at pp. 331-2:
>
> > "I wish, however, to emphasize that in every civil action before the tribunal can safely find the affirmative of an issue of fact required to be proved it must be reasonably satisfied, and that whether or not it will be so satisfied must depend on the totality of the circumstances on which its judgment is formed including the gravity of the consequences . . ." "

[101] The consequence of the orders we are making under section 127 will be to severely interfere with Donnini's ability to earn a livelihood in the securities industry; however, as in the *Gordon Capital* case involving registration, which counsel for the respondent referred us to, the focus of the proceeding has not been to deprive Donnini of anything but to determine whether it is in the public interest to make the orders: *Gordon Capital Corp.* v. *Ontario (Securities Commission)* (1991), 50 O.A.C. 258 at paragraph 36 (Div. Ct.) (*Gordon Capital*), relying on the earlier registration case *Re The Securities Commission and Mitchell*, [1957] O.W.N. 595 at 599 (C.A.). A proceeding under section 127 of the Act is different from a proceeding in the courts under section 76(1). Having stated this, in the case before us, we were firmly convinced well beyond a balance of probabilities, by facts which we found, based on cogent evidence, to be clear and convincing, that Donnini had knowledge of material facts with respect to KCA that had not been generally disclosed when he purchased and sold shares of KCA on February 29 and March 1, 2000.

B. Insider Trading

1. Statutory Framework

[102] Section 76 of the Act provides:

> (1) No person or company in a special relationship with a reporting issuer shall purchase or sell securities of the reporting issuer with the knowledge of a material fact or material change with respect to the reporting issuer that has not been generally disclosed.
>
> (2) A "person or company in a special relationship with a reporting issuer" means,
>
> > (b) a person or company that is engaging in or proposes to engage in any business or professional activity with or on behalf of the reporting issuer...
> >
> > (c) a person who is a director, officer or employee of…a person or company described in...clause (b);
> >
> > (d) a person or company that learned of the material fact or material change with respect to the reporting issuer while the person or company was a person or company described in the clause...(c);

[103] Section 1(1) of the Act defines "material fact" and "material change" as follows.

> "material fact", where used in relation to securities issued or proposed to be issued, means a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of such securities;

> "material change", where used in relation to the affairs of an issuer, means a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer and includes a decision to implement such a change made by the board of directors of the issuer or by senior management of the issuer who believe that confirmation of the decision by the board of directors is probable;

[104] The purposes of the Act are to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets. Among the primary means for achieving these purposes are requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants.

2. Harm to Investor Confidence in the Capital Markets

[105] Shortly after the introduction of the forerunner to section 76(1), in *Re Kaiser Resources Limited* (1981), 1 O.S.C.B. 13C at 16C (*Kaiser*), the Commission articulated the policy basis for this provision:

> Persons in a special relationship with a reporting issuer are likely to be in a preferential position with respect to material corporate information. Accordingly they are in a unique position to exploit their position to their advantage, and to the disadvantage of other investors not having that opportunity. If the credibility of the capital markets is to be preserved, it is essential that a high level of responsibility be expected and demanded of such persons, and any failure to meet that standard must be regarded with great seriousness. This responsibility, of course, includes the filing of reports by insiders even though this requires the giving up by them of certain of their rights to privacy, and the restrictions by those in a special relationship of their activity in the public markets when they are in possession of undisclosed material information.

[106] In *Re Woods* (1995), 18 O.S.C.B. 4625 at 4627 (*Woods*), the Commission stated,

> The prohibition on 'insider trading', i.e. trading in securities of a reporting issuer with the knowledge of a material fact or material change with respect to the reporting issuer which has not generally been disclosed, is a significant component of the scheme of investor protection and of the fostering of fair and efficient capital markets and confidence in them, that are the cornerstones of the Act. It would be grossly unfair to permit a person who obtains undisclosed material information with respect to a reporting issuer because of his relationship with the issuer to trade with the

> informational advantage this gives him or her. To quote the striking analogy used by Farley J.:
>
> > "It is not just a question of the house in a casino situation moving the odds in a card game or the dealer counting cards, it is akin to the dealer being able to play with marked cards."
>
> As Farley J. went on to say:
>
> > "when one actually trades with the benefit of inside information, then the seller is not an innocent and lucky winner. Rather the insider trader is a rapacious thief.
>
> As well, such activity, if countenanced, would detract from the credibility of our capital markets and lead to the undermining of investor confidence in those markets. In addition, the prohibition encourages timely disclosure of material changes, enabling investors to make better informed investment decisions. Accordingly, an intentional violation of the prohibition is, and must be regarded by the Commission as being, a very serious matter. It is not for us to punish the offence, the courts have already done that. Having found that Woods was guilty of insider trading, what we now are obliged to consider is whether, and if so to what extent, the public interest requires us to intervene to protect the marketplace, and investors in it, from future improper or illegal activities by Woods.

3. The Essential Elements of Insider Trading

[107] Larry Woods was a director of the Plastic Engine Technology Corporation (Plastic Engine). Woods did not trade for his own account. Instead, he sold Plastic Engine shares for a Mr. Richardson, in an effort to protect Richardson's investment in the company. In *R.* v. *Plastic Engine Technology Corp*. (1991), 15 O.S.C.B. 2637 (Ont. Prov. Div.), Woods was found guilty and convicted of short selling stock while in possession of material information which had not been generally disclosed. In sentencing Woods, Justice Young reiterated his earlier finding that Plastic Engine's dire financial condition was a material fact: *R.* v. *Plastic Engine Technology Corp*. (1991), 15 O.S.C.B. 2651 (Ont. Prov. Div.). Justice Young's finding was upheld by Justice Farley of the Ontario Court of Justice, General Division, in *R.* v. *Plastic Engine Technology Corp*. (1994), 88 C.C.C. (3d) 287 (Ont. Gen. Div.) (*Plastic Engine*), leave to appeal refused (1994), 89 C.C.C. (3d) 499 (Ont. C.A.).

[108] In *Plastic Engine*, at 300, Justice Farley examined the statutory provision on insider trading in its four constituent parts:

> a) the respondent is in a special relationship with the reporting issuer;
>
> b) the respondent purchases or sells securities of that reporting issuer;

c) with the respondent having knowledge of material information about the reporting issuer;

d) which material information has not been generally disclosed.

[109] In the case before us, KCA was a reporting issuer at the material time. As soon as Paterson proposed to Milligan in the morning phone call to do a second financing, Yorkton was in a special relationship with KCA. Donnini was an employee of Yorkton and he learned of the proposed second special warrants financing in his capacity as an employee of Yorkton. Therefore, under paragraphs (c) and (d) of section 76(2), Donnini was in a special relationship with KCA. Donnini admitted that he purchased and sold common shares of KCA on February 29 and March 1, 2000. The second special warrants financing was not generally disclosed until March 2, 2000.

[110] The key questions before us were: (i) whether information concerning the second special warrants financing was material, (ii) whether the information constituted a fact, and (iii) whether Donnini's knowledge of the information was knowledge of a material fact. With respect to the first two questions, however, under the Act there is only one determination: is the information a "material fact"? In making this determination, we considered it useful, as a preliminary step, to analyze the questions of when material information may be considered to be established as a "fact", and what is "material".

4. Use/Benefit

[111] In 1987, the Ontario legislature repealed a statutory defence to section 76(1), which had permitted an individual to prove that she or he did not make use of a material fact of which she or he had knowledge. In *Plastic Engine*, Justice Farley observed at 300-301 that "[t]he offence, then, is in essence *not* a question of *using* insider information *but* of *buying or selling securities* of a company *while possessed of insider information*." [emphasis in the original] He continued: "[t]he critical aspect is not, of course, that insider information is in fact used to make the trading decision, but rather that a person with a special relationship with a reporting issuer cannot trade while possessed of insider information."

[112] In assessing Woods' argument in respect of the statutory interpretation of the insider trading provision of the Act, Justice Farley stated at 310:

> Given the mischief rule and its application, it appears that the mischief to be corrected in the present instance was that of unequal opportunity in the securities market – *i.e.*, someone in a special relationship with a company (a director) might employ insider information to buy or sell shares of the company to the disadvantage of those without such insider information. It does not seem to me that the person in a special relationship must benefit from the misuse of insider information; this is obvious from the prohibition against tipping since the tippee is the one who benefits.

[113] Accordingly, we did not need to find that Donnini used undisclosed material facts, or that he benefited personally from the misuse of inside information. We needed only to find that he traded while in possession of undisclosed material facts.

[114] We were satisfied that the evidence, without taking into account use or benefit, was sufficient for us to find the necessary knowledge. Nevertheless, we also determined that Donnini did, indeed, use undisclosed material facts. His use of undisclosed material facts further confirmed our conclusion that Donnini had the necessary knowledge.

[115] Donnini used the undisclosed material facts as follows. After the 2:45 p.m. meeting in Paterson's office, Donnini continued his trading activities. Donnini testified that he used jitney traders to short KCA shares because he believed, based on his second telephone conversation with Milligan, that Milligan would be upset that Yorkton was shorting the stock. Donnini testified that Yorkton clients did not always understand that Yorkton had the right to mitigate risk, which is how Donnini consistently characterized his trading activities in KCA. The trade orders were large and the evidence showed that in one case a price limit of $6.90 was given for the short sale orders. It does appear that initially Donnini was mitigating the risk of Yorkton's long position in KCA stock held after the completion of the first special warrants financing on February 24, 2000. However, once that initial risk was completely hedged, Donnini continued to short KCA stock subsequent to learning about the second special warrants financing and prior to its public announcement.

[116] Both Donnini and his counsel repeatedly stated that Donnini was not speculating, that he was not shorting the stock outright, but was only mitigating risk. This testimony was very revealing to us. A logical conclusion is that at some point the short positions being placed were to mitigate risk associated with the second special warrants financing. Corroborating evidence supports this conclusion. Yorkton did not require a reconfirmation clause in the second special warrants financing to protect it from overnight risk, a normal "out clause" included in such financings. Evidence showed that the order book was checked before the final engagement letter was signed and the risk mitigating reconfirmation clause was dropped. We noted that such a risk mitigating reconfirmation clause was required in the first special warrants financing. Second, Yorkton retained 650,000 units from the second special warrants financing for its own account despite being unable to fill all client orders.

