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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)

REASONS AND DECISION

Hearing: May 23-25 and August 8, 2006

Panel:	Wendell S. Wigle, Q.C.	-	Commissioner (Chair of the Panel)
	Robert W. Davis, FCA	-	Commissioner
	Carol S. Perry	-	Commissioner
Counsel:	Pamela Foy	-	On behalf of Staff of the Ontario Securities Commission
	Bob Hutchins Scott Hutchinson	-	On behalf of Alexander Funt
Respondent:	Howard Rash	-	On behalf of himself
	Momentas Corporation	-	Unrepresented

REASONS AND DECISION

OVERVIEW

A. The Hearing

[1] This was a hearing pursuant to sections 127 and 127.1 of the *Securities Act*, R.S.O. 1990, c. S. 5 as amended (the "Act") to consider whether it is in the public interest to make an order against Momentas Corporation ("Momentas") and the individual respondents, Howard Rash ("Rash") and Alexander Funt ("Funt") (collectively, the "Respondents").

[2] This matter arose out of a Notice of Hearing issued by the Commission on June 24, 2005 in relation to a Statement of Allegations issued by Staff of the Commission ("Staff") on the same day.

[3] Momentas is a corporation constituted to day-trade equities and foreign currencies.

[4] In order to finance its operations, including the development of proprietary equities trading software, Momentas sold Momentas "Series A Secured Convertible Debentures" (the "Convertible Debentures") pursuant to an Offering Memorandum dated August of 2003 and an Amended Offering Memorandum dated April 1, 2004 (together the "OM"). The Convertible Debentures were sold commencing in August of 2003 and continuing until June 9, 2005, when the Commission made a temporary cease trade order against Momentas (which is discussed below). The Convertible Debentures were for a 3 year term, bore a fixed but increasing interest rate, paid a premium on maturity and were convertible into common shares of Momentas.

[5] Staff allege that through Momentas' stated enterprise as a "professional trader of equities" and through the sale of the Convertible Debentures, Momentas has been holding itself out as and has been engaging in the business of trading securities in Ontario. Accordingly, it has been acting as a market intermediary and is required to be registered pursuant to section 25 of the Act. Further, Staff allege that Rash, Funt, Suzanne Morrison ("Morrison") and Malcolm Rogers ("Rogers") have engaged in conduct which constitutes "trading" in securities without being registered in accordance with section 25(1)(a) of the Act by carrying out acts directly or indirectly in furtherance of trades of the Convertible Debentures. In addition, it is alleged that Rash and Funt, acting in a similar capacity to officers and directors of Momentas, and Morrison and Rogers, as officers and directors of Momentas, have authorized, permitted or acquiesced in Momentas' conduct.

[6] The main issues for us to determine are:

(1) whether Momentas was a market intermediary and has been engaging in the business of trading securities in Ontario without appropriate registration in violation of the Act;

(2) whether Rash and Funt have engaged in conduct which constitutes "trading" in securities without being registered by carrying out acts directly or indirectly in furtherance of trades of Convertible Debentures; and

(3) whether Rash and Funt have acted in a similar capacity to officers and directors of Momentas and authorized such trades.

[7] We held a hearing on the merits on May 23-25, 2006 and heard closing submissions on August 8, 2006. We decided to provide the parties with an opportunity to make further submissions relevant to sanctions at a later date, if we were to find that the respondent(s)'s conduct violated the Act.

B. The Respondents

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

[9] Rash and Funt are co-founders and promoters of Momentas. They were also managing directors of Momentas. Rash and Funt are not registered with the Commission in any capacity.

[10] Funt was represented by counsel, Rash attended and represented himself. No one appeared for Momentas.

[11] Morrison and Rogers entered into settlement agreements with Staff. The Commission approved the respective settlement agreements as being in the public interest following separate hearings on April 4, 2006.

