

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

AND

**IN THE MATTER OF
MOMENTAS CORPORATION, HOWARD RASH,
ALEXANDER FUNT, SUZANNE MORRISON
AND MALCOLM ROGERS
(Sections 127 and 127.1)**

Motion Hearing:

July 14, 2005

Panel:

Paul M. Moore, Q.C.
Wendell Wigle, Q.C.
Carol S. Perry

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Vice-Chair (Chair of the Panel)
Commissioner
Commissioner

Counsel:

Pamela Foy
Shauna Flynn

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For Staff of the Ontario Securities
Commission

Linda Fuerst
Jennifer King
(Summer Student)

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For Momentas Corporation

REASONS

[1] These are the reasons for an order issued by the Ontario Securities Commission (the “Commission”) after a hearing on July 14, 2005, in which the temporary order of June 9, 2005, and the order of July 8, 2005 against Momentas Corporation (“Momentas”) were extended pursuant to section 127 of the *Securities Act*, R.S.O. 1990, C. s.5 as amended (the “Act”). Similar orders against the other respondents were extended on consent.

Findings and Order

[2] On July 14, 2005, the Commission held a hearing to determine whether or not it was in the public interest to extend the temporary order against Momentas requiring that it cease trading in securities and removing the applicability of any exemptions in Ontario securities laws to Momentas.

[3] In particular, Staff sought an order of the Commission: (1) extending the terms of the temporary order as against Momentas until the conclusion of a hearing in this matter; and (2) extending the terms of the order of the Commission of July, 8, 2005 that Momentas cease trading in any securities until the conclusion of the hearing in this matter.

[4] After having heard the arguments made by both counsel for Staff and for Momentas, and upon considering the evidence before it, the panel concluded that Momentas had been acting as a market intermediary and distributing securities without being registered. Further, the panel concluded that it would be in the public interest to grant an extension of the temporary order and the order of July 8, 2005, until the earlier of the conclusion of the hearing in this matter or the date upon which Momentas becomes registered as a limited market dealer and its officers, directors and/or employees involved in the sale of securities to the public become registered in accordance with Ontario securities law.

[5] In granting the extension to the temporary order and the order of July 8, 2005, pending the conclusion of the hearing, the panel provided Momentas with two exceptions from the trading ban: (1) Momentas may trade securities beneficially owned by it through a registered dealer for the purpose of continuing to test and develop its automated equity trading system on the condition that reports of all such trades are delivered to Staff of the OSC within 5 days of each trade; and (2) Momentas may offset or eliminate open positions in foreign currency exchange contracts on the condition that Momentas shall provide to Staff weekly account status reports.

The Evidence

[6] Staff filed six documents as exhibits. These documents were: (1) a letter to Staff from Harry G. Black, Q.C., former counsel for Momentas, dated February 14, 2005, together with a sample of documentation provided (i.e. Form 45-501, closing settlement statement, subscription agreement,

investor accreditation certificate and letter of direction); (2) a letter from Harry G. Black, Q.C. dated March 9, 2005, providing requested information which shows that Momentas employs a sizable sales team to solicit investors to purchase the Convertible Debentures; (3) Momentas' promotional brochure; (4) Momentas' confidential offering memorandum as amended April 1, 2004; (5) A print-out of Momentas' website from June 2005; and (6) Form 45-501 F1s filed by Momentas. These documents were not challenged by Momentas.

The Facts

A. Momentas Corporation

[7] Momentas is a private corporation incorporated pursuant to the laws of the Province of Ontario on July 30, 2003, with its head office located in Toronto.

[8] Momentas is not registered in any capacity with the Commission and is not a reporting issuer in Ontario.

[9] In its offering memorandum, Momentas describes its principal business activities as being the use of an automated equities trading system ("ARF") for equities trading and the trading of foreign currencies through foreign exchange traders.

[10] Since approximately August 2003, Momentas has been issuing and selling its own Convertible Debentures to residents of Ontario and elsewhere pursuant to the offering memorandum as amended April 1, 2004 to fund those business activities.