[117] In short, it appeared from the evidence that from Yorkton's point of view, the second special warrants financing was part of a hedge transaction from the outset. Paterson proposed to Milligan "this kind of transaction involving a hedge fund", and encouraged Milligan to call Donnini for an explanation of hedge transactions. Milligan testified that he lost interest when Donnini explained that "the hedge fund begins the transaction by shorting the stock of the issuer." Donnini testified that he thought Milligan's second telephone call on the morning of February 29, 2000 occurred because Milligan was upset about the shorting activity in KCA stock, whereupon Donnini switched to the use of a Jitney trader for his short trades. The deal that would be done would be the one Yorkton could place. The deal Paterson had in mind all along involved a transaction in which hedgers would be significant purchasers.

[118] We did not accept the assertion of respondent's counsel that Donnini and Yorkton did not benefit from such trading to the detriment of others. He had material information other traders

did not have. Furthermore, hedge funds and other investors who might have wished to short the shares of KCA and to buy under the second special warrants transaction were not provided with the same opportunities that Yorkton had when Donnini, with the material information he had, sold short shares of KCA February 29 and March 1, 2000.

5. Can a Contingent Event be a Fact?

[119] Counsel for the respondent argued that before a fact can become material, it has to be established. He referred us to *Coughlan* v. *Westminer Canada Ltd.* (1993), 120 N.S.R. (2d) 91 (T.D.) (*Amirault*), aff'd (1994), 127 N.S.R. (2d) 241 (C.A.), leave to appeal to the Supreme Court of Canada refused, [1994] S.C.C.A. No. 117. *Amirault* was a Nova Scotia civil case based on facts and issues bearing no resemblance to those before us. The information in question concerned undisclosed preliminary assay results from bulk testing of mineral deposits. The case pre-dates the decision of the Supreme Court of Canada in *Pezim* v. *British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 (*Pezim*). In the court of first instance in *Amirault*, Justice Nunn wrote, at paragraph 563:

> While those involved in the regulatory process may very well wish for everything to be reported, it is my view that such a view is neither reasonable nor practical. Before a fact can become material, it has to be established. Seabright had not reached that point. True, it was getting close but the evidence is clear that it did not occur until after the take-over and perhaps quite some time after, when the recommended assay checks had been completed on the bulk sample. It is easy to say with hindsight that the plaintiffs should have known that there would not be a mine or that there were no reserves or that the grade expected just was not there from the daily information. However, the plaintiffs and all concerned did not have that benefit and they were entitled to proceed as recommended so as to be able to determine just what the actual facts were. Had they not been taken over, the plaintiffs clearly would have been obliged to file a material change report and issue press releases and file material information reports after the final results of the bulk sample were in.

[120] A similar stance was taken by the majority of the British Columbia Court of Appeal in *Pezim* v. *British Columbia (Superintendent of Brokers)* (1992), 96 D.L.R. (4th) 137 (B.C.C.A.) (*Pezim BCCA*). The central issue involved whether assay results constituted a change with respect to or in the companies' assets, and were material for the purposes of the British Columbia Securities Act. The majority of the Court of Appeal disagreed with the British Columbia Securities Commission with respect to the meaning of a material change. Writing for the majority, Justice Lambert stated, at 148, that undisclosed assay results could not constitute a material change:

> In my opinion, geological information of the nature obtained on a continuing basis as a result of a planned drilling program does not constitute a change in the business, the operations, the assets or the

> ownership of the issuer, no matter what information is obtained from the drilling results. Such information may constitute a basis for a perception that there has been a change in the value of an asset. But that is a far different thing than a change in an asset.

Justice Lambert distinguished between a reporting provision of the British Columbia Securities Act dealing with a material change and another provision, a prohibitory provision, dealing with material facts. Having made the distinction between material facts and material changes, the majority of the Court of Appeal further held that the reporting requirement section of the British Columbia Securities Act does not impose a duty to inquire into material facts prior to engaging in securities transactions.

[121] Speaking for a unanimous Supreme Court of Canada in *Pezim*, at 597-98, Justice Iacobucci reversed the decision of the majority of the Court of Appeal:

> Both "material change" and "material fact" are defined in s. 1 of the Act. They are defined in terms of the significance of their impact on the market price or value of the securities of an issuer. The definition of "material fact" is broader than that of "material change"; it encompasses any fact that can "reasonably be expected to significantly affect" the market price or value of the securities of an issuer, and not only changes in the "business, operations, assets or ownership of the issuer" that would reasonably be expected to have such an effect.
>
> The use of these two terms in the Act also reflects the differences in their scope. For example, a prospectus relating to a public distribution of securities must disclose all material facts relating to the issuer: ss. 44(1), 45(2), 49(1) and 50(1). However, the prospectus need be amended only when an material change occurs: ss. 47(1), (2) and 48(1).
>
> Sections 67 and 68 of the Act also reflect the differences between a material change and a material fact. As Victor P. Alboini points out in *Securities Law and Practice*, 2nd ed., vol. 2 (1984), at p. 18-13, "[t]he concept of 'material change' should be distinguished from that of 'material fact'. Undisclosed material facts concerning a reporting issuer may not require timely disclosure . . . although they do restrict trading." Under the timely disclosure provision of the Act, s. 67, only material changes require that a press release be issued and that a report be filed. In contrast, under the insider trading provision, s. 68, a person who is in a special relationship with a reporting issuer is prohibited from buying or selling securities of the issuer when the person knows of <u>either</u> a material change or a material fact which has not been publicly disclosed. [emphasis in the original]

[122] The U.S. materiality rules, at least prior to the *Sarbanes-Oxley Act of 2002*, Pub. L. No. 107-204, 116 Stat. 745, did not require immediate disclosure of material changes. They did, however, deal with selective disclosure and disclosure of material facts in documentation that

needs to be filed from time to time, e.g. prospectuses, 10Ks, etc. Under our securities law, in contrast, we have a positive disclosure obligation when a material change occurs. In addition, under our securities law, when certain documents are filed, such as prospectuses and continuous disclosure documentation, there is an obligation to disclose material facts. In addition, our law imposes restrictions on certain persons trading with knowledge of either a material fact or material change with respect to reporting issuers before the material fact or material change has been generally disclosed. As indicated in *Pezim*, facts may be a material fact without being a material change. A material change, on the other hand, will always also be a material fact. In the case before us, we were concerned with whether a material fact existed, not with whether the material fact had matured into a material change requiring immediate timely disclosure pursuant to section 75 of the Act.

[123] In *Pezim*, Justice Iacobucci referred to the passage by Justice Lambert quoted above. In rejecting that statement, Justice Iacobucci endorsed the approach to materiality taken by the British Columbia Securities Commission and by Justice Locke of the Court of Appeal in his dissent, and said (at 599-601):

> As already mentioned, the determination of what constitutes a material change for the purposes of general disclosure under s. 67 of the Act is a matter which falls squarely within the regulatory mandate and expertise of the Commission. Consequently, when the majority of the Court of Appeal rejected the Commission's findings on this matter, it fell into error. Furthermore, the majority's view on this point is, in my opinion, clearly wrong and is inconsistent with the economic and regulatory realities the Act sets out to address. . . .
>
> [F]rom the point of view of investors, new information relating to a mining property (which is an asset) bears significantly on the question of that property's value. Accordingly, I agree with the approach taken by the Commission, namely that a change in assay and drilling results can amount to a material change depending on the circumstances. . . .
>
> Consequently, I am of the view, as found by the Commission and Locke J.A., that the assay results constituted a change with respect to or in the companies' assets and is 'material' for the purposes of the Act.

[124] In *Re Bennett*, [1996] 34 B.C.S.C.W.S. 55 at 181-182, the British Columbia Securities Commission held that merger discussions and facts regarding negotiations were material facts:

> During August and September 1998, the fact Merlo and Doman were having serious discussions about a merger and the facts regarding the negotiations, including price and timing and other matters, were all facts that could reasonably be expected to significantly affect the market price of the Doman shares and, therefore, were material facts within the definition of material fact in section 1(1) and were material facts in the affairs of Doman Industries under section 68(1)(b). We already know the effect that the rumours of a take over had on the market price for Doman

> shares. It is a reality that information related to take over negotiations very often could significantly affect the market price of the shares if disclosed to the market. As a consequence, responsible market participants go to great lengths to ensure confidentiality about negotiations until they are about to announce a deal. They will keep the group who have access to information as small as possible. They will watch the trading in the shares affected, so they will know immediately of any unusual trading. If there is unusual trading, and it appears to be related to the negotiations, they then deal with the unfortunate situation where an announcement may need to be made, notwithstanding that a deal has not been made between the parties. They will watch who trades the shares affected. Most certainly they would have alerted all those involved in the negotiations to the provisions of section 68. Sadly, it appears to us that these negotiations were conducted without these matters in mind.

And further at 182:

> We have found that Doman's June decision to sell Doman Industries was a material fact and a material change under section 68(1)(b). We have also found that the fact that Merlo and Doman were having serious discussions about a merger was a material fact and a material change and the facts regarding the negotiations, including price and timing and other matters, were material facts, all under section 68(1)(b). Are these facts and changes that Doman knew or ought reasonably to have known were material facts and material changes in the affairs of Doman Industries which he knew had not been generally disclosed? Doman was the controlling shareholder and the chief executive officer of Doman Industries. We find that these were facts and changes that Doman knew or ought reasonably to have known were material facts and material changes in the affairs of Doman Industries which he knew had not been generally disclosed.

[125] In *Re Danuke* (1981), 2 O.S.C.B. 31C (*Danuke*), and *Re Royal Trustco Ltd.* (1981), 2 O.S.C.B. 322C (*Royal Trustco*), the Commission held that contingent or unrealized events were material. In *Danuke*, the material fact was an intention to announce the intention to purchase units; in *Royal Trustco*, the material fact was an opinion of management given by way of verbal assurance that certain entities would not tender to a take-over bid.

[126] *Royal Trustco* involved the conduct of White and Scholes, the President and Chief Executive Officer, and Senior Vice President, respectively, of Royal Trustco. In response to a take-over bid by Campeau Corporation, White and Scholes embarked upon a campaign to persuade "friends" of Royal Trustco to defeat the Campeau bid. As part of their campaign, White and Scholes met with senior officers of the Toronto Dominion Bank, in an effort to persuade them not to tender to the Campeau bid. During this meeting, White and Scholes assured the representatives of the bank that about 60% of the shares of Royal Trustco would not be tendered. The Commission found that this was a material fact which had not been generally

disclosed. Accordingly, the Commission held that White and Scholes had tipped, contrary to section 75(1)(b).