C. The Facts

[12] Momentas was formed in July of 2003 by Rash and Funt to, allegedly, day-trade equities using software designed to identify buying and selling patterns in the market. Momentas had initially planned to use a third-party equities trading software program ("Magus") that required operator input when making buy/sell decisions. Trading of foreign currencies was conducted at all times through brokers.

[13] Around July or August of 2003, Momentas determined that the Magus system was not performing to its satisfaction and decided to develop its own proprietary equities trading software program ("ARF") that would not require operator input when making the buy/sell decision.

[14] Momentas' business plan contemplated: using first Magus and then ARF to trade equities for Momentas' own account and benefit; trading foreign currencies for Momentas' own account and benefit; and licensing ARF for use by third parties.

[15] Momentas sold the Convertible Debentures pursuant to the OM to finance its operations, including the development of ARF. Since approximately August 2003, Momentas, through its officers, directors, and employees, has been selling Momentas Convertible Debentures to residents of Ontario and elsewhere.

[16] 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.

[17] 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. Momentas stated that it intended to raise $10 million from the sale of the Convertible Debentures to fund its business activities.

[18] 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 as follows:

> 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.

[19] Between August 2003 and June 2005, Momentas raised $7,862,000 from Canadian investors from the sale of its Convertible Debentures using an in-house sales team whose efforts was devoted exclusively to selling securities of Momentas through a cold-call system of telephone solicitation.

[20] Neither Momentas nor its officers, directors and/or employees who were involved in selling the Convertible Debentures were registered with the Commission in any capacity.

D. The Temporary Orders in Effect Until the Conclusion of the Hearing

[21] On June 9, 2005, the Commission ordered that all trading by Momentas and its officers, directors, employees and/or agents in securities of Momentas shall cease, pursuant to paragraph 2 of subsection 127(1) of the Act, (the "Temporary Order"). The Commission further ordered as part of the Temporary Order that all trading in any securities by Rash, Funt and Morrison shall cease and that, pursuant to paragraph 3 of subsection 127(1) of the Act, any exemptions contained in Ontario securities law do not apply to Momentas, Rash, Funt and Morrison.

[22] On June 24, 2005, the Commission issued a Notice of Hearing pursuant to subsection 127(1) and section 127.1 of the Act ,accompanied by the Statement of Allegations of Staff against Momentas, Rash, Funt and Morrison. On that date the Commission also extended the Temporary Order on consent of the parties until July 8, 2005.

[23] On July 8, 2005, Rash, Funt and Morrison consented to, and the Commission ordered, an extension of the Temporary Order as it related to them until the conclusion of the hearing of this matter, subject to three exceptions.

[24] 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 law to Momentas.

[25] The Panel concluded, based on the evidence before it at the time, 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.

[26] 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.

[27] On August 2, 2005, an order was issued by the Commission in which the Temporary Order of June 9, 2005 and the order of July 8, 2005 against Momentas were extended pursuant to section 127 of the Act. Similar orders against the other respondents were extended on consent.

[28] At the time of the commencement of the hearing on the merits, Momentas was still not registered as a limited market dealer and its officers, directors and/or employees involved in the sale of securities to the public were not registered in accordance with Ontario securities law.

E. The Evidence

[29] Staff adduced both oral and documentary evidence at the hearing. Staff called two witnesses, Morrison and Rogers.

[30] Morrison has held the positions of director, President and Chief Financial Officer of Momentas since its incorporation in July 2003. Morrison also acted as the office manager and bookkeeper of Momentas. Her duties consisted primarily of bookkeeping, banking and office administration. She also had some administrative responsibilities related to the sale of securities of Momentas to members of the public.

[31] From July 2003 to May 1, 2005, Rogers held the position of Chief Executive Officer of Momentas and held the position of director from July 2003 to August 10, 2005. His involvement consisted primarily of reviewing software systems that Momentas was purportedly proposing to develop, training some of the operators on the proposed software systems and reviewing simulations of the proposed software.

