

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

AND

**IN THE MATTER OF
STEPHEN DUTHIE**

Hearing: April 16, 17, 21-23 and 28, 2003

Panel: H. Lorne Morphy, Q.C. - Commissioner (Chair of the Panel)
Robert W. Davis, FCA - Commissioner

**Appearances: Tracy Pratt - For Staff of the
Ontario Securities Commission**

Stephen Duthie - Self-Represented

REASONS FOR DECISION

[1] Stephen Duthie was a fixed income arbitrage trader with Phoenix Research and Trading Corporation (“Phoenix Canada”) before it closed. Staff of the Commission seek a section 127 order against Duthie as a result of his conduct as a trader for Phoenix Canada.

[2] The Phoenix Group was a hedge fund management group structured as a master-feeder fund arrangement. Unitholders invested in feeder funds which in turn, together with other investors, purchased units in master funds. One of these master funds was The Phoenix Income Arbitrage Limited Partnership (“PFIA-LP”).

[3] Pursuant to agreements, Phoenix Canada rendered investment advice and portfolio management services to the master funds, including PFIA-LP.

[4] Duthie was responsible for PFIA-LP’s U.S. portfolio. In the trading of this portfolio, Duthie exercised his discretion as to the specific income securities which he bought or sold for PFIA-LP. This discretion was, however, not unlimited but subject to both the investment parameters of PFIA-LP and the internal guidelines of Phoenix Canada.

[5] Duthie reported to Ronald Mock, who was the CEO and president of Phoenix Canada. Mock testified, as did other employees of Phoenix Canada, that the limits on discretionary trading were well-established and well-known to the staff of Phoenix Canada, including Duthie, and that compliance with these limits was obligatory.

[6] Commencing in late 1998 and throughout 1999, Duthie traded in various U.S. benchmark treasuries for the account of PFIA-LP. His trading was directional and unhedged, contrary to the investment parameters of PFIA-LIP and Phoenix Canada guidelines. By this trading in unhedged long bonds, PFIA-LP was exposed to market risk. The evidence was that through misstating the actual price of the long bonds, as of December 31, 1999, Duthie gave the PFIA-LP U.S. portfolio a value of more than US \$80 million in excess of its actual value. Through this mispricing and the use of contingency collateral, Duthie was able to obscure his unauthorized trading from being uncovered.

[7] His mispricing resulted in inaccurate information being given to unitholders as to the value of their investments.

[8] By reason of his trading activity, by early January 2000, PFIA-LP had incurred a loss in excess of U.S. \$100 million which caused its collapse. At that time, Duthie had accumulated a long position of US \$3.3 billion 6% U.S. Treasury notes.

[9] Duthie’s trading was contrary to the mandate given to him as a trader, and was a serious breach of his obligation to act in the best interests of his client, PFIA-LP.

[10] In so trading, and by masking his trading activity to prevent it from being uncovered, including his mispricing, Duthie’s actions were intentional and he must have appreciated the consequences of

what he was doing.

[11] Duthie has never been registered with the Commission as an adviser or in any other capacity. Staff alleged that Duthie engaged in registerable activity and should have been registered under section 25 of the *Securities Act* (the Act).

[12] Paragraph 25(1)(c) of the Act provides that no person shall act as an adviser unless the person is registered as an adviser. Adviser is defined in subsection 1(1) of the Act as “a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others as to the investing in or the buying or selling of securities”. Section 99 of the General Regulation under the Act states:

Every person or company that is required to register as an adviser shall be registered and classified into one or more of the following categories:

1. Financial advisers, being persons or companies that engage in or hold themselves out as engaging in the business of advising others as to investing in or the buying or selling of securities on a basis that does not require their classification in another category of adviser.
2. Investment counsel, being persons or companies that engage in or hold themselves out as engaging in the business of advising others as to the investing in or the buying or selling of specific securities or that are primarily engaged in giving continuous advice as to the investment of funds on the basis of the particular objectives of each client.
3. Portfolio managers, being persons or companies that are registered for the purpose of managing the investment portfolio of clients through discretionary authority granted by one or more clients.
4. Securities advisers, being persons or companies that hold themselves out as engaging in the business of advising others either through direct advice or through publications or writings, as to the investing in or the buying or selling of specific securities, not purporting to be tailored to the needs of specific clients.
5. International advisers (investment counsel, portfolio managers or securities advisers), being persons or companies that have registered under the Act in reliance on Ontario Securities Commission Rule 35-502 Non-Resident Advisers and that are,
 - i. investment counsel,
 - ii. investment counsel and portfolio managers, or
 - iii. securities advisers.

[13] Duthie strongly maintains that he was not an adviser as he was not paid for providing investment advice. We do not accept that submission. As an arbitrage trader, Duthie had discretion to buy and sell, and in exercising that discretion he was, in effect, advising his client as to an appropriate investment with a mandate to carry out that advice. That such activity is contemplated within the definition of adviser is confirmed by section 99 of the General Regulation, and in particular, category 3 thereof. Duthie was therefore required to be registered as an adviser.

[14] Duthie's improper trading activity was clearly contrary to the purposes of the Act as found in section 1.1, namely:

(a) to provide protection to investors from unfair, improper or fraudulent practices; and

(b) to foster fair and efficient capital markets and confidence in capital markets.

[15] Duthie's conduct, if not fraudulent, was both unfair and improper.

[16] It should also be noted that section 2.1 of the Act sets out the principles to consider in pursuing those purposes. The second of these principles states that "requirements for maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants" are one of the primary means for achieving the purposes of the Act.

[17] Duthie was a market participant, as the definition of a market participant includes a registrant, and a registrant is defined as a person or company registered or required to be registered under the Act.

[18] Having regard to Duthie's conduct, which we have found to be contrary to the purposes of the Act, and his failure to register, it is in the public interest that Duthie be sanctioned under section 127 of the Act. Furthermore, in our view, Duthie is undeserving of registration until he can demonstrate that he can meet the high standards of fitness and business conduct required of market participants.

[19] Staff submitted that if we found the conduct of Duthie duplicitous, a cease trade order of 15 to 20 years was appropriate except for personal trading through a registered dealer after five years. Staff also submitted that he should be prohibited from being a director or officer of a reporting issuer for 15 to 20 years.

[20] Duthie did not make any submissions regarding sanctions.

[21] Staff also requested a costs order to cover part of the costs of Staff's investigation. Based on the bill of costs which was filed, Staff suggested that an order should be made in the range of \$85,000 to \$95,000.

[22] Duthie also made no submissions regarding costs.

[23] We find that Duthie's conduct was duplicitous. In the public interest, we are ordering that:

- (a) pursuant to paragraph 2 of subsection 127(1) of the Act, trading in any securities by Duthie shall cease for 20 years from the date of our order, except for personal trading through a registered broker after a period of five years;
- (b) pursuant to paragraph 6 of subsection 127(1), Duthie is reprimanded;
- (c) pursuant to paragraph 7 of subsection 127(1), Duthie resign any position he holds as a director or officer of a reporting issuer;
- (d) pursuant to paragraph 8 of subsection 127(1), Duthie is prohibited from becoming or acting as a director or officer of any issuer for 20 years from the date of this order; and
- (e) pursuant to section 127.1 of the Act, Duthie shall pay costs of the Commission in the amount of \$90,000.

Dated at Toronto this 27th day of May, 2003.

"H. Lorne Morphy"
H. Lorne Morphy

"Robert W. Davis"
Robert W. Davis