[127] The Divisional Court dismissed an appeal taken by White and Scholes: *Re Royal Trustco Ltd. and Ontario Securities Commission* (1983), 42 O.R. (2d) 147 (Div. Ct.). The Court found that the "information disclosed fell easily within the category of material facts within the context of the legislation and in the prevailing circumstances." The Court specifically recognized that, at the relevant time, it was not certain that the "friends" of Royal Trustco would not tender to the Campeau bid. Justice Reid wrote, at 152:

> In my opinion, the information disclosed fell easily within the category of material facts within the context of the legislation and in the prevailing circumstances. That the appellants could not guarantee that the known holders of Trustco's shares would not sell or deposit their shares does not reduce the disclosure to a level less than fact. It was made clearly to encourage the officers of the bank not to sell or deposit the 10% of the outstanding shares of Trustco that it had acquired after earlier representations to it by White and Scholes and it achieved that purpose …. I do not think the term "fact" should be read supercritically. In my opinion, the information was sufficiently factual or a sufficient alteration of circumstances to be a material "change" to fall within the section. In my opinion the Commission was justified in holding that the section had been breached.

[128] *Re Sheridan* (1993), 16 O.S.C.B. 6345 (*Sheridan*) dealt with whether a fact was a material change and whether Sheridan failed to cause a timely disclosure of the change. In the present case, we were not dealing with an alleged material change. Indeed, if we were to determine when a material change occurred, we believe it more likely to have been when the parties reached agreement in principle sometime on March 1, 2000, or, perhaps, on March 2, 2000, after the board of directors of KCA and the bought deal committee of Yorkton had approved the transaction. However, we did not need to decide this question because the matter at issue was not whether and when a material change occurred in the affairs of KCA with respect to the special second warrants financing, but rather whether the information which Donnini had after his meeting with Paterson and McQueen on the afternoon of February 29, 2000 constituted a material fact.

[129] We determined that the negotiations for the second special warrants financing were sufficiently advanced at 2:45 p.m. on February 29, 2000 that the information about the proposed transaction at that time was a fact for purposes of the definition of "material fact" in the Act.

6. Probability/Magnitude Test

[130] In *Sheridan*, in the course of its materiality analysis, the Commission specifically referred to the leading U.S. cases of *Basic Inc. v. Levinson*, 485 U.S. 224 (1988) (*Basic*), and *Securities and Exchange Commission v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (*Texas Gulf*

Sulphur). Quoting *Texas Gulf Sulphur* at 849, the Commission observed at 6350 that materiality in cases of contingent or speculative developments depends:

> at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.

Immediately thereafter, the Commission also quoted J.W. Bagby & J.C. Ruhnka, "The Predictability of Materiality in Merger Negotiations Following *Basic*" (1988) 16 Sec. Reg. L.J. 245 as follows:

> Materiality is reached when some unspecified minimum threshold of both probability and magnitude is reached. Only when there is some probability of the event's occurrence and some magnitude to the event can it be expected that a reasonable investor would consider the disclosure a factor in making an investment decision. Materiality is indicated when there are high probabilities the event will occur and high magnitudes of the event's impact on the registrant . . . . Instead of balancing the two against each other, the materiality analyst will weigh both of them separately and then discount the potential magnitude by the probability of non-occurrence . . .

[131] In *Texas Gulf Sulphur*, in addressing whether a reasonable person would attach importance to the facts in question in determining his or her course of action in the transaction in question, the United States Court of Appeals for the Second Circuit stated at 849 that, "The speculators and chartists of Wall and Bay Streets are also 'reasonable' investors entitled to the same legal protection afforded conservative traders." Therefore, the Court concluded in their next sentence, material facts include not only information in respect of earnings and distributions, but also "facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell or hold the company's securities." After that, at 849-850, the Court articulated the probability/magnitude test:

> In each case, then, whether facts are material within Rule 10b-5 when the facts relate to a particular event and are undisclosed by those persons who are knowledgeable thereof will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity. Here, notwithstanding the trial court's conclusion that the results of the first drill core, K-55-1, were "too 'remote' to have had any significant impact on the market, i.e. to be deemed material," . . . knowledge of the possibility, which surely was more than marginal, of the existence of a mine of the vast magnitude indicated by the remarkably rich drill core located rather close to the surface (suggesting mineability by the less expensive open-pit method) within the confines of a larger anomaly (suggesting an extensive region of mineralization) might well have affected the price of TGS stock and would certainly have been an

> important fact to a reasonable, if speculative, investor in deciding whether he should buy, sell or hold.

[132] Since the potential magnitude of the second special warrants financing was highly significant for the value of KCA shares, a lower probability of occurrence than we determined was actually present would still have led us to conclude that each of the financing, the negotiations and the potential price and size of the financing was a material fact.

[133] In *Basic*, in the context of preliminary corporate merger discussions, the United States Supreme Court at 239 explicitly adopted the probability/magnitude test from *Texas Gulf Sulphur*, and endorsed the following approach to the application of that standard:

> Whether merger discussions in any particular case are material therefore depends on the facts. Generally, in order to assess the probability that the event will occur, a factfinder will need to look to indicia of interest in the transaction at the highest corporate levels. Without attempting to catalog all such possible factors, we note by way of example that board resolutions, instructions to investment bankers, and actual negotiations between principals or their intermediaries may serve as indicia of interest…. No particular event or factor short of closing the transaction need be either necessary or sufficient by itself to render merger discussions material.

[134] Hyde testified that he relied on Milligan to negotiate and complete deals from the document perspective. Based on this, and the fact that Milligan was the Chief Financial Officer and Executive Vice President of KCA, we concluded that Milligan had the authority to negotiate for KCA, subject to final approval of Hyde and the board of KCA. Milligan had already engaged outside counsel and intended to go to his board the next day. Paterson wanted to do the deal and had already instructed McQueen to begin to prepare an engagement letter. Accordingly, the second special warrants financing met the test of interest at the highest levels of both KCA and Yorkton by 2:45 p.m. on February 29, 2000.

7. Materiality

[135] As stated in National Policy Statement 40 (Timely Disclosure), materiality is a fact-specific relative concept that varies from issuer to issuer according to size of profits, assets and capitalization, the nature of its operations, and many other factors.

[136] Counsel for staff referred us to the materiality standard used in the United States and quoted the United States Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 at 449 (1976) (*TSC Industries*):

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote . . . . It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor

> to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

[137] The reasonable investor standard referred to in *TSC Industries* is not one that is in our Act. Our Act includes the test of whether a fact "would reasonably be expected to have a significant effect on the market price or value" of securities. In determining what would reasonably be expected to have a significant effect on the market price or value of KCA shares on February 29, 2000, we believe the American test of market interest, i.e. investor and potential investor interest, to be very useful. Although the U.S. and Ontario tests for determining materiality are worded differently, the American test is helpful, if not analogous, in coming to a determination under the Ontario test.

[138] We concluded that there would have been a substantial likelihood on February 29, 2000 that the disclosure of the information that Donnini had about the proposed second special warrants financing would have been viewed by reasonable investors as important information for making a decision to buy, sell or hold shares of KCA after 2:45 p.m. on February 29 and on March 1, 2000.

[139] A material fact is broadly defined in the Act as a fact that significantly affects, or would reasonably be expected to have significant effect on, the market price or value of such securities.

[140] KCA remained a financially challenged company after the first special warrants financing of $5 million closed on February 24,2000. According to Milligan's testimony, the second special warrants financing of $10 million gave KCS more time and options and provided a cushion against running out of cash before the end of the year 2000. The two financings together represented 25% of issued and outstanding shares of the company at the beginning of the year, and were the maximum allowable without shareholder approval under the TSE's private placement rules. We concluded that these facts were sufficient to determine that the magnitude of the second special warrants financing was material from the point of view of both size and impact.

[141] With respect to the market value of KCA shares, we determined that on February 29, 2000, the value of KCA shares with the second special warrants financing would have reasonably been expected to be significantly greater than the value of such securities at such time without the second special warrants financing.

[142] With respect to the market price of KCA shares, paradoxically, to some investors, such information would indicate that the prospect of KCA would be much more secure because it was less likely to run out of cash in the near future and that, for this reason, the share price would reasonably be expected to rise significantly. On the other hand, sophisticated investors, including hedge funds, familiar with the fundamentals of the company, might regard the proposed second special warrants financing, if they were allowed to participate, as providing an

opportunity to lock in a profit and short sell the stock. Usually, selling stock brings downward pressure on the stock price. We note that the price of KCA shares had been extremely volatile in the period leading up to February 29, and that market interest, as reflected in volumes of trading of KCA shares, had increased substantially since the beginning of the year.

[143] In conclusion, we have no doubt that it would have been reasonable at the time to conclude that the second special warrants financing would add significantly to the intrinsic value of KCA shares. Furthermore, we determined that under all the circumstances that existed at 2:45 p.m. on February 29, 2000, the fact that KCA and Yorkton were in negotiations for a second special warrants financing with a likely size of $10 million and a likely price of $6.75 per share would have reasonably been expected to have a significant effect on the market price or value of the shares of KCA. As a result, we concluded that each of (i) the proposed second special warrants financing, (ii) the negotiation concerning it and (iii) the proposed price and size of it, were material facts.

8. Donnini's Knowledge

[144] Counsel for the respondent kept stressing that what was at issue here was a three-minute "hallway-type" conversation. We disagreed. In determining the state of Donnini's knowledge, we took into consideration all facts and circumstances.

[145] Donnini, although not an officer or director of Yorkton Securities Inc., was a director and the fourth largest shareholder of Yorkton's parent company. He was more than a common employee or foot soldier of the organization. He was the head liability and head institutional trader at Yorkton. He was a colleague of Paterson. He described their relationship as akin to a partnership. He was a chief lieutenant of Paterson. He was intimately involved in managing Yorkton's exposure to KCA, at least from February 15 on through the material time of February 29 and March 1, 2000. He kept Paterson informed on a daily basis of Yorkton's exposure to KCA and of his risk management activities. He knew that Paterson was a superior dealmaker who made things happen. Paterson was "king" of the corporate finance department at Yorkton. Paterson's instincts were extremely important in ascertaining the probability of what eventually might happen with respect to projects on which Paterson was working. Donnini knew this.