[32] Staff also filed a number of documents to establish the nature of the operations carried out by Momentas and its staff, including the overall costs incurred by Momentas.

ANALYSIS

[33] When determining the aforementioned issues set out in paragraph 6, we are required to consider the Commission's public interest mandate as reflected in the purposes of the Act at section 1.1 which are:

> (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.

[34] The primary means for achieving the purposes of the Act are:

> (a) requirements for timely, accurate and efficient disclosure of information;

(b) restrictions on fraudulent or unfair market practices and procedures; and,

(c) requirements for the maintenance of a high standard of fitness and business conduct to ensure honest and responsible conduct by market participants.

(1) Has Momentas, through the sale of the Convertible Debentures, been acting as a market intermediary and been engaging in the business of trading securities in Ontario without being a registrant?

[35] The first issue that we must determine is whether Momentas was a market intermediary when it undertook the sale of its own Convertible Debentures.

Parties' Submissions

[36] 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.

[37] 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. Even if 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, this made Momentas a market intermediary. Accordingly, Staff submit that Momentas, in selling Momentas' Convertible Debentures to residents of Ontario and elsewhere could not rely upon an exemption for selling securities to accredited investors contained in OSC Rule 45-501.

[38] Rash submitted that the business activities carried out by Momentas were not confined to the "business of trading securities in Ontario", that the business activities of Momentas were diverse and included activities both within and outside of Ontario. Rash submitted that Momentas was in the business of:

1. trading in securities for the stated purpose of testing its proprietary automated trading system known as "ARF" with a view to marketing and/or licensing the "ARF" technology to third parties for the purpose of earning a profit as well as deploying the "ARF" technology for the internal use of Momentas with a similar view to earning a profit;

2. selling prescriptive medicines through its acquisition of a 20% minority interest in Mercantile Rx Corp.;

3. acquiring and developing real estate properties both in Canada and abroad through its 48% equity interest in Momentas Realty Corp.; and

4. acquiring and developing other business enterprises such as Frankz Finest Culinary Corp. through its indirect equity interest in Momentas Realty Corp.

With regard to 2, 3 and 4 above, no detailed evidence was filed in connection with these business activities.

[39] Rash also submitted that the definition of market intermediary as set out in section 204(1) of the Regulations is not applicable to Momentas, as Momentas was in the business of trading equities and foreign currencies for its own account for investment only and not with a view to resale or distribution.

[40] Rash further submitted that Momentas did not trade securities with accounts fully managed as agent or trustee and the performance or lack thereof by Momentas as to profits or losses was not tied to fixed income returns promised to debenture holders..

[41] Rash submitted that the sale of the Convertible Debentures were to accredited investors who purchased as principal. Rash relied on former Rule 45-501 and submitted that the salespersons employed by Momentas to effect the sale of the Convertible Debentures were exempt from the registration requirement. According to Rash, there is no express or implied prohibition contained in former Rule 45-501, restricting an issuer from hiring employees for the purpose of selling the securities of its own issue, if the purchaser is an accredited investor and purchases as principal.

[42] Counsel for Funt submitted that Momentas did not become a market intermediary because it sold its own Convertible Debentures and that the business model did not make it a market intermediary. Counsel argued that a company is not a market intermediary for the purposes of the sale of its own securities and referred us to the notion of an intermediary as someone who interposes herself or himself between two things. In the context of the Act, the term "market intermediary" contemplates an entity that interposes itself between investors and issuers/securities markets.

[43] Counsel for Funt also submitted that Momentas did not become a market intermediary by virtue of describing itself as being in the business of trading in securities for its own account and benefit nor did it become a market intermediary because it sold its own securities. An issuer selling its own securities is not "in the business of trading in securities". As Momentas did not seek to generate a profit through the sale of its Convertible Debentures, counsel submitted that it is difficult to conceive how, because of the sale of Convertible Debentures, it could be said to be "in the business" for the purposes of the definition of a market intermediary.

