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

– and –

IN THE MATTER OF
PARADIGM CAPITAL INC.
PATRICK MCCARTHY
EDEN RAHIM

Private Placements – Overtrading – Insider Trading – Material Non-Public Information – Behaviour Contrary to the Public Interest – Settlement Agreement

Facts: During the material time, Paradigm Capital Inc. ("Paradigm") was acting as a co-lead agent in connection with a private placement of special warrants to be issued by Bioscrypt Inc. ("Bioscrypt"), a reporting issuer listed and trading on the Toronto Stock Exchange. Patrick McCarthy ("McCarthy"), an institutional salesperson at Paradigm, was actively involved in the sale of the warrants by means of a private placement. Pursuant to the policies in place at Paradigm, Bioscrypt was placed on its restricted list. Eden Rahim ("Rahim") was a portfolio manager of the Royal Canadian Growth Fund ("RCGF") at RBC Global Investment Management Inc. ("RBC GIM"). Rahim advised McCarthy that he intended to invest $2 million in the private placement and it was agreed that Rahim would pay $1.60 per share in the private placement agreement. McCarthy discussed with Rahim the possibility of participating in an overtrade. An overtrade involves an investor purchasing freely trading shares in a company from an existing shareholder, in this case RCGF, with the existing shareholder replacing those shares by purchasing shares on a new issue from the company's treasury. McCarthy and Rahim agreed that the overtrade would include 600,000 shares at $1.70 per share, over and above the private placement investment of 1,250,000 shares at $1.60 per share. On the morning of November 1, 2001, trading in the shares of Bioscrypt opened at $1.90 on the market. In order for Paradigm to complete the overtrade at $1.70 per share, it was necessary to displace all better-priced bids in the market. By means of 34 sell transactions which totaled 56,100 shares on the secondary market, Paradigm got the price of Bioscrypt down to $1.70 per share. The purchasers of the 56,100 shares had no knowledge of the private placement offering price of $1.60 per share. Once the price of the Bioscrypt shares was down to $1.70 per share, two institutional investors who also had no knowledge of the private placement offering price of $1.60 per share, bought a total of 543,900 shares of Bioscrypt, between them, at $1.70.

Held: The Settlement Agreements with Paradigm, McCarthy and Rahim were in the public interest. It is fundamental to the integrity of the capital markets that registrants adhere to the highest standards when dealing with confidential material information that has not been generally disclosed. The result of not adhering to the highest standard in the instant case is that shares of an issuer were sold by persons with knowledge of a material fact, which had not been generally disclosed, to persons who had no knowledge

of that material fact. This result, even though not intended, clearly undermines the integrity of the markets and the public's confidence in those markets and undermines the level playing field which we seek to foster for all investors. This is the first case to come before the Commission relating to an industry practice known as "overtrading" in connection with an offering of securities, but prior to a public announcement of the offering. The parties indicated they were not aware that permitting overtrading in this instance was wrong. This is an unacceptable practice.

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IN THE MATTER OF
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Settlement Hearing: June 11, 2004

Panel:	**Wendell S. Wigle, Q.C.**	**-**	**Commissioner (Chair of Panel)**
	Harold P. Hands	**-**	**Commissioner**
	Suresh Thakrar	**-**	**Commissioner**
Counsel:	**Jay Naster**	**-**	**For the Staff of the Ontario Securities Commission**
	Peter Wardle		**For Paradigm Capital Inc.**
	Terrence O' Sullivan		**For Patrick McCarthy**
	Nando De Luca		**For Eden Rahim**

REASONS

I. The Proceedings

[1] This matter comes to us by way of a Notice of Hearing dated June 8, 2004 pursuant to sections 127 and 127.1 of the Securities Act (the Act).

[2] The purpose of the hearing on June 11, 2004 was to consider a settlement agreement between staff of the Commission and the respondents in this matter.

II. Factual Background to the Settlement

The Respondents

[3] Paradigm Capital Inc. ("Paradigm"), is registered in Ontario as a broker and investment dealer. During the material time Paradigm was acting as a co-lead agent in connection with a private placement of special warrants to be issued by Bioscrypt Inc. ("Bioscrypt"), a reporting issuer in Ontario, listed and posted for trading on the Toronto Stock Exchange ("TSX"), under the trading symbol "BYT".