[146] It was not appropriate to exclude from our minds the context of all the other information Donnini had about KCA, Milligan, Paterson and McQueen in addition to what he learned in the three-minute meeting. The two telephone conversations between Milligan and Donnini were relevant to the question of Donnini's knowledge. They confirmed that Donnini knew that Paterson had been speaking to Milligan that day. Furthermore, McQueen, a member of the corporate finance team of Yorkton, went and got Donnini for the 2:45 p.m. meeting and stayed in the room for the meeting. Therefore, in Donnini's mind, Yorkton's corporate finance group was obviously involved with Paterson in moving the second special warrants financing forward.

[147] On June 11, 2002, we announced our findings that Donnini had the following knowledge after the conversation with Paterson in the presence of McQueen on February 29, 2000. Paterson had proposed a second transaction. Milligan was negotiating with Paterson. KCA was cash

starved and, by any reasonable standard, could be expected to be enthusiastic about proceeding with the transaction. The market for shares of high technology companies, including shares of KCA, was "unbelievable", "unprecedented" at that time. Paterson was comfortable with proceeding with the transaction. Hedge funds would be the principal purchasers.

[148] As we stated earlier in these reasons, we were satisfied that the evidence, without taking into account Donnini's trading activities, was sufficient for us to find that Donnini had knowledge of the material facts in question. Donnini's trading on February 29 and March 1, 2000 further confirmed our conclusion that Donnini indeed had knowledge of the material facts.

[149] Donnini consistently characterized his trading activities in KCA shares as mitigating risk, and not speculating. However, once Yorkton's initial risk relating to the positions it acquired from the first special warrants financing had been fully mitigated, Donnini continued to short KCA stock subsequent to learning about the second special warrants financing and prior to its public announcement, and went "naked short," *i.e.*, he took a speculative position. Of course, he would not really have been "naked short" if his true intention (as we believed it was) had been to mitigate risk from an anticipated position of Yorkton in the second special warrants financing. In continuing to short the stock of KCA after the three-minute meeting on February 29 and on March 1, 2000, Donnini acted in the same manner that a hedge fund intending to participate in the second special warrants financing might have behaved. Donnini's pattern of trading gave us no reason to believe that he did not have the necessary knowledge of the material facts. To the contrary, as we stated above, it further confirmed that Donnini did, indeed, have the necessary knowledge.

[150] During the three-minute meeting, when Paterson advised Donnini of the probable size of $10 million and probable price of $6.75, Paterson also asked Donnini about Yorkton's short position in KCA. Thereby, he connected, or juxtaposed the second special warrants offering and Yorkton's short position. Donnini replied that Yorkton was half a million to a million shares short. Paterson then asked the average price of the short position, and when Donnini replied with a number greater than $7.00 a share, Paterson mused aloud about the difference between $6.75 and $7.00 and how anything greater than 25 cents could be shared with KCA. The content of this conversation had a level of specificity that indicated a potential deal was well advanced. It also suggested that the financing had the potential to provide a locked-in profit on a hedge transaction if Yorkton retained a portion of the offering to cover the short position Donnini was putting in place. (This ultimately occurred.)

[151] In summary, we believed that much of the evidence we heard, in addition to the evidence relating to the three-minute meeting between Paterson and Donnini in the presence of McQueen, was relevant in determining the state of Donnini's knowledge.

[152] In *Securities and Exchange Commission v. Mayhew*, 121 F.3d 44 (2d Cir. 1997) (*Mayhew*), the United States Court of Appeals for the Second Circuit applied *Texas Gulf Sulphur*, *TSC Industries* and *Basic* with respect to the probability/magnitude test. Citing *Texas Gulf Sulphur,* the court noted, at 52, that "a major factor in determining whether information was material is the importance attached to it by those who knew about it." *Mayhew* concerned a securities trader who had received inside information in respective of a potential merger and traded on the basis of that information. Based on the facts, the court employed a contextual

approach and held, at 52, that, "Although Mayhew was not given the specific details of the merger, a lesser level of specificity is required because he knew the information came from an insider and that the merger discussions were actual and serious." Accordingly, the Court concluded that the information at issue was material. In our case, Donnini may not have been aware of all the specifics of the negotiation but he knew it was being undertaken at the highest level at Yorkton and KCA and that Paterson was keen, while KCA was in need of further financing and interested: he knew that the negotiations were actual and serious.

[153] In conclusion, taking into account the foregoing and based on clear and convincing facts, including the agreed facts, the undisputed facts and the facts found by us based on cogent evidence, we determined that Donnini, after 2:45 p.m. on February 29 and on March 1, 2000, had knowledge of material facts with respect to KCA that had not generally been disclosed.

[154] Finally, in view of the high volume of short sale orders placed on February 29 and March 1, 2000, we concluded that Donnini's actions were deliberate and intentional, and that his trades could not be excused on the basis of reasonable mistake. Accordingly, when Donnini purchased and sold shares of KCA after 2:45 p.m. on February 29 and on March 1, 2000 he breached section 76(1) of the Act.

9. Donnini's Duty as a Registrant

[155] In *Pezim*, at 592-593, the Supreme Court of Canada referred to the protective role of a securities commission, as stated in *Gregory & Co.* v. *Quebec Securities Commission*, [1961] S.C.R. 584 at 588:

> The paramount object of the Act is to ensure that persons who, in the province, carry on the business of trading in securities or acting as investment counsel, shall be honest and of good repute and, in this way, to protect the public, in the province or elsewhere, from being defrauded as a result of certain activities initiated in the province by persons therein carrying on such a business.

[156] In *Re Gordon Capital Corp.* (1990), 13 O.S.C.B. 2035 at 2069 (*Re Gordon Capital*), the Commission observed that "[p]ublic investors rightly expect full regulatory compliance by registrants and public confidence in the integrity of the markets is damaged when compliance fails." Affirming the Commission's decision, the Divisional Court, per Justice Craig, said in *Gordon Capital* at paragraph 38:

> As reflected in its decision, the OSC insists that registrants such as Gordon remain abreast of all of the laws and policies governing the securities industry in Ontario and that they abide by them in the operation of all aspects of their businesses. In my opinion, this insistence is imperative in the public interest.

[157] In *Danuke*, the respondents were not "persons in a special relationship" with the reporting issuer. Nevertheless, the Commission ascribed a high duty to the registrants in respect of their use of inside information, observing at 39C-40C:

> The Commission accepts Seitz' evidence that he understood the information to be rumour, being unaware that the source of at least some of the information was an officer of T.D. As the supervisor of some 42 registered salespersons employed by [McLeod Young] in the Toronto area, he had a special responsibility to monitor the activities of those salespersons and to protect the interests of [McLeod Young's] nearly 13,000 customers.
>
> These registrants are persons with special training and responsibilities who have demonstrated through the passage of relevant examinations a certain minimum academic competence which permits them, in the case of the sales persons to advise and trade on behalf of customers and, in the case of Seitz, to supervise and give direction to sales persons for whom he is responsible. It is also fundamental to the registration process that persons granted registration be honest and of good reputation. It is the concept of honesty and integrity, of fair dealing as between classes of investors, which is the issue here. It is in the public interest that registrants conduct themselves in accordance with these precepts and not take advantage of inside information.
>
> It is the Commission's view that all registrants ought to understand that they have a duty not to attempt to profit, directly or indirectly, through the use of inside information that they believe is confidential and know or should know came from a person having a special relationship with the source of the information.

[158] In judging Donnini's conduct under the circumstances, none of us was 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 high standard of conduct. In this regard, Ontario Policy 33-601 (Guidelines for Policies and Procedures Concerning Inside Information), designed to assure the investing public that it may have confidence in a fair marketplace, was available to Donnini as guidance. This policy 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.

[159] Counsel for the respondent argued that Donnini was entitled to rely on being told by Paterson or some other senior officer of Yorkton whether or not the information he had was material information and that he should stop trading. However, Donnini, as a registrant, was ultimately responsible for fulfilling his own duties as a registrant. When led by counsel for staff

through the requirements applicable to a registrant and the law on material information, he admitted that he was trained and aware of what his duties were.

[160] Donnini's colleagues McQueen and Campbell both testified that they did not need a restricted list to stop them trading. They did not need anyone to tell them that they had material information, and not to trade.

10. Use of a 'Grey List'

[161] Counsel for the respondent on several occasions referred to the fact that Yorkton did not place KCA on its grey list or, until the second special warrants financing was publicly announced, on its restricted list. There was some confusion during the hearing on the part of the respondent and his counsel regarding the role of a grey list and a restricted list. We did not find this topic to be of much relevance in reaching our conclusions on the merits. However, in view of the amount of time spent on this topic during the hearing, we make the following observations.

[162] A corporation has knowledge when one of its officers, directors, employees or agents has knowledge. Accordingly, if a trader for the corporation without actual knowledge traded shares of a reporting issuer when an officer or director had knowledge of a material fact respecting that reporting issuer, the corporation would be guilty of an infraction of section 76(1) of the Act. Section 175(1) of the regulation under the Act, R.R.O. 1990, Reg. 1015, provides as follows:

> A person or company that purchases or sell securities of a reporting issuer with knowledge of a material fact or material change with respect to the reporting issuer that has not been generally disclosed is exempt from subsection 76(1) of the Act and from liability under section 134 of the Act, where the person or company proves that,
>
> (a) no director, officer, partner, employee or agent of the person or company who made or participated in making the decision to purchase or sell the securities of the reporting issuer had actual knowledge of the material fact or material change; and
>
> (b) no advice was given with respect to the purchase or sale of the securities to the director, officer, partner, employee or agent of the person or company who made or participated in making the decision to purchase or sell the securities by a director, partner, officer, employee or agent of the person or company who had actual knowledge of the material fact or the material change,
>
> but this exemption is not available to an individual who had actual knowledge of the material fact or change.

Section 175(3) of the regulation provides:

> In determining whether a person or company has sustained the burden of proof under subsection (1), it shall be relevant whether and to what extent the person or company has implemented and maintained reasonable policies and procedures to prevent contraventions of subsection 76(1) of the Act by persons making or influencing investment decisions on its behalf and to prevent transmission of information concerning a material fact or material change contrary to subsection 76(2) or (3) of the Act.