[44] Counsel for Funt submitted that the proposed Companion Policies 45-106 CP and 45-501 CP contained a policy statement that, in the Commission's view, where an issuer retains an employee whose primary job function is to actively solicit members of the public for the purposes of selling the issuers' securities, the issuer and the employee are deemed to be in the business of selling

securities and are market intermediaries. According to counsel, the coming into force of these Companion Policies post-dates the impugned activity by Momentas. Those proposed Companion Policies which were released for comments in mid-December 2004, did not come into force until September 14, 2005. Counsel is not aware of any policy statement by the Commission prior to December 2004 to similar effect. Counsel submitted that this "new law" cannot be applied retroactively to make Momentas liable for an activity that was legal at the time Momentas undertook it.

[45] Counsel for Funt submitted that Momentas proceeded with the offering of Convertible Debentures on the basis that it was entitled to raise funds under the Accredited Investor Exemption. Counsel submitted that the evidence establishes that if Momentas can rely upon the Accredited Investor Exemption, then it complied with the requirements of that exemption. Momentas provided the regulatory filings required to rely upon this exemption. Counsel submitted that Momentas took appropriate steps to ensure that all purchasers of its Convertible Debentures were accredited investors as that term is defined in the Act. There is nothing in the evidence to suggest that Momentas sold Convertible Debentures to persons who were not accredited investors.

Discussion

[46] In order to ensure that there is fairness and confidence in Ontario's capital markets, it is critical that brokers, dealers and other market participants in the business of selling or promoting securities meet the minimum registration, qualification and conduct requirements of the Act.

[47] Sections 25 and 53 of the Act contain the general registration and prospectus requirements for trading in securities. Pursuant to subsection 25(1)(a) of the Act, no company shall trade in a security unless the company is registered as a dealer.

[48] As stated in *Re Ochnik* (2006), 29 O.S.C.B. 3929, paras. 65-67, the test for determining whether there was unregistered trading in violation of the Act is:

> (a) first, to determine whether there was a trade by way of a sale or disposition for valuable consideration or by way of any act, solicitation or conduct directly or indirectly in furtherance of a trade; and
>
> (b) second, to determine whether any exemptions are applicable.

[49] The concept of "trading" is a broad one and includes any sale or disposition of a security for valuable consideration including any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of such a sale or disposition.

[50] 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. To finance its operations including the ongoing

development of ARF, Momentas has been issuing and selling its own Convertible Debentures to residents of Ontario and elsewhere pursuant to the OM.

[51] Rash argued that the viva voce evidence and the written evidence respecting the business of Momentas supported his position. He referred us to the evidence from the cross-examination of Morrison by counsel for Funt, where she said that she was employed on a full-time basis by Momentas and when asked whether the business of Momentas was to sell securities, she responded…"no". Further, he submitted that Morrison's evidence confirmed Momentas' investment in Mercantile Rx Corp. which was part of Momentas' business and explained the mechanics of the ARF system and the strategy deployed by Momentas' foreign exchange traders.

[52] However, the evidence shows that Momentas Corporation raised $7,862,000 from approximately 250 Canadian investors from the sale of its Convertible Debentures using an in-house sales team whose efforts were devoted strictly to selling securities of Momentas through a cold-call system of telephone solicitation.

[53] Counsel for Funt submitted that Momentas did not become a market intermediary because it sold its own Convertible Debentures, that the notion of an intermediary contemplates an entity that interposes itself between investors and issuers/securities markets. While we agree with the proposition that traditionally, a "market intermediary" has been an individual or company who is interposed between the issuer and the investing public, the form of the conduct at issue should not override the substance of conduct of those who, in effect, are expending their business efforts on raising capital by selling securities to accredited investors. As stated in *Pacific Coast Coin*: "[s]ubstance, not form, is the governing factor" (see *Pacific Coast Coin Exchange of Canada v. Ontario Securities Commission* [1978] 2 S.C.R. 112 (S.C.C.) at para. 43). The evidence of Morrison and Rogers demonstrated that Momentas consisted primarily of a sales team devoted to selling the Convertible Debentures and that Rash and Funt were highly involved in the sales process.