[4] Patrick McCarthy ("McCarthy"), is a shareholder and institutional salesperson at Paradigm and is registered in Ontario as a salesperson. McCarthy owns a 6.5% equity interest in Paradigm. During the material time McCarthy, on behalf of Paradigm, was actively involved in the sale of special warrants being issued by Bioscrypt by means of a private placement.

[5] Eden Rahim ("Rahim") was a portfolio manager at RBC Global Investment Management Inc. ("RBC GIM"), and was registered in Ontario as a portfolio manager. During the material time Rahim was the portfolio manager of the Royal Canadian Growth Fund ("RCGF"), an RBC Mutual Fund in respect of which RBC GIM exercised management authority.

The Offering

[6] By letter dated October 11, 2001, Bioscrypt was advised by National Bank Financial Inc. ("NBF") that a syndicate of agents would be formed to work with Bioscrypt in connection with a proposed private placement of special warrants (the "Offering"). NBF agreed to invite Paradigm, as well as other securities dealers, to act as an agent. The letter specified that Paradigm was to be allocated 42.5% of the Offering and that the terms of the Offering were to include the following: that the special warrant would be exercisable for no additional consideration into a common share; that the Offering would be for gross proceeds of $10 million; that the agents would market the Offering on a best efforts basis; that the Offering would close on November 13, 2001; and that the agents' commission would be 6.5% of the gross proceeds of the Offering, as well as compensation options. On October 12, 2001 the President and CEO of Bioscrypt, Pierre Donaldson ("Donaldson"), accepted the terms and conditions set out in the October 11, 2001 letter, subject to a minor amendment specifying that only 5% commission would be paid in connection with gross proceeds received from insiders.

[7] On October 11, 2001, Paradigm placed Bioscrypt on a Restricted List. It was the policy of Paradigm at that time to place an issuer on its Restricted List in circumstances where: Paradigm had been asked to act as an underwriter in a public offering; Paradigm was working on an engagement which was sufficiently

developed; and, where Paradigm was in a special relationship with the issuer according to section 76(5)(b) of the *Securities Act* (Ontario) (the "Act"). Pursuant to the Paradigm policy, once a security was placed on the Restricted List, trading in that security was limited to: normal market making; unsolicited orders; and, transactions as part of a basket for hedging, provided that any trading was done by persons who did not have knowledge of any material non-public information. The security could be removed from the Restricted List where the material non-public information had been generally disclosed to the marketplace, for example, upon the issuance of a press release covering all of the relevant facts.

[8] On October 17, 2001, a meeting was held at the offices of NBF attended by the members of the syndicate, including Paradigm, and management of Bioscrypt. At this meeting, a dry run was held of the presentation which was to be given during a cross country "road show" which was to commence on October 22, 2001. The dry run included the presentation of the Terms of the Issue (the "Terms") which specified the nature of the security being offered (special warrants), the size of the Offering (approximately $10 million, of which $1 million had been committed to by Donaldson), the closing date (November 13, 2001), the escrow conditions, and the agents on the Offering.

[9] By letter dated October 17, 2001, Bioscrypt made an initial request to the TSX to grant price protection in respect of the Offering, noting that the closing price of Bioscrypt's common shares on October 16, 2001 was $2.38. In a further letter to the TSX dated October 22, 2001, Bioscrypt provided additional details in respect of the terms of the proposed Offering including the fact that insiders of Bioscrypt intended to participate in the Offering. By letter dated October 26, 2001 the TSX confirmed that price protection had been granted by the TSX to yield a minimum issue price of $2.12 per special warrant. A subsequent amendment of the price protection was sought by Bioscrypt on October 30, 2001 in order to reflect the closing price of Bioscrypt's common shares of $1.95 on October 29, 2001. The TSX granted the amendment, but only in respect of arm's length purchasers of the Offering. As a result, the special warrants were ultimately issued to arm's length purchasers at $1.60, and to insiders (i.e. Donaldson) at $1.74.

[10] In the period October 22, 2001 to October 30, 2001 the road show was conducted. A series of presentations to market the Offering were made to various institutional investors in Montreal, Toronto, Winnipeg and Vancouver by senior officers of Bioscrypt, and representatives from the syndicate. At these meetings, the Terms of the Offering were discussed with the would-be investors. In addition to the formal "road show" presentations, during this same period, the members of the syndicate also solicited the interest of institutional investors via telephone communications.