[163] The grey list is a tool that may be implemented and maintained as a reasonable policy and procedure under section 175(3) of the regulation to prevent contraventions of section 76(1) of the Act by persons making or influencing investment decisions on its behalf and to prevent transmission of information concerning a material fact or material change contrary to section 76(2) or (3) of the Act. If a trader, such as Donnini, gains actual knowledge of material information, then notwithstanding that he is unaware of the grey list, if he trades with knowledge of the material information, neither he, nor his firm, has an exemption from section 76 (1) of the Act.

[164] Ontario Policy 33-601 provides general guidelines that registrants may wish to consider in satisfying the requirements of the exemption contained in section 175(1) of the regulation under the Act. The Policy defines a "grey list" to mean a highly confidential list, compiled by a registrant, of issuers about which the registrant has inside information; and defines a "restricted list" to mean a list, compiled by a registrant, of issuers about which the registrant may have inside information. Sections 2.3 to 2.6 of Ontario Policy 33-601 provide in part as follows:

> 2.3 (a)(ii) To limit the unauthorized transmission of inside information, a registrant should consider . . . in the case of a smaller registrant, treating all of its departments as being "behind the wall" so that if the registrant is in receipt of inside information, all trading and advisory activities of the registrant are subject to any restrictions imposed.
>
> 2.4 (2) Policies and procedures commonly used by a registrant to restrict transactions include the use of grey lists and restricted lists.
>
> 2.5 (1) A registrant should normally place an issuer on the grey list when it has received inside information about the issuer; for example, when the registrant has been invited to manage or participate in a possible offering or to act concerning a possible merger or acquisition or other corporate assignment.
>
> (2) A registrant should normally disseminate grey lists only to those employees who require the list to monitor unusual principal or agent trading in the securities by the registrant or its employees and, if necessary, to inquire about or restrict trading.
>
> (3) A registrant should seek legal or other advice before new research materials and opinions concerning securities on the grey list are published or disseminated by it or its employees.

> (4) A registrant should normally remove an issuer's name from the grey list when the registrant no longer has inside information regarding the issuer.
>
> 2.6 (1) A registrant should normally move an issuer's name from the registrant's grey list to the registrant's restricted list when the registrant has agreed to act as an underwriter, or banking group member, or to represent the issuer in a merger or acquisition and the transaction in which the registrant is acting has been generally disclosed but the registrant is still in possession of or may gain access to inside information during the course of the transaction.
>
> (2) Trading by the registrant as principal, except for normal market-making or other permitted activities, should cease and the dissemination of research materials should be restricted or stopped for securities of issuers on the restricted list .
>
> (3) A registrant should normally remove an issuer's name from the restricted list when the registrant is no longer in possession of inside information, for example, when that information has been disclosed following completion of a distribution or a merger or acquisition.

[165] It is, among other reasons, to allow traders to continue to trade that investment dealers erect Chinese walls and take other precautions so that persons outside the corporate finance department do not inadvertently or otherwise learn about potential material transactions.

[166] Persons invited behind these walls or in organizations where no such walls exist may enter into a special relationship with an issuer and depending on the facts become subject to the restrictions that apply to insider trading.

[167] Counsel for Donnini argued that it was perfectly legitimate for Paterson to say to Donnini, “Look, I've had some discussion with Kasten Chase, we're talking perhaps about another deal, what do you think the market would do? Would the market take it?” Counsel stated that that goes on every day and suggested that we cannot cut that off because, he suggested, there was no other way for the investment banker to know how to proceed with a deal. We reject the suggestion that it is necessary for the efficient operation of the market to allow, without consequences limiting trading, conversations about potential deals as depicted by respondent's counsel.

[168] When one looks at how investment firms operate, we acknowledge that it is quite often that people in corporate finance departments of investment dealers will talk to people in the trading department to ascertain market tone with respect to an issuer. But in our experience, reputable firms have Chinese walls and other procedures and take steps to prevent confidential inside information from flowing to those who trade. In some cases, the necessity for obtaining market information may require an investment firm to bring someone over the wall so that the firm can obtain key market advice on the receptivity of a proposed transaction. When that happens, the person brought over the wall obtains confidential inside information and is thereby

precluded from trading in the issuer's securities until public disclosure and other procedures have been satisfied.

[169] Firms have Chinese walls and other procedures to prevent information flowing to traders for at least two reasons. First, the law requires it, and the policy statements that have been adopted by the Commission, and good industry practice, suggest that those that want to foster investor confidence in the market should play by these rules. The second reason is one of legitimate self-interest. Investment dealers do not want their traders to be frozen out of normal trading activity by being contaminated with insider knowledge, because, under the law and especially the regulation that applies to insider trading, the investment dealer will be deemed to have the knowledge that its employees have and the exception provided by the regulation would not be available. In our experience, reputable firms meticulously follow the procedures in Ontario Policy 33-601 and are not faced with a set of facts that Mr. Donnini was faced with because of the way that Yorkton appeared to be operating, based on the evidence we saw in this case.

11. No New Policies

[170] In deciding this case, we were mindful of the submission of counsel for the respondent that we should limit ourselves to applying existing law and policy to the facts of this case and not wander into the area of declaring new policies or procedures at the expense of the respondent. We agreed with this submission. We considered that this case is not novel, does not change the way industry is going to have to operate, and really does not clarify the law in any great respect; but it is, rather, a clear example of how the law works. We considered that in this case, we were applying existing principles with respect to materiality and existing policy and industry practice on how confidential inside information by employees of investment dealers in a special relationship with an issuer should act. While this case may be a clear example of how industry should operate, it does not introduce any new elements of law or policy.

VIII. Sanctions

A. Questions Put to Counsel

[171] On June 11, 2002, once we were of the opinion, based on the evidence presented, that Donnini breached section 76(1) of the Act and otherwise acted in a manner unbecoming a registrant, we asked counsel to present additional evidence and submissions as to sanctions, and 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?

[172] On July 11, 2002, we heard additional evidence from Donnini relating to the issue of appropriate orders that we might make under section 127 and heard submissions from counsel.

B. Submissions

1. Staff Submissions

[173] We were advised by both counsel that Donnini's registration has been under suspension since he resigned from Yorkton in April of 2001. Counsel for staff put into evidence correspondence and a consulting agreement outlining arrangements that had been made by Donnini with another investment firm to provide consulting advice on a contract basis. Counsel for staff suggested this evidence was relevant to demonstrate the level of activity Donnini continued to have in connection with the securities industry over the course of the past year.

[174] Counsel for staff filed a written submission on sanctions, copies of settlement agreements and orders in connection with Yorkton, Paterson and others, and two settlement agreements entered into between Donnini and the Canadian Venture Exchange (CDNX) on one occasion and the TSE on another. The settlement agreements with the CDNX and the TSE related to several events over a number of days and involved the following violations admitted by Donnini:

(1) between December 1999 and February 2000, Donnini conducted six average price trades, contravening CDNX Rule F.2.01(2)

(2) on January 14, 2000, Donnini failed to move the market in an orderly manner or to seek directions from the TSE prior to executing a trade that caused a change greater than $1.00 in the price of a security that was selling below $20.00, contrary to Part XXIII of the Rulings and Directions of the TSE Board;

(3) on January 24, 2000, Donnini through his personal account purchased 25,000 shares of Book4Golf, off the CDNX from a U.S. broker/dealer, contravening CDNX Rule C.2.01 by conducting the trade within Canada without any of the exemptions found in CDNX Rule C.2.01 applying;

(4) on September 14, 2000, Donnini improperly triggered a Registered Trader's Minimum Guaranteed Fill (MGF) requirement of the TSE by splitting a single client order to buy shares of a listed security into several smaller orders and entering these orders as MGF-eligible orders, contrary to section 11.20 of the TSE General By-Law and the TSE Ruling relating to the MGF facilities; and

(5) on January 3, 2001, Donnini received a client order to sell less than 5,000 shares of a listed security and executed the order in a principal transaction at a price that was not higher than the price of any order on any Canadian stock exchange on which the security was listed, contrary to Rule 4-502(2) of the TSE Rules.

Sanctions for those violations included the payment by Donnini of $20,000 to the TSE, plus $5,000 in costs, as well as CDNX fines totalling $35,000, plus $6,000 in costs. Yorkton made restitution in the amount of $77,128 to clients harmed by Donnini's conduct.

[175] In her written submission, counsel for staff also referred us to National Policy 34-201, which indicates that a registrant's breach of the by-laws, rules or practices of a stock exchange or other self-regulatory organization "may be considered by the securities regulatory authority to be prejudicial to the public interest and to affect the fitness for registration or continued registration of the applicant or registrant."

[176] Counsel for staff submitted that the circumstances of this case permit the Commission to set the precedent for future cases that may come before the Commission and the precedent which will send a clear and unambiguous signal to the public of the Commission's strong denunciation of the conduct engaged in by Donnini. She suggested it was imperative that the sanctions adequately serve as a general deterrent for those who may contemplate engaging in illegal insider trading. She stated that our capital markets, and the public who invest in them, must depend on those in a position of trust, such as registrants holding senior positions in a firm, performing their duties in good faith, with honesty and integrity. It is the responsibility of the Commission, she argued, to make it clear that the consequences will be serious for those who choose to depart from the standard. We agree with these submissions.

[177] Counsel for staff suggested that, taking everything into account, a minimum of 15 years for a cease trade order, with no carve-outs for Donnini's personal account or RRSPs, would be appropriate as a minimum. She referred us, for comparison, to the sanctions imposed in *Woods*. She commended the approach in *Woods* and submitted that the sanctions imposed in that case were more consistent with current public interest requirements in capital markets than sanctions imposed in some of the earlier cases.

[178] As a matter of general deterrence, counsel for staff suggested the addition of 10 years to the 15-year period in *Woods*, for a total of 25 years. She submitted that the Commission can take

general deterrence into account and referred us to *Re Dornford* (1998), 21 O.S.C.B. 7499 at 7505, where the Commission stated:

> In our view, taking into account general deterrence, in the case before us, would not be for the purpose of punishing Dornford, as argued by Mr. Douglas, but rather for a prophylactic purpose, the future protection of the marketplace not only from actions by Mr. Dornford but also from breaches of trust by others. Although *Mithras* speaks of deterring future improper conduct of a respondent, it does note that the Commission is "here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient." It seems to us that *Warnes* does not in any way indicate that general deterrence can be taken into account for punitive purposes, but rather, in the securities law context, that it can be taken into account in determining what is necessary to restrain conduct by others that is likely to be prejudicial to the public interest in having capital markets that are fair and efficient.