[54] Counsel for Funt argued that it cannot be the case that, every time a company such as Momentas is in its initial start-up/capital raising stage and sells its own securities using its own employees, that company is a market intermediary. However, a key consideration for us is the degree to which management's activities and the proceeds of the offering were allocated to the raising of capital as opposed to being invested in the company's stated business activities.

[55] We do not agree with the argument made by counsel for Funt that although a substantial portion of Momentas' workforce was devoted to the sale of Convertible Debentures, Momentas' capital raising activities were incidental to, and in furtherance of, its business purposes. The evidence showed that Momentas employed approximately 27 individuals, 19 of them for the primary purpose of selling its Convertible Debentures. Momentas' core business involved the selling of the Convertible Debentures, as evidenced by the overall composition of Momentas' workforce, the overall expenses incurred by Momentas and the overall sources of revenue generated by Momentas.

[56] Rash's argument that business activities carried out by Momentas were not confined to the "business of trading securities in Ontario", that the business activities of Momentas were diverse

and included activities both within and outside of Ontario is not helpful to the respondents. The fact that a respondent is involved in more than one business is not determinative of whether the business purpose test will be met. As stated by the Divisional Court in *Costello*:

> There is nothing in this legislation to suggest that the business of advising must be the only business in which a person must be involved in order to trigger the requirement of registration.
>
> (*Re Costello* (2003) 26 O.S.C.B. 1617, aff'd (2004), 242 D.L.R. (4th) 301 (Div. Ct.) at para. 62).

[57] While Momentas' business included the development of ARF and other ventures such as MercanRX and Momentas Realty, a significant part of its business, as evidenced by the composition of its workforce, was the business of selling its Convertible Debentures.

[58] Momentas' costs related to sale of the Convertible Debentures constituted approximately 40% of the overall costs incurred by Momentas and over 60% of its overall costs if the "management draws" of Rash and Funt are not counted for the cost analysis. Momentas' costs related to the offering, which total $3,231,000 are comprised of:

(a) $23,000 in trustee fees;

(b) $64,000 in professional fees;

(c) $2,300,000 in salaries and commissions;

(d)$150,000 in advertising and printing;

(e) $157,000 in rent;

(f) $65,000 in postage;

(g) $360,000 in miscellaneous costs associated with office supplies and equipment, bank charges etc.

(h)$112,000 in telephone and internet costs.

[59] Further, Rash and Funt received together $2,560,000 as management draws, the direct source of which was the proceeds from the sale of the Convertible Debentures. Rash received a management draw of $1.3-million and Funt received a management draw of $1.26 million.

[60] By comparison, the evidence reveals that Momentas' expenditures on its stated business activities was much lower, amounting to less that 15% of the offering:

(a) $146,000 for the development of ARF and SCARF;

(b) approximately $200,000 invested in currency trading and simulated testing of ARF;

(c) $385,000 invested in MercanRx; and

(d) $400,000 invested in Momentas Realty.

[61] The manner in which Momentas generated revenue is also a factor when determining its business purpose. Other than some minor unrealized capital gains achieved in the Oanda trading account (which ultimately resulted in a loss), Momentas had no other source of revenue other than through the sale of its Convertible Debentures.

[62] A further indication of a "business purpose" relevant to Rash and Funt is their receipt of substantial compensation from the proceeds of the offering (*Costello v. Ontario Securities Commission* cited above at paras. 57 to 62).

[63] Notwithstanding Rash's and Funt's involvement in other aspects of Momentas' business, such as ARF, Mercan RX and/or Momentas Realty, they were highly involved in the sales process. It is uncontroverted that Rash and Funt received approximately 30% of the funds raised in the offering. The management draws were taken directly from the proceeds from the offering and were taken as compensation for their role in Momentas.