[11] The offering memorandum discloses, among other things, the proposed use of the funds by Momentas, the nature of Momentas' business, and the highly speculative nature of an investment in the Convertible Debentures. In particular, Momentas states in its offering memorandum that it intends to raise \$10 million from the sale of the Convertible Debentures for its stated business. Further, the offering memorandum provides that the Convertible Debentures are to be issued in denominations of \$5,000 and multiples of \$2,500 thereafter. The Convertible Debentures provide for significant returns:

Each Convertible Debenture bears interest at a rate of 10% per annum until August 31, 2004, 12% per annum thereafter until August 31, 2005 and 14% per annum thereafter until August 31, 2006, calculated and payable monthly until maturity on August 31, 2006. On maturity, the Corporation will pay on each Convertible Debenture a premium of 20% of the principal amount of such debenture. The Convertible Debentures are redeemable at the option of the Corporation at any time upon payment to the holder of the principal amount of the debenture, the 20% premium and any accrued and unpaid interest to the date of redemption. The principal amount and the premium, but not the interest, of each debenture is convertible in whole or in part at the

option of the holder on maturity of the Convertible Debentures into common shares (“Common Shares”) of the Corporation at a conversion price of \$1.00 per Common Share subject to adjustment in specified circumstances.

[12] To date, Momentas has raised approximately \$6 million through the sale of the Convertible Debentures. Of this amount, approximately \$2.9 million has been raised from the sale of Convertible Debentures to Ontario residents.

[13] Momentas employs approximately 27 individuals, 19 of them for the primary purpose of selling its Convertible Debentures. These individuals are either “lead generators” or “sales representatives.” Lead generators call prospective investors to explain the nature of the Convertible Debentures and to ascertain that individuals are accredited. These employees earn a base salary of between \$400 and \$1,200 per week, plus sales commissions of 10%.

[14] In selling the Convertible Debentures to Ontario residents, Momentas has purportedly relied upon an exemption for selling securities to accredited investors contained in OSC Rule 45-501.

[15] Virtually all of Momentas’ capital comes from the proceeds of the sale of its Convertible Debentures.

Staff’s Submissions

[16] Staff submitted that Momentas, through the sale of its Convertible Debentures, and in acting as a “professional trader” of equities and foreign currencies using funds raised from investors through the sale of its Convertible Debentures, has been acting as a market intermediary, and consequently, is required to be registered pursuant to section 25 of the Act, which it has failed to do.

[17] Staff argued that the fact that Momentas employed and paid its staff to sell its own securities, in itself, made Momentas a market intermediary regardless of its other businesses. However, Staff argued, the fact that Momentas intended to use the proceeds of the sale of its Convertible Debentures to invest and trade professionally for the indirect benefit of its investors in the Convertible Debentures (i.e. to generate funds to pay the 10-14% coupon rates and repay the principal and 20% premium owing on the Convertible Debentures) also made Momentas a market intermediary.

Momentas’ Submissions

[18] Momentas submitted that Momentas is not a market intermediary. Selling its own securities (the Convertible Debentures), even through its own employees retained and remunerated for such purposes, was not the business of Momentas, but an incident of its funding. The business of Momentas, argued Momentas, includes the ongoing development and use of ARF for equities trading and foreign currency trading, which is funded by the sales of Convertible Debentures issued by the company. Momentas argued that clauses (a),(b),(c),(d), of subsection 204 of the Regulation under the Act contemplate that a “market intermediary” is an entity involved in the trading of

securities of another issuer and not its own. Rather, Momentas submitted, the term “intermediary” contemplates an entity that interposes itself between an issuer and investors.

[19] Furthermore, Momentas submitted that it does not become a market intermediary simply by virtue of describing itself as being in the business of professionally trading securities for itself. According to Momentas, such trading is always for investment, being the laying out of money with a view to obtaining profit or gain.

[20] Momentas further submitted that in the circumstances where the Commission has released no decision interpreting or explaining what constitutes a “market intermediary”, it would be unfair to issue a cease trade order. Further, it is inappropriate for the Commission to use interim cease trade orders to make new policy or law.