2. Respondent Submissions and Testimony by Donnini

[179] As precedents for sanctions, counsel for the respondent referred us to *Re Mithras Management Ltd.* (1990), 13 O.S.C.B. 1600; *Re Gordon Capital*, affirmed in *Gordon Capital*; *Re Aatra Resources Ltd.* (1990), 13 O.S.C.B. 5109; *Re Belteco Holdings Inc.* (1998), 21 O.S.C.B. 7743 (*Belteco*); *Seal*; *Re Riley* (1999), 22 O.S.C.B. 3549; and *Committee for the Equal Treatment of Asbestos Minority Shareholders* v. *Ontario (Securities Commission)*, [2001] 2 S.C.R. 132 (*Asbestos*).

[180] Counsel for the respondent objected to the following statement in our decision on the merits that we rendered orally on June 11, 2002:

> 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.

[181] He stated that before he called Donnini as a witness with respect to sanctions, we needed to level the playing field. He submitted that what we had done with the statement was to go into sanctions as part of our reasons for our decision on the merits. Counsel wanted to make it clear, in calling Donnini to the stand, that Donnini had every right to defend himself and that it was only after the decision on the merits had been made that Donnini could come forward and express his contrition. The fact he defended himself should not be taken against him.

[182] We advised counsel that this statement did not preclude him from putting Donnini on the stand in the sanctions part of the hearing and testifying that he was repentant. As we stated in rendering our decision on June 11, 2002, "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 conclusion." We felt it was necessary to inform counsel of our finding

as to Donnini's credibility and state of remorse, based on the evidence we had heard in the merits portion of the hearing. Our decision of June 11 was not our reasons. As we stated on June 11, "We will issue reasons for our decision after we have made a decision as to appropriate sanctions." We assured counsel that we would listen attentively to anything Donnini had to say in the sanctions portion of the hearing and that we would take that into account in coming to a decision as to appropriate sanctions.

[183] Donnini testified at the sanctions portion of the hearing that the press coverage of the hearing to date had been devastating to him. It had placed tremendous stress on his family. He believed the relentless coverage had probably permanently damaged his ability to seek comparable employment in the only industry that he has ever worked in.

[184] While we do not believe it appropriate for us to place any stock in newspaper articles reporting on events at the hearing, we permitted to be entered as Exhibit 21 a bundle of newspaper articles taken from the Internet, and we understand the point that was made by Donnini and his counsel that as a result of this case it will be difficult for Donnini to obtain comparable employment in the securities industry in the future.

[185] Donnini assured us that he would not repeat his contravention of the Act or engage in any other contravention of the Act in the future. He stated, "I think it would be inconceivable and beyond belief that every action, from answering to a phone call to having a casual conversation in an elevator with any individual I would ever deal with will not be - coloured is the wrong word - but guided by what I have gone through here and what I've learned to be the Commission's position." In answer to the question, "So, in future, if and when you go back in the industry, how will you deal with information like this?" he replied, "I will take the strictest interpretation possible of any securities regulation and apply it appropriately." We would have been surprised had Donnini answered otherwise.

[186] Donnini described his infractions of CDNX and TSE regulations, described in the settlement agreements, as regrettable, or inexcusable, but of a technical nature. They occurred, according to Donnini, because persons at Yorkton were ill prepared to deal with the unprecedented volumes that they had to deal with. Yet Donnini had received warnings from the TSE's market surveillance department on three prior occasions for violations of the TSE's client-principal trading rule. Donnini's infractions of CDNX and TSE regulations were advertent and not inadvertent. We would not classify the infractions as technical in nature. The infractions included the purchase of 25,000 shares of Book4Golf, listed on CDNX, in off-floor transactions at a discount to the market, and the dividing up of a client order to trigger the TSE's MGF requirement. Donnini also admitted to contravening Rule XXIII of the TSE. The intent of the rule at issue was to ensure a fair and orderly market by allowing market participants a sufficient amount of time to react to significant price changes caused by a particular trade or put-through. One of the purposes of that rule is to prevent market manipulation. Other trades referred to in the settlement agreements involved trades for a number of clients at Yorkton's inventory account whereby Yorkton received the benefit that properly belonged to the clients.

[187] In addition, on March 30, 2001, Yorkton reprimanded and fined Donnini for a trading infraction that occurred in March 2000 relating to trading of shares in a company that was on Yorkton's restricted list. Donnini indicated that it was not the TSE that took action. He seemed

to believe that it was relevant to the matters we were considering that it was only Yorkton, his employer, and not the TSE, a regulator, that reprimanded and fined Donnini for this trading infraction. We find the following exchange indicative of the reasons why we felt a certain discomfort with the testimony of Donnini, not only in the sanctions part of the hearing, but also in the part on the merits:

> Question: There's also a reference to the fact that on March 30, 2001, Yorkton reprimanded and fined you for a trading infraction which occurred in March 2000 relating to a trade while trading of that company's shares was restricted?
>
> Answer: Yes. Yorkton did, but the TSE did not.
>
> Question: Yes, but Yorkton, the registrant, had to take action to deal with it?
>
> Answer: But the TSE did not.
>
> Question: I'm not saying that they did.
>
> Answer: That's fine. And I'm saying that they didn't.
>
> Chair: Mr. Donnini, you don't deny that the infraction – or maybe it doesn't admit that the infraction occurred.
>
> Answer: It doesn't. I paid a fine. We settled it like that. It was an internal matter, basically, Mr. Commissioner.

[188] Counsel for staff suggested that the conclusions to be drawn from Donnini's evidence in connection with the facts surrounding KCA, and the TSE and CDNX settlement agreements entered into by him, as well as the disciplinary matter resulting in a reprimand and fine of Donnini by Yorkton were that, at best, Donnini displayed an ignorance of someone in a very responsible position who failed to appreciate the significance of his role as a registrant and the various rules in place to protect the integrity of the market; at worst, it represented a cavalier and dishonest temperament of an individual who was prepared to break whatever rules suited him in order to get the job done. We believe the proper conclusion involves elements of both.

[189] Considering all of Donnini's conduct in its entirety, we concluded that he did not appreciate, at the time of his conduct or during the hearing, that his conduct has been egregious and abusive of the capital markets. In the final analysis, notwithstanding Donnini's assurances that he would interpret Ontario securities law strictly in the future, we were left with the concern, based on his past conduct, that Donnini may continue to exhibit a disregard for Ontario securities law and the principles underlying it.

C. Analysis

1. Paterson / Yorkton Settlements

[190] In response to the first part of the first question we posed to counsel on June 11, 2002, counsel for staff submitted that we should not give much relevance, if any, to the sanctions imposed under the Paterson and Yorkton settlements.

[191] Pursuant to the Paterson settlement agreement, the Commission ordered that the registration of Paterson be suspended for two years; that trading in securities by Paterson cease for six months, with the exception of any sale of his interest in Yorkton; that Paterson be reprimanded; and that Paterson pay $100,000 of the Commission's costs with respect to the matter. In addition, Paterson agreed to make a voluntary payment to the Commission in the amount of $1,000,000, to be allocated by the Commission for purposes that will benefit Ontario investors; not to be an officer or director of a registrant for two years; not to directly or indirectly own any interest in a registrant for two years, with the exception of his current interest in Yorkton; and to take necessary and reasonable steps to sell all or a portion of his current interest in Yorkton; during the time in which he owns any interest in Yorkton, not to exercise voting rights, control or otherwise influence or attempt to influence management of Yorkton or the affairs of Yorkton for two years, except as may result from the sale of his current interest in Yorkton; and not to purchase any additional shares of Yorkton for two years.

[192] Pursuant to the Yorkton settlement agreement, the Commission ordered that as terms and conditions on its registration, Yorkton require each officer and employee of Yorkton to execute an undertaking as a condition to continued employment with Yorkton, and report to Commission staff if Yorkton receives information that any officer or employee of Yorkton has breached or is in breach of the undertaking; that Yorkton implement the proposed amendments to IDA Regulation 1300 and any amendments thereto; that Yorkton retain, at its sole expense, the Regulatory Compliance group of PricewaterhouseCoopers LLP (PwC) to conduct a independent review of the plan adopted by Yorkton to ensure satisfactory implementation of the plan, and to provide a report to Yorkton and Commission staff as to the results of the review; that the PwC report be completed within a reasonable time frame to be set out by PwC, in consultation with Yorkton and Commission staff; that Yorkton be reprimanded; and that Yorkton pay $200,000 of the Commission's costs with respect to the matter. In addition, Yorkton agreed to make a voluntary payment to the Commission in the amount of $1,250,000, to be allocated by the Commission for purposes that will benefit Ontario investors, and to cooperate with the Commission and its staff with any additional investigation conducted by staff in relation to matters concerning other persons and companies, including former and current employees of Yorkton.

[193] Counsel for the respondent argued that Paterson engaged in the same events as Donnini, and that, in fact, Paterson was the instigator who initiated the transactions and the deal: Donnini was never part of it. However, as counsel for staff pointed out, Paterson did not engage in the illegal insider trading, and there was no evidence before the Commission in the Paterson settlement hearing that Paterson encouraged or instructed Donnini to do so. There was nothing wrong in Paterson's instigating and promoting the second special warrants financing or in seeking Donnini's input. Paterson's failure, according to the settlement agreement, was a failure

in management and supervisory functions. We find Paterson's conduct as admitted in the settlement agreement, and Donnini's conduct as evidenced in the case before us, very different in degree and nature. As for Yorkton, it admitted that it failed to properly supervise Paterson and Donnini, and permitted a culture of non-compliance in connection with the second special warrants financing. Staff did not allege, nor did Yorkton admit, in the Yorkton settlement a breach of section 76(1). The Commission panel that heard the Yorkton settlement was not privy to the evidence that was presented to us in the case before us.

[194] Counsel for staff submitted that where a party agrees to settle, such action could be taken into account to give a lesser sanction than might otherwise be appropriate. However, she argued that the Commission should not make sanctions more severe than they otherwise might be just because Donnini, unlike Paterson and Yorkton, did not agree to settle this matter.