[11] On November 2, 2001 Bioscrypt issued a press release in respect of the Offering announcing that NBF, as lead agent, together with Paradigm as co-lead, and two other securities dealers, had agreed to act as agents on a "best efforts" basis in connection with a private placement of $10 million of Special Warrants to be issued at $1.60 each. The private placement closed on November 14, 2001.

"The Overtrade"

[12] On October 18, 2001, McCarthy sent an e-mail to Eden Rahim, a portfolio manager at RBC Global Investment Management Inc. ("RBC GIM"), forwarding a copy of the Terms of the Offering. McCarthy suggested that a meeting be held the following week, at which Bioscrypt's CEO, Donaldson, would attend. Rahim managed the Royal Canadian Growth Fund ("RCGF") which held, at that time, approximately 1,551,100 freely trading shares of Bioscrypt. Approximately 570,000 of these shares had been purchased in the period July 1 to September 30, 2001 in an RBC GIM account at Paradigm in respect of which McCarthy was the institutional salesperson.

[13] On or about October 26, 2001, a meeting was held with Rahim at the offices of RBC GIM attended by McCarthy and Donaldson. During the course of the meeting a presentation was made to Rahim in respect of the Offering. By no later than October 30, 2001, Rahim advised McCarthy that he intended to invest $2 million in the Offering on behalf of the RCGF.

[14] At the time of engaging in these discussions, Rahim's employer, RBC GIM, had an insider trading policy to address circumstances where a portfolio manager learns of material facts, from a person in a special relationship with an issuer, which have not been generally disclosed. Rahim was required to annually review and sign off on this policy. The RBC GIM policy in effect at that time stated as follows:

> *If an RBC GIM Portfolio Manager or employee comes into possession of insider information, the law is clear that the portfolio manger or staff member is automatically prohibited from trading in that security. From a practical stance however, as an investment management company RBC GIM has a fiduciary responsibility to all account holders to continue to manage their money in accordance with the terms of their contracts and in their best interests.*
>
> *Accordingly, to avoid the use of insider information in connection with trades in securities on behalf of our account holders, the following procedures must be followed:*
>
> *1. As soon as a Portfolio Manager ("PM") or other RBC GIM staff member comes into possession of information relating to a reporting issuer that is not public or has not been publicly disclosed, the PM or staff member must immediately cease from passing on such information or talking about the information with any person, other than persons indicated in items 2 and 3 of this procedure document.*
>
> *2. The PM or staff member affected will immediately notify the President of RBC GIM, who does not actively invest for clients' portfolios.*
>
> *3. The President will notify the Vice President, Compliance, of the acquisition of the information, determine if the information is indeed "insider" information and if necessary, obtain legal counsel depending on the particulars of the situation.*
>
> *4. No personal trading in the security that is the subject of the information may be made by the affected PM, any staff who also are aware of the information, or by the President and the Vice President, Compliance.*
>
> *5. The portfolios managed by the affected PM continue to be managed in the ordinary course, except that the affected PM will not participate in any decisions relating to the security to which the information relates. Rather, all trading in this security will be handled following the same strategy used for all accounts by the portfolio managers who are not aware of the insider information.*
>
> *6. Depending on anticipated public disclosure of the relevant information, the President will determine with the Vice President, Compliance the appropriate timeframe in which the moratorium on having the PM trade in that particular security for his/her client's account should last…*
>
> *7. The employees affected will take not action with respect to the security until advised by the President in writing that they can do so.*

[15] Contemporaneous with confirming Rahim's interest on behalf of the RCGF in the Offering, McCarthy also discussed with Rahim participating in what McCarthy described as an “overtrade” involving the freely trading shares of Bioscrypt held by the RCGF. An “overtrade” was understood to be an investment strategy that resulted in an investor purchasing freely trading shares in a company from an existing shareholder with the existing shareholder replacing those shares by purchasing shares on a new issue from the company's treasury.

[16] On October 31, 2001, McCarthy e-mailed Rahim, stating “I need to talk to you on BYT, we are closing the books tonight and I want to make sure that we are clear on a few things. I have you in the book for $2m plus the overtrade, which we talked about being 450,000 shares at $1.70, but I could make that slightly bigger if you are interested. Please give me a call…”

[17] On the morning of November 1, 2001 , Rahim sent an e-mail in response to McCarthy, stating “that's fine if you need to make the overtrade larger, let me know how much, and I'll put it on the desk with JP [an equity trader at RBC GIM]”. McCarthy replied to Rahim the same day, stating:

> Just want to double check all of the numbers with you:
> You are buying 1,250,000 shares of the deal at $1.60.
> The overtrade we are proposing has been increased to 600,000 shares at $1.70.
> Therefore, you will be subscribing for 1,850,000 shares of the deal, and writing a cheque on November 12 for closing on November 13 for $2,960,000.
> On the overtrade, you will have proceeds of $1,020,000.
> Please confirm that this is OK, and we can do that trade later today.

