

3.1.2 Fulcrum Financial Group Inc. et al.

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

AND

IN THE MATTER OF
FULCRUM FINANCIAL GROUP INC., SECURED LIFE VENTURES INC.,
ZEPHYR ALTERNATIVE POWER INC., TROY VAN DYK, WILLIAM L. ROGERS,
LESZEK DZIADDECKI, WERNER REINDORF and REINDORF INVESTMENTS INC.

SETTLEMENT HEARING

Hearing: March 6, 2006

Panel: Paul M. Moore, Q.C., Chair
Robert W. Davis, Commissioner
David L. Knight, Commissioner

Appearances: Gregory W. MacKenzie For the Staff of the Commission
Melanie Adams

Philip Anisman For Zephyr Alternative Power

Also present: Edward Tsang

ORAL RULING AND REASONS

The following text has been prepared for purposes of publication in the Ontario Securities Commission Bulletin and is based on excerpts of the transcript of the hearing. The excerpts have been edited and supplemented and the text has been approved by the chair of the panel for the purpose of providing a public record of the decision.

- [1] We approve the settlement agreement. I'm going to give oral reasons.
- [2] Zephyr is an Ontario corporation that manufactures wind turbines. To fund its operations Zephyr has raised capital through equity and debt financing, including the issue of convertible debentures.
- [3] Relying upon the accredited investor exemption in Rule 45-501, with the assistance of limited market dealers, the respondent Dziadecki and others, Zephyr issued convertible debentures.
- [4] The limited market dealers earned a sales commission of 20 percent for each convertible debenture sale.
- [5] Zephyr understood that the convertible debentures could only be sold to accredited investors who met the income or financial asset minimums prescribed by Rule 45-501.
- [6] Between May and October 2005 Zephyr received proceeds of \$476,000 from the sale of convertible debentures to sixteen investors and paid \$95,000 in sales commissions.
- [7] If a prospective investor wished to purchase a convertible debenture, the limited market dealer would provide the investor with a subscription agreement. The investor was required to sign the subscription agreement and to complete schedule B to it, certifying the investor's accredited investor status.
- [8] Specifically, the investor was required to check the appropriate box on schedule B, indicating which of the accredited investor income or financial asset qualification criteria applied to the investor.
- [9] After a subscription agreement was signed by a prospective investor, the limited market dealer sent Zephyr the subscription agreement along with the investor's cheque for the amount of the proposed convertible debenture purchased ranging from \$5,000 to \$100,000.

[10] Zephyr deposited the investor's cheque and the president of the company countersigned the subscription agreement on behalf of Zephyr and issued the convertible debenture.

[11] Zephyr would then send a copy of the countersigned subscription agreement to the investor, including a copy of the convertible debenture in the amount purchased by the investor.

[12] The evidence is that Zephyr believed that all sales of its convertible debentures were in compliance with Ontario securities law.

[13] Four of the sixteen subscription agreements signed by prospective investors and provided by one of the salespersons to Zephyr, contained a schedule B that was not completed and thus did not certify that the prospective investor was accredited.

[14] The evidence is that Zephyr did not notice that these Schedule Bs were not completed. Zephyr countersigned the subscription agreements and issued the convertible debentures in respect of the four investors for proceeds of \$200,000, of which \$40,000 was paid by Zephyr to the limited market dealer in sales commissions.

[15] The information contained in schedule C to the subscription agreements regarding sales commissions to be paid by Zephyr states: "Additionally, the corporation expects to pay commissions of 20 percent of the gross proceeds of the issuance of the convertible debentures."

[16] Some of the subscription agreements provided to Zephyr by the limited market dealers and in turn by Zephyr to investors who purchased convertible debentures, contained an earlier draft of schedule C which said that "commissions of 10 percent" would be paid by Zephyr instead of the 20 percent which Zephyr paid to the limited market dealers.

[17] Nine of the sixteen subscription agreements signed by investors and sent to Zephyr by the limited market dealers, including the four subscription agreements referred to previously, contained a schedule C referencing a 10 percent sales Commission.

[18] The evidence is that Zephyr did not notice these errors.

[19] Zephyr countersigned the subscription agreements and issued the convertible debentures in respect of the nine investors for proceeds of \$361,000, of which \$72,000 was payable by Zephyr in sales Commission.

[20] In respect of certain sales of its convertible debentures, Zephyr:

1. in respect of the sales to the four investors described above, failed to take steps to ensure that a prospectus exemption was available contrary to its responsibilities described in section 3.3 of Companion Policy to Rule 45-501 of this Commission.
2. in respect of the sales to the nine investors described above, failed to ensure that the information contained in the subscription agreements regarding the amount of sales commissions to be paid to persons selling Zephyr debentures was correct.

[21] Both these failures amounted to conduct contrary to the public interest.

[22] This case is a reminder that there is an obligation on an issuer that wishes to rely on an exemption to satisfy itself that that exemption is available. Notwithstanding any inquiry, if the exemption is not available, then it is not available.

[23] We note that Zephyr has been co-operative in the investigation of this matter and that the time from the issuing of the notice of hearing and the statement of allegations to the time of the settlement has been just four months.

[24] There is a requirement for Zephyr to inquire further as to whether each of the investors, and not just the four investors who did not check off the box, but whether each of the sixteen investors is in fact an accredited investor. Once those inquiries are made, whether or not the investors are accredited investors, if they do not wish to rescind, then the transactions will be allowed to stand.

[25] We were somewhat concerned that the procedures agreed to contemplate that each of the sixteen investors will be given the right to rescind and if he or she does not exercise the right to rescind, then the transaction will be binding regardless of whether the investor is, in fact, an accredited investor.

[26] We have decided to approve this settlement notwithstanding that fact. We accept the submissions of counsel that an investor who is not an accredited investor and who is given the right of rescission would be in the same or better position that he

or she would be in had there not been a settlement, namely, the ability to pursue through legal resource (but without being obliged to do so) to seek to undo the transaction.

[27] We're satisfied that this provision doesn't, somehow, open the possibility in the future of a back door exemption to our prospectus requirements.

[28] The terms of the settlement include:

1. an order by the Commission that
 - (a) pursuant to clause 4 of section 127(1), Zephyr immediately institute a program of compliance described in schedule 1 to the settlement agreement to ensure that future exempt sales of securities by Zephyr are in compliance with Ontario securities law;
 - (b) pursuant to clause 6 of section 127(1), Zephyr be reprimanded; and
 - (c) pursuant to clause 2 of section 127(1) and section 144, the temporary order made by this Commission on November 3, 2005, and continued until April 11, 2006, shall cease to apply to Zephyr; and
2. An undertaking by Zephyr that:
 - (a) Zephyr will continue to cooperate with Staff in relation to the investigation of this matter and any related enforcement proceedings.
 - (b) Zephyr will in accordance with the procedures acceptable to the Commission make a rescission offer to any Zephyr convertible debenture holder who:
 - i. was not an accredited investor at the time of purchase; or
 - ii. received a subscription agreement referencing a 10 percent sales commission and at the time of purchase did not understand and would not have purchased a convertible debenture if he or she had understood that Zephyr would pay a 20 percent sales commission; or
 - iii. was induced to purchase by a salesperson making misleading representations regarding the nature of level of risk regarding the Zephyr convertible debenture and would otherwise not have purchased the convertible debenture.

[29] The Commission accepts the compliance protocol and also accepts the rescission protocol set out as exhibits to the settlement agreement and tendered to the Commission today as exhibits 2 and 3.

Approved by the chair of the panel on March 9, 2006.

"Paul M. Moore"