[64] We find that Momentas was a market intermediary. It traded Convertible Debentures and raised a total of $7,862,000 from approximately 250 Canadian investors, $2,949,000 of which was raised from the sale of Convertible Debentures to 98 Ontario residents.

[65] Our finding is consistent with the Commission's decision in *Re Allen*, a matter addressing the issue of registration requirement for market intermediaries selling securities in reliance upon Rule 45-501. In *Re Allen*, the securities of Andromeda, an Ontario corporation, were sold pursuant to Rule 45-501 by the respondent Allen and sales representatives hired by Allen. The Commission concluded that Allen and the sales representatives, who had been raising capital for Andromeda through a cold-call system of telephone solicitation were engaged in the distribution of securities as market intermediaries to members of the public purportedly pursuant to the Accredited Investor Exemption provided by Rule 45-501 (*Re Allen* (2005), 28 O.S.C.B. 8541 at paras. 22-27).

[66] Having determined that Momentas was acting as a market intermediary, we need to determine whether Momentas could rely upon the Accredited Investor Exemption provided by Rule 45-501 as argued by the Respondents.

Accredited Investor Exemption and 2005 Policy Statement

[67] 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.

[68] Former Rule 45-501 (now National Instrument Policy 45-106) provided certain exemptions from the registration requirements for trading in securities. One of the categories of exemptions contained in Rule 45-501 included the sale of securities to "accredited investors". The Accredited Investor Exemption permits an issuer to sell its securities to a class of sophisticated investors with fewer regulatory demands, including the requirement that an issuer be registered.

[69] Section 2.3 of Rule 45-501 provided that sections 25 and 53 of the Act did 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 removed the registration exemption for market intermediaries.

[70] 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.

[71] On July 8, 2005, the Canadian Securities Administrators published a proposed new rule that proposed to harmonize and consolidate prospectus and registration exemptions across Canada. The proposed rule carried forward the current law on market intermediaries and the unavailability of the registration exemptions for them when dealing with accredited investors. The proposed companion policy to the proposed new rule stated 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) O.S.C.B. (Supp. 3)).

[72] The proposed Companion Policies 45-106 CP and 45-501 CP, which were released for comments in mid-December, did not come into force until September 14, 2005. These Companion Policies do not convey new policy, but a statement of the view of the Commission with respect to the current law. A policy statement issued by the Commission is not "law". As stated by the Commission in its interim decision in *Momentas*: "[t]his 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" (*Momentas Corporation et al.*, CarwsellOnt 3375 (Ont. Sec. Comm.) at para. 30).

[73] Indeed, our conclusion is consistent with authorities regarding the "business purpose" test which has been developed in connection with the issue of the registration requirements for "advisers" (*Re Costello* (2003), 26 O.S.C.B. 1617 (Ont. Sec. Comm.), aff'd (2004), 242 D.L.R. (4th) 301 (Div. Ct.) at paras. 57-62; *Re Maguire* (1995), 18 O.S.C.B. 4623 (Ont. Sec. Comm.) as cited in *Re Costello*).

[74] Accordingly, we dismiss the argument made by counsel that the proposed Companion Policies 45-106 CP and 45-501 CP constitute "new law" which cannot be applied retroactively to make Momentas liable for an activity that was legal at the time Momentas undertook it.

(2) Have Rash and Funt engaged in conduct that constitutes "trading" in securities without being registered by carrying out acts directly or indirectly in furtherance of trades of the Convertible Debentures?

[75] Staff allege that Rash and Funt have engaged in conduct that constitutes trading in securities, for which they had to be registered.

[76] The definition of "trade", is set out at subsection 1(1) of the Act, there are three elements of an "act in furtherance of a trade":

a) the general "act or conduct";

b) an advertisement; or

c) a solicitation.