[21] Momentas argued that it is not in the public interest to continue the cease trade order when Momentas is complying with securities law and cooperating with Staff’s inquiries and where there are no other circumstances justifying the continuation of the orders. Notwithstanding this position, counsel submitted that in the event that the Commission were to extend the temporary order in the public interest, broad carve-outs ought to be made in order to allow trading activities on a very limited basis.

The Issues

[22] The issues that the panel had to determine were as follows:

- (1) Is Momentas a market intermediary?
- (2) What is the appropriate order, if it is a market intermediary?

The Law

A. The Accredited Investor Exemption

[23] Sections 25 and 53 of the Act contain the general registration and prospectus requirements for trading in securities.

[24] Pursuant to subsection 25(1)(a) of the Act, no company shall trade in a security unless the company is registered as a dealer.

[25] OSC Rule 45-501 provides certain exemptions from the registration requirements for trading in securities.

[26] One of the categories of exemptions contained in Rule 45-501 includes the sale of securities to “accredited investors”. Section 2.3 of Rule 45-501 provides that sections 25 and 53 of the Act do not apply to trades in securities if the purchaser is an accredited investor and purchases as principal. However, section 3.4 of Rule 45-501 removes the registration exemption for market intermediaries.

B. The Definition of Market Intermediary

[27] The definition of market intermediary is set out at section 204(1) of the Regulation:

“market intermediary” means a person or company that engages or holds himself, herself or itself out as engaging in Ontario in the business of trading in securities as principal or agent, other than trading in securities purchased by the person or company for his, her or its own account for investment only and not with a view to resale or distribution, and, without limiting the generality of the foregoing, includes a person or company that engages or holds himself, herself or itself out as engaging in the business of,

(a) entering into agreements or arrangements with underwriters or issuers, in connection with distributions of securities, to purchase or sell such securities,

(b) participating in distributions of securities as a selling group member,

(c) making a market in securities, or

(d) trading in securities with accounts fully managed by the person or company as agent or trustee,

whether or not the person or company engages in trading in securities purchased for investment only.

Policy Statement

[28] On July 8, 2005, the Canadian Securities Administrators published a proposed new rule that proposes to harmonize and consolidate prospectus and registration exemptions across Canada. The proposed new rule would carry forward, virtually unchanged, the current law on market intermediaries and the unavailability of the registration exemptions for them when dealing with accredited investors.

[29] The proposed companion policy to the proposed new rule states in part:

The Ontario Securities Commission takes the position that if an issuer retains an employee whose primary job function is to actively solicit members of the

public for the purposes of selling the issuer's securities; the issuer and its employee are in the business of selling securities. Further, if an issuer and its employees are deemed to be in the business of selling securities the Ontario Securities Commission considers both the issuer and its employees to be market intermediaries (Appendix C, National Instrument 45-106, (2004) OSCB (Supp. 3)).

[30] This is not new policy, but a statement of the view of the Commission with respect to the current law, even though it is recorded in a proposed companion policy to the proposed new rule.

Analysis

A. Momentas a market intermediary

[31] The basis for the temporary order was that Momentas and the other respondents appeared to hold themselves out as engaging in the business of trading in securities in Ontario and appeared to be acting as market intermediaries without being registered pursuant to the Act. Further, it appeared that no exemptions could be relied upon by the respondents.

“Engages or holds itself out as engaging in Ontario in the business of trading in securities as principal or agent”

[32] Momentas has been raising capital through the sale of its Convertible Debentures in order to carry out its stated business as a “professional trader” and as a developer of a computer software trading system known as “ARF”.

[33] It has hired and remunerated a significant number of employees (approximately 70% of its workforce) for the sole purpose of raising capital. It is carrying on, internally, the business of raising funds, rather than relying on the efforts of others in the business of raising funds. This alone is sufficient to constitute Momentas a market intermediary.

[34] Momentas was also acting as a market intermediary when the sale of its Convertible Debentures and the use of the proceeds are considered together. The investors in the Convertible Debentures supplied most of the capital used by Momentas; a minuscule amount came from other investors. Most of the capital raised was to be invested in the capital markets (in fixed income, equity and foreign exchange securities). Some of the net proceeds received from the sale of the Convertible Debentures were to be invested in the ARF software development. The ARF trading program and other trading activities were to be used to generate the funds necessary for Momentas to pay the returns promised on the Convertible Debentures.