Rahim replied shortly thereafter, stating “That's fine, I'll put the order on the desk”.

[18] During the course of the road show in respect of the Offering, certain institutional investors, including Synergy Asset Management Inc. (“Synergy”), and Canadian Pacific Management Limited (“CP”), advised Paradigm that they were not interested in purchasing securities pursuant to the Offering (which securities were subject to certain resale restrictions), but were interested in purchasing freely trading stock.

[19] Peter Hodson (“Hodson”) was a portfolio manager at Synergy serving as lead manager for the Synergy Canadian Small Cap Fund. Synergy was a client of Paradigm. On October 23, 2001, Hodson met with officials from Bioscrypt and Paradigm during which time a presentation was made in respect of the Offering. Hodson declined to purchase special warrants under the Offering but advised Paradigm that Synergy would be interested in purchasing freely trading shares of Bioscrypt. On November 1, 2001 Synergy placed an order to purchase up to 150,000 shares of Bioscyrpt at $1.70.

[20] Chayanne Fickes (“Fickes”) was a portfolio manager with CP where she managed the Canadian Pacific North American Pension Trust. CP was a client of Paradigm. On or about November 1, 2001, Fickes became aware of a block of Bioscrypt stock being made available. As a result, on November 1, 2001 CP placed on order to purchase up to 450,000 freely trading shares of Bioscrypt at $1.70.

[21] On November 1, 2001, trading in shares of Bioscrypt opened at a price of $1.90. In order for Paradigm to complete the “overtrade”, which was to be filled at $1.70, it was necessary for Paradigm to displace all better-priced bids in the market to achieve the “crossing” price for the overtrade. By means of 34 sell transactions, totaling 56,100 Bioscrypt shares (which formed part of the 600,000 shares to be sold on the “overtrade” by RBC GIM), the price of Bioscrypt was brought down to $1.70. The purchasers of

these 56,100 shares, at an average price of $1.7984, had no knowledge of the Offering at the time their buy orders were filled by Paradigm on November 1, 2001.

[22] Once the share price was brought down to $1.70, the cross of the remaining 600,000 shares from the "overtrade" was executed. The 56,100 shares sold to bring the price down were deducted on a pro-rata basis from the orders placed by Synergy and CP. As a result of the "overtrade", Synergy purchased 135,000 shares at $1.70; CP purchased 408,900 at $1.70; and RBC GIM sold 600,000 shares at an average price of $1.7092.

[23] In connection with the sale of the 600,000 special warrants to the RCGF and the cross of the 600,000 shares further to the overtrade, Paradigm earned a commission of $43,340. In addition to these commissions, Paradigm also received 24,000 compensation options in connection with the sale of the 600,000 special warrants sold to the RCGF which options were exercised and subsequently sold at a profit to Paradigm of $12,415. Paradigm's total profit with respect to these transactions was $55,755.

III. Behaviour Contrary to the Public Interest

[24] The Settlement Agreement contained the following list which was conceded by the respondents as consitututing behaviour contrary to the public interest:

- Paradigm's conduct was contrary to the public interest in failing to properly supervise and restrict the activities of McCarthy, and other employees, in connection with the conduct of secondary market trading in shares of Bioscrypt, at a time when Bioscrypt was on the Paradigm Restricted List as a consequence of Paradigm agreeing to act as an agent for the purpose of an offering which had not been generally disclosed to the public.

- McCarthy acted contrary to the public interest by agreeing to facilitate a transaction in the secondary market, the "overtrade", which resulted in shares of Bioscrypt being sold by persons, with knowledge of a material fact which had not been generally disclosed, to persons who had no knowledge of that material fact, despite Bioscrypt having been placed on a Paradigm Restricted List.