[195] We agree with the arguments of counsel for staff that the Paterson and Yorkton settlements are not of much relevance for the case before us, and that Donnini should not receive more severe sanctions than otherwise appropriate just because he did not agree to settle the case against him.

2. Proxy Value of Voluntary Payments

[196] Counsel for staff submitted that we should not give any proxy value to the monetary payments that Yorkton and Paterson agreed to pay in their settlement agreements. We agree.

3. Other Precedents

[197] Counsel for staff acknowledged that although looking at other cases, including settlements, may be helpful in determining appropriate sanctions, each case is very fact specific. We agree with that observation.

[198] We are of the opinion that of all the precedents that have been referred to, the present case comes closest to *Woods*. In *Woods*, Woods sold securities with knowledge of a material fact or material change which had not been generally disclosed. Woods had been convicted of insider trading and imprisoned for 90 days. Unlike Donnini, Woods was not a registrant, although he had arranged financings for others, was considered by the Commission to be a professional in the marketplace, and was an active trader. Woods used insider information illegally when he traded for the account of his friend and, like Donnini, he obtained no direct benefit for himself. Woods was relatively young. However, unlike Donnini, Woods did not act for the benefit of his employer, and did not stand to profit as a shareholder of his employer, or by enhancing his performance as a liability trader with his employer.

[199] In arriving at an appropriate sanction in *Woods*, the Commission observed, at 4630,

> Woods is still a relatively young man and, in the normal course, could be a participant in the capital markets for a good many years. It could certainly

> be argued that an order for a limited period would not be appropriate since, if he has not yet learned that what he did was, to use a neutral term, inappropriate, it may not be likely that he will do so as a result of his removal from the marketplace for a limited period.
>
> However, it appears that permanent clause 3 orders have heretofore generally been made, after a hearing, in situations in which there has been a course of conduct involving protracted and continued breaches of the Act. This is not such a case. Without deciding that it is only in such circumstances that a permanent order should be made, we have concluded such an order should not be made here.
>
> We have concluded that, in all the circumstances of this case, an order for a lengthy, but definite, period is required, and that a 15-year period is appropriate.

In light of all the circumstances of the case, the Commission concluded that exemptions contained in Ontario securities law would not apply to Woods for a period of 15 years, with certain exceptions.

4. Investor Confidence

[200] Counsel for staff argued that the Commission should consider an infraction of the insider trading prohibition as a matter of particular concern insofar as it impacts the confidence that investors place in a fair and efficient marketplace.

[201] In *Asbestos*, at paragraph 42, Justice Iacobucci emphasized the protective and preventive nature of section 127 and its focus on future harm:

> [I]t is important to recognize that s. 127 is a regulatory provision. In this regard, I agree with Laskin J.A. that "[t]he purpose of the Commission's public interest jurisdiction is neither remedial nor punitive; it is protective and preventive, intended to be exercised to prevent likely future harm to Ontario's capital markets" (p. 272). This interpretation of s. 127 powers is consistent with the previous jurisprudence of the OSC in cases such as *Canadian Tire*, *supra*, aff'd (1987), 59 O.R. (2d) 79 (Div. Ct.); leave to appeal to C.A. denied (1987), 35 B.L.R. xx, in which it was held that no breach of the Act is required to trigger s. 127. It is also consistent with the objective of regulatory legislation in general. The focus of regulatory law is on the protection of societal interests, not punishment of an individual's moral faults: see *R.* v. *Wholesale Travel Group Inc*., [1991] 3 S.C.R. 154, at p. 219.

[202] In *Re M.C.J.C. Holdings Inc. and Michael Cowpland* (2002), 25 O.S.C.B. 1133 at 1135 (*M.C.J.C.*), the Commission said:

> We have a duty to take steps to make sure that manipulative or other improper practices in the financial marketplace are not tolerated and that there is a reason for confidence in that marketplace.
>
> Illegal insider trading by its very nature is a cancer that erodes public confidence in the capital markets. It is one of the most serious diseases our capital markets face. If we do not act in the public interest by sending an appropriate message in appropriate circumstances, then we fail in doing our duty.

[203] Where a registrant, who after all is a part of the market system, trades illegally while in possession of confidential material information obtained through his employment, the potential harm to investor confidence in a fair marketplace is all the more serious.

5. Relevant Considerations

[204] In *Belteco*, at 7746, the Commission set out a series of factors to consider when setting sanctions:

> [I]n determining both the nature of the sanctions to be imposed as well as the duration of such sanctions, we should consider the seriousness of the allegations proved; the respondent's experience in the marketplace; the level of a respondent's activity in the marketplace; whether or not there has been a recognition of the seriousness of the improprieties; and whether or not the sanctions imposed may deter not only those involved in the case being considered, but any like-minded people from engaging in similar abuses of the capital markets.

[205] In *M.C.J.C.*, at 1136, the Commission referred to the importance of assessing impact on a respondent when determining the appropriateness of sanctions as being in the public interest:

> In determining impact, we need to consider all relevant factors in proportion to circumstances relevant to a respondent to be sure sanctions are proportionately appropriate. Such factors may include in varying importance the following: the size of any profit (or loss avoided) from the illegal conduct; the size of any financial sanction or voluntary payment when considered with other factors; the effect any sanction might have on the livelihood of the respondent; the restraint any sanction may have on the ability of the respondent to participate without check in the capital markets; the respondent's experience in the marketplace; the reputation and prestige of the respondent; the shame, or financial pain, that any sanction would reasonably cause to the respondent; and the remorse of the respondent. These are some of the factors that we believe may be relevant in various degrees. There may be others, and perhaps all of the factors we have mentioned would not be relevant in this or another particular case.

[206] We consider the factors mentioned in *Belteco* and *M.C.J.C.* to be useful and have taken them into account in deciding what sanctions are appropriate in the present case.

[207] Donnini was an experienced trader. He was the fourth-largest shareholder of Yorkton, the senior liability trader and the senior institutional trader of Yorkton. As we previously stated, he was more a chief lieutenant than a common foot soldier. His activity in the marketplace was influential. On February 29, 2000, Donnini traded 1,094,120 KCA shares, or 29.3% of the total volume for KCA that day. On March 1, 2000, Donnini traded 437,200 KCA shares, or 24.2% of the total volume for KCA that day. He was trading on a massive scale while in possession of confidential material information.

[208] Donnini was well positioned to recognize the seriousness of the impropriety of trading KCA shares with material undisclosed information contrary to section 76(1) of the Act. He admitted to counsel for the staff in cross-examination that:

> a) he had taken all the necessary courses to inform himself about his responsibilities as a registrant, and the conduct expected of him as a registrant;
>
> b) in his role as head trader, he appreciated that the integrity of the capital markets depended on equal access to information by all prospective investors;
>
> c) as head trader, information gathering, in terms of knowing what to trade in and how to conduct trading strategies, was part of his job;
>
> d) he understood the concept of a level playing field for all investors having equal access to information;
>
> e) he agreed that if the rules were not abided by, if an investor traded in material undisclosed information, the integrity of the markets would break down; and
>
> f) he understood and recognized that as a head trader, he had a responsibility not to trade on material undisclosed information, and to ensure that those he supervised did not do so.

[209] Donnini's entire working experience has been in the securities industry. He is approximately half-way through a typical 35-year working life in the securities industry. Securities trading by house professionals is becoming more and more a career for younger persons.

D. Conclusions on Sanctions

[210] In *Asbestos*, at paragraph 43, Justice Iacobucci endorsed *Mithras*, where the Commission emphasized, at 1610-1611:

> [T]he role of this Commission is to protect the public interest by removing from the capital markets – wholly or partially, permanently or temporarily, as the circumstances may warrant – those whose conduct in the past leads us to conclude that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct; that is the role of the courts, particularly under section 118 of the Act. We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient. In so doing, we must, of necessity, look to past conduct as a guide to what we believe a person's future conduct might reasonably be expected to be; we are not prescient, after all.

[211] We are of the opinion that a period of 15 years for a suspension of Donnini's registration and for restrictions on trading and acting as a director or officer of a registrant, is appropriate for protective and preventive purposes, considering Donnini's market conduct, including his infractions of CDNX and TSE requirements and his violation of Yorkton's internal procedures, and in view of his lack of appreciation of the seriousness of his conduct. The 15-year period is appropriate to keep Donnini out of the securities industry and unable to repeat his conduct for most of his remaining working years.

[212] The conduct of Donnini at issue in the case before us – trading while in possession of undisclosed material facts – arose in his capacity as a liability trader for his employer and not while trading for his own account. (We note, however, that his January 24, 2000 violation of the CDNX's off-floor trading rule involved the purchase by Donnini of 25,000 shares of Book4Golf through his personal account. This violation of the off-floor trading rule did not have the same gravamen as illegal insider trading, and it was dealt with by the CDNX.) The restrictions on his registration and trading for others will have a severe impact on him. Therefore, we do not believe it necessary to restrict trading for his own account.

[213] In selecting a 15-year period for protective and preventive purposes, the sanctions will also, incidentally, serve as general deterrence; we do not believe it necessary or appropriate to lengthen the 15-year period for general deterrence purposes as suggested by counsel for staff.

[214] We accept the truth of Donnini's testimony, in the sanctions part of the hearing, that the findings announced on June 11, 2002, and reported in the press have had a devastating impact on him. However, the sanctions we are ordering are still necessary to have the appropriate impact on Donnini and deter him from violating Ontario securities law when he trades for his own account or if, in the future, he becomes involved in the securities industry again.

[215] Counsel for staff suggested that we consider whether it is desirable in this case to prohibit Donnini from serving as an officer or director of any public company. She made no recommendations about this. In light of the specific facts of this case, we determined that the disciplines of the marketplace and the procedures followed by public companies in selecting and electing directors and appointing officers should be adequate to address public interest concerns if the opportunity for Donnini to serve as an officer or director of a public company should arise. Accordingly, we are not prohibiting Donnini from acting as a director or officer of any public company.

[216] Counsel for staff requested that we reprimand Donnini. The Commission will frequently issue a reprimand under clause 6 of section 127(1) to send the message that a respondent's conduct has been unacceptable. In the case before us, we believe the message will be sent by the severity of the sanctions we are ordering and the words we have used in commenting on Donnini's conduct, which serve as a sufficient reprimand. A further reprimand would be anti-climactic, if not redundant.