“Other than trading in securities purchased by the company for its own account for investment

only”

[35] We do not accept the argument made by Momentas that it was engaged in the trading of securities purchased by it for its own account for investment only.

[36] When analysing the nature of Momentas’ business activities, we focused on the substance and not merely on the form of these activities. In *Pacific Coast Coin Exchange of Canada v. Ontario Securities Commission*, [1978] 2 S.C.R. 112 at para. 43, the Supreme Court of Canada held that:

Such remedial legislation must be construed broadly, and it must be read in the context of the economic realities to which it is addressed. Substance, not form, is the governing factor.

[37] Not only were the investors in Convertible Debentures the only significant source of funds for Momentas, but the returns promised on the Convertible Debentures were extremely rich and, obviously, were dependent on the successful execution by Momentas of its professional trading activities.

[38] In this regard, Momentas was acting very similarly to a manager of a pooled investment fund for fully managed accounts: essentially obtaining funds from investors for the purpose of investing the funds in a proprietary trading and investment program to generate promised or expected returns.

[39] We do not consider the fact that the returns on the Convertible Debentures were not explicitly tied to the performance by Momentas of its professional trading activities to be a significant factor. We viewed the fixed rate of returns on the Convertible Debentures more analogous, in effect, to a guaranteed performance promise with respect to the ARF trading program and other trading activities. In addition, we considered the convertible feature a factor connecting performance of the trading activities with potential returns on the Convertible Debentures.

[40] Consequently, all of the aforementioned factors led us to the conclusion that Momentas was in essence, if not in form, soliciting investors through the sale of its Convertible Debentures for funds to be invested for their benefit through its ARF trading program and other trading activities.

B. Appropriate Order

[41] In making our determination as to whether it is in the public interest to extend the temporary order and the order of July 8, 2005, the panel considered the following facts: (1) there were no allegations of fraud or manipulation against Momentas; (2) no allegations that the investors were not accredited investors; (3) no allegation that any trading activity, day trading or program trading, was somehow improper; (4) no allegation of misuse of funds; (5) no allegations that there were misstatements in the offering memorandum; and (6) no allegation that the disclosure was incomplete. The sole issue that the panel had to determine was whether Momentas was, in fact, acting as a market intermediary and if so, what the appropriate remedy was pending the hearing on

the merits.

[42] The registration requirements set out in the Act exist to protect investors. Compliance with these provisions is in the public interest.

[43] The panel recognized that a temporary cease trade order is an extraordinary power that should be resorted to cautiously. In this case, we had regard to the impact of the cease trade order on the ability of Momentas to carry on its business, and the effect of such impact upon the financial interest of the existing investors who had been sold the Convertible Debentures.

[44] In the circumstances of this case, we were particularly mindful of the need to craft an order that would minimize harm to existing investors, while preventing the sale of Convertible Debentures to new investors when an exemption from registration is not available to Momentas. The carve-outs in our order of July 14, 2005 are extremely limited. The first carve-out enables Momentas to continue developing ARF, one of the business activities set out in the offering memorandum, subject to the monitoring of Staff. The second carve-out enables Momentas to choose the most advantageous time for closing out foreign currency exchange positions, also subject to Staff oversight.

[45] In conclusion, we determined that it was in the public interest to grant an extension of the temporary order and the order of July 8, 2005 until the earlier of the conclusion of the hearing in this matter or the date upon which Momentas becomes registered as a limited market dealer and its officers, directors and/or employees involved in the sale of securities to the public become registered in accordance with Ontario securities law.

[46] The panel requests, in the event that Momentas and its officers, directors and/or employees seek registration prior to the hearing on the merits, that this be allowed to be done on an expedited basis. We also suggest that Staff not hold against the applicants for registration the fact that they failed to register in this case, but subject to normal inquiries and considerations not related to the facts considered by us.

Dated at Toronto this 2nd day of August, 2005

“Paul M. Moore”

Paul M. Moore

“Wendell Wigle”

Wendell Wigle

“Carol S. Perry”

Carol S. Perry