- Rahim acted contrary to the public interest by agreeing to sell shares of Bioscrypt in the secondary market pursuant to the overtrade, after being informed of a material fact which had not been generally disclosed, in circumstances where Rahim, in accordance with the policy of his employer, may have been required not to participate in any decisions relating to trading shares of Bioscrypt in the secondary market. Although not intended or anticipated by Rahim, his conduct contributed to shares of Bioscrypt being sold by persons with knowledge of a material fact respecting Bioscrypt which had not been generally disclosed, to persons who had no knowledge of that material fact.

IV. Terms of Settlement

[25] Paradigm agreed to the following terms of settlement:

> (a) that further to a recent review of its practices and procedures respecting the receipt of confidential material information while acting as an agent on behalf of an issuer, Paradigm will implement a revised policy with such modifications as may be requested by Staff;
>
> (b) that Paradigm be reprimanded;

(c) that Paradigm will make a settlement payment of $55,755 to the Ontario Securities Commission for allocation to or for the benefit of such third parties as may be approved by the Minister under section 3.4(2) of the Act; and

(d) that Paradigm will make a payment of $30,000 to the Ontario Securities Commission in respect of a portion of the costs of the investigation and this proceeding.

[26] McCarthy agreed to the following terms of settlement:

(a) that McCarthy's registration as a salesperson be restricted to institutional sales for a period of one year from the date of the Commission order;

(b) that McCarthy will take the Canadian Securities Course on Securities Law and Regulations within one year from the date of the Commission order;

(c) that McCarthy be reprimanded; and

(d) that McCarthy will make a payment of $30,000 to the Ontario Securities Commission in respect of a portion of the costs of the investigation and this proceeding.

[27] Rahim agreed to the following terms of settlement:

(a) that Rahim's registration as a portfolio manager be subject to a term and condition; specifically, that for a period of one year from the reinstatement of his registration, Rahim is not permitted to participate in a private placement of securities on behalf of any fund that he may manage without the prior written consent of his supervisor with respect to that trade,

(b) that Rahim be reprimanded; and

(c) that Rahim will make a payment of $30,000 to the Ontario Securities Commission in respect of a portion of the costs of the investigation and this proceeding.

V. Reasons for the Settlement Agreement

[28] On Friday June 11, 2004 we found the terms of the settlement agreement to be in the public interest; however, we indicated that we would be releasing reasons for our decision.

[29] It is fundamental to the integrity of the capital markets that registrants adhere to the highest standards when dealing with confidential material information. That is, material information in respect of an issuer that has not been generally disclosed. The result of not adhering to the highest standard in the instant case is that shares of an issuer were sold by persons with knowledge of a material fact which had not been generally disclosed to persons who had no knowledge of that material fact. This result, even though not intended, clearly undermines the integrity of the markets and the public's confidence in those markets and undermines the level playing field which we seek to foster for all investors.

[30] Our system permits the dissemination of this information in the legitimate course of marketing a private placement of securities. However, what must be recognized by registrants is that the receipt of this information will trigger corresponding obligations which must be respected to maintain a fair marketplace. These obligations will result in restrictions on what the registrant can and cannot do in the context of engaging in trading in the secondary market so long as that material information remains undisclosed. These obligations will attach not only to the investment dealer who is trying to market a

private placement on behalf of its client, but also to a portfolio manager who has been solicited by the dealer to purchase securities under the private placement.

[31] This is the first case to come before the Commission relating to an industry practice known as "overtrading" in connection with an offering of securities but prior to a public announcement of the offering. The parties indicate they were not aware that permitting overtrading in this instance was wrong. We believe we must indicate this is an unacceptable practice and send a message to those who would contemplate similar actions in the future. As this is the first case, the sanctions were not severe; however, in any future case, the sanctions could be much more severe.

[32] We note that the "overtrade" earned the underwriter a total profit of $55,755 in trading commissions with the mutual fund and others. This figure represents an unfair practice that cannot be condoned or permitted to continue.

[33] This is a form of insider trading in that a select few had access to information which was not disclosed to the general public. It is therefore important that we make it perfectly clear that this form of trading will not be tolerated.

[34] These reasons are intended to emphasize the absolute necessity, not only for investment dealers, but for all registrants, such as portfolio managers, to both implement and adhere to policies and procedures with respect to the implications of receiving, in the course of business, material information which has not been generally disclosed.

DATED at Toronto this 18th day of June, 2004.

"Wendell S. Wigle"

Wendell S. Wigle, Q.C.

"Harold P. Hands"

Harold P. Hands

"Suresh Thakrar"

Suresh Thakrar