E. Orders

[217] Accordingly, being of the opinion that it is in the public interest to do so, we are ordering that:

(1) pursuant to clause 1 of section 127(1) of the Act, the registration granted to Donnini under Ontario securities law be suspended for 15 years;

(2) pursuant to clause 2 of section 127(1), trading in any securities by Donnini cease for 15 years, with the exception that Donnini be permitted to trade in securities

  (a) in personal accounts in his name in which he has sole beneficial interest, and

  (b) in registered retirement savings plans in which he, either alone or with his spouse, has sole beneficial interest;

(3) pursuant to clause 7 of section 127(1), Donnini resign all positions that he holds as a director or officer of an issuer that is a registrant, or that directly or indirectly holds more than a 5% interest in a registrant; and

(4) pursuant to clause 8 of section 127(1), Donnini is prohibited for 15 years from becoming or acting as a director or officer of an issuer that is a registrant, or that directly or indirectly holds more than a 5% interest in a registrant.

IX. Costs

1. Matters Considered

[218] Section 127.1 of the Act gives the Commission the discretion to order a person to pay the costs of an investigation and a hearing if the Commission is satisfied that the person has not complied with the Act or has not acted in the public interest. In this regard, section 127.1(4) of the Act permits the Commission, in ordering the payment of costs, to include, without limitation, costs incurred in respect of services provided by persons appointed or engaged under sections 5, 11 or 12 of the Act, costs of matters preliminary to the hearing, costs for time spent by the Commission or staff, any fees paid to a witness, and costs of legal services provided to the Commission.

[219] Counsel for staff submitted a bill of costs in the amount of $186,052.30. Counsel for the respondent objected that staff's bill of costs merely sets out the number of hours that counsel and the investigator had incurred with a suggested hourly rate for each of them, but did not contain docket details. Relying on his experience before the courts and how a solicitor's bills are taxed, he suggested that counsel for staff should provide dockets giving details of the hours spent and what the hours are for. He submitted that the court would always have a full docket record so that at the very least on the first level, one could make submissions about whether the work performed was in relation to the matter, whether it was necessary, and whether a lot of work was unnecessary. Without such detail, counsel for the respondent suggested, he had no means of testing the claim for costs.

[220] Counsel for staff observed that we are not the Superior Court of Ontario, which would have regard to the *Courts of Justice Act*, the sections and legislative objectives of that scheme, the related rules of civil procedure and the Ontario grid that was submitted as Exhibit 20. Our discretion under Section 127 is not one to punish or penalize the respondent, but is a public interest one. She submitted that, as with other administrative bodies, the Commission has the authority under section 127.1 to consider costs in relation to what the legislation provides and what is put before the Commission. She suggested that it would not be appropriate and would not meet the regulatory objectives of efficiency for the Commission to be turned into taxing officers to scrutinize dockets. She argued that, as we all know, the securities industry supports and funds the Commission through fees that it pays. The objective of our legislation, she argued, is to allow for the Commission to impose a costs order so that there can be recovery of costs. That is not, she argued, what the *Courts of Justice Act* and related rules are designed to do. They are designed to control costs, to allow litigants in private disputes where there is a profit element, to have some sense of whether or not they are going to continue on with litigation or bear the costs of litigation. She submitted it would be wrong to try to import that system into our system.

[221] She went on to say that none of the time spent prior to January 14, 2002 or subsequent to June 24, 2002, was included in the bill of costs. In other words, no claim has been made for a portion of costs incurred prior to January 14, 2002, in connection with the investigations and efforts relating to Yorkton and Paterson and that undoubtedly were also related, at least in part, to the proceeding against Donnini. We also note that no costs have been included for the time of the Commission panel hearing this matter.

[222] We were advised by counsel for staff that the bill of costs also does not include the work performed by two law clerks who were involved in the file. While we were not provided with docket entries, we were advised by counsel that the senior litigation counsel on the case in the enforcement branch of the Commission, who was called to the bar in 1990, had carriage of and primary responsibility for the litigation in respect of Yorkton, including the Donnini proceedings. Her involvement included: obtaining and reviewing information in documents; making disclosure of 46 volumes of material; preparing for and conducting interview of witnesses; and all aspects of preparing for and attending the hearing. The other litigation counsel in the enforcement branch was called to the Bar in 1995. She was assigned to the Donnini case on April 22, 2002. Her primary role was to research, review and prepare written submissions on the law. To this end, she conducted a detailed review of Canadian and U.S. law, prepared written submissions and compiled the necessary cases and statutory authorities. She also assisted senior litigation counsel in the weeks leading up to the hearing and attended the hearing. Written legal

submissions drafted by her were: An Overview of the Law (dealing with the statutory regime, in Canadian and U.S. cases in respective insider trading and materiality); Evidentiary Principles and Cases under the *Statutory Powers Procedure Act*; The Separation of the Liability and Sanction Phases; supplementary submissions (in response to the respondent's submissions and cases, which were provided to staff on Thursday, May 16, 2002); and submissions on sanctions. The staff investigator obtained and reviewed information and documents; assisted in the disclosure process; prepared for and conducted witness interviews; and conducted detailed analyses of the trades carried out by Donnini (including preparation of the chart marked as Exhibit 11).

[223] Counsel for the respondent also questioned the methodology used by staff in preparing its bill of costs. He suggested that costs incurred by the Commission should not be determined by applying an hourly rate to the hours incurred by salaried employees of the Commission, and that perhaps only a proportion of the time spent should be so included. He argued, for example, that if an investigator on the file spent 200 hours, and one would expect that his or her yearly number of hours would be 1800, the appropriate amount would be 1/9 of his or her annual salary. Counsel for the respondent suggested another way to go about dealing with costs, other than taking a proportion of each salaried employee's salary based on time spent on this matter in comparison with the average number of hours that the employee would be expected to expend in a year. That other way was to look at the recent costs grid put out by the courts.

[224] We do not agree with counsel for the respondent that the methodology of applying an appropriate dollar amount to the hours incurred by staff is inappropriate. The Commission incurs overhead through rent, administration and other legitimate costs, a portion of which can be cost accounted for each matter. We believe that an hourly rate applied to time expended by persons involved in a case is a meaningful methodology to determine costs. We note, and counsel for the respondent does not dispute the fact, that the hourly rates applied in the bill of costs are not out of line with the partial indemnity scale suggested for the courts as evidenced by Exhibit 20.

[225] Taking into account all the exhibits that have been filed in this case, and the reports and investigations that are evidenced by the materials, the number of hours claimed for each of the three persons since January 14, 2002, did not raise a red flag in our minds suggesting that there might be some padding. We did not believe it desirable in this case to examine dockets or a summary of dockets for staff. We were satisfied, especially in view of the January 14, 2002 start date, and the fact that time has been included for only three persons, and in view of the hourly rates selected for the three persons, that staff's bill of costs did not overstate the costs incurred by the Commission in this matter, taking into account the parameters set out in section 127.1 of the Act.

[226] We agree with counsel for staff that cost recovery is the purpose of section 127.1, and that over time, costs recovered by the Commission indirectly reduce the level of fees that the Commission would otherwise need to extract from the securities industry to pay for the Commission's enforcement activities. Cost recovery is fair to other participants in the capital markets. In *Asbestos*, at paragraph 41, Justice Iacobucci emphasized the importance of the Commission considering the efficiency of the capital markets when exercising its public interest discretion. We do not see any reason, in exercising our discretion regarding costs, to arbitrarily cut the recovery level to an amount lower than what is stated in the bill of costs before us. The

bill of costs does not include all of the Commission's costs in this matter, and as we indicated earlier, there is no reason to believe that the hours claimed in the bill of costs are overstated.

2. Order Regarding Commission Costs

[227] Accordingly, we are ordering that Donnini pay $186,052.30 as costs of the Commission in investigating his affairs and of, or related to, conducting the hearing in this matter.

Dated at Toronto this 12th day of September, 2002.

"Paul M. Moore"   "Kerry D. Adams"

By Commissioner Hands

[228] I concur with the detailed review of the evidence, considerations and analysis of the key issues in this case as expressed by Commissioners Moore and Adams. I differ only on the conclusion that on February 29 and March 1, 2000, Donnini knew, or ought to have known, that the information which he had received about a possible $10 million financing by KCA was a material fact.

[229] I agree with counsel for the respondent that in a charge as serious as insider trading, there should be a high burden of proof upon staff to demonstrate "clear and convincing proof based upon cogent evidence" (*Coates*, cited in *Rosen*) that the respondent knew he was in possession of an undisclosed material fact when he continued to trade KCA shares after 2:45 p.m. on February 29 and up to the release of the material fact to the public on March 2, 2000. After reviewing the testimony presented in this case, I am not satisfied that any of Paterson, McQueen or Milligan clearly conveyed to Donnini during their conversations the fact that by 2:45 p.m. on the afternoon of February 29, 2000, there was a very high probability that the proposed $10 million treasury financing by KCA would proceed. As a result, I did not conclude that Donnini's actions in trading KCA shares constituted a breach of section 76(1) of the Act.

[230] However, I am satisfied that the information that Donnini possessed concerning KCA at the end of his conversation with Paterson and McQueen should have raised sufficient red flags that it could be a material fact that he should have made further enquiries of Paterson or others before continuing to trade KCA shares. Donnini remembers having two conversations earlier on February 29 with Milligan, the chief financial officer of KCA, a man who was previously unknown to him. After the second conversation he changed the method of his KCA short sales to a jitney arrangement so that KCA could not trace the short sales to Yorkton. A few hours later, Paterson and McQueen asked for his views on the market's capacity to accept a $10 million treasury offering which Paterson had proposed to KCA. I am satisfied that the conversation took place, although Donnini has no recollection of it. 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 KCA shares until he had made further enquiries to determine the significance of the non-public information that he had learned about KCA that day. His failure to exercise proper due diligence to avoid a possible breach of section 76(1) was contrary to the public interest.

[231] As a result of the decisions reached by Commissioners Moore and Adams, it is not necessary for me to determine what sanctions and costs would have been appropriate to impose on Donnini for his failure to exercise the due diligence which represented conduct contrary to the public interest.

Dated at Toronto this 12th day of September, 2002.

"Harold P. Hands"