[77] Staff submit that the jurisprudence on this issue shows that decision-makers adopt a contextual approach to determine whether non-registered individuals or companies have engaged in acts in furtherance of a trade. Such approach requires an examination of the totality of the conduct and the setting in which the acts have occurred, the primary consideration of which is the effects the acts had on those to whom they were directed (see *Re Guard Inc.* (1996), 19. O.S.C.B. 3737 at para. 77; *Re American Technology Exploration Corp.* (1988) B.C.S.C.W.S. 984 at 9-10; *Re First Federal Capital (Canada) Corp.* (2003), 27 O.S.C.B. 1603 at para. 55).

[78] Further, a final sale is not a necessary element of an act in furtherance of a trade. Accordingly, a final sale need not occur in order for the conduct in issue to constitute trading. Further, the acceptance of funds can equally constitute an act in furtherance of a trade within the meaning of the Act, even where no specific sales have occurred as a result of the conduct (*Re Guard* cited above at para. 77 and *Re Lett*, (2003), 27 O.S.C.B. 3215 at paras. 55 and 61).

[79] The inclusion of the word "indirectly" in the definition of acts in furtherance of trade reflects the intention by the Legislature to capture conduct which seeks to avoid registration requirements by doing indirectly that which is prohibited directly (see *R. v. Sussman* (1993), 16 O.S.C.B. 1209 at paras. 47-48).

[80] Example of activities found in the jurisprudence to that have fallen within the definition of a trade as "acts in furtherance" include:

(a) providing potential investors with subscription agreements to execute;

(b) distributing promotional materials concerning potential investments;

(c) issuing and signing share certificates;

(d) preparing and disseminating of materials describing investment programs;

(e) preparing and disseminating of forms of agreements for signature by investors;

(f) conducting information sessions with groups of investors; and

(g) meeting with individual investors.

(See *Re Hrappstead*, [1999] 15 B.C.S.C.W.S. 13; *R. v Sussman* cited above, *R. v Guard* cited above; *Re First Federal* cited above; *Re Dodsley* (2003), 26 O.S.C.B. 1799; *Del Bianco v. Alberta (Securities Commission*), [2004] A.J. No. 1222 (Alta C.A.)).

[81] When considering the evidence, we found that Momentas, Rash and Funt engaged in activities which constituted acts in furtherance of a trade.

[82] In particular, we found that Momentas engaged in the followings acts in furtherance of a trade in the Convertible Debentures by:

(a) maintaining an "open door policy" where potential investors were invited to attend at the Momentas offices and meet with management;

(b) hiring and remunerating sales representatives to solicit members of the public to purchase the Convertible Debentures;

(c) printing and distributing a brochure (the "promotional brochure") containing:

i. a description of the purported business of the company;

ii. an investment summary which laid out the terms of the Convertible Debentures;

iii. the Offering Memorandum;

iv. The Trust Indenture between Momentas and Heritage Trust Company;

v. A series of news bulletins announcing Momentas' achievements, including an investment in MercanRx Corp., the announcement of the SCARF system and the formation of Momentas Realty Corp.;

vi. A CD-ROM containing a digitalized video of the "First Annual Debenture Holder Presentation" of June 3, 2004. and

(d) making a copy of the Offering Memorandum, subscription agreement and Trust Indenture readily available to the public on the Momentas website.

[83] We found that Rash engaged in the following acts in furtherance of a trade by:

(a) hiring those employees referred to in paragraph 82(b) of these Reasons;

(b) drafting the script that was circulated and used by the sales team in selling the Convertible Debentures;

(c) authorizing the content of the Promotional Brochure that was distributed to potential investors;

(d) making arrangements for the OM;

(e) negotiating the Trust Indenture Agreement with the transfer agent;

(f) as a member of management, meeting with potential investors as part of the "open door" policy; and

(g) providing ad hoc advice to the sales team regarding questions about the sales process and or potential investors.

[84] As set out above, Rash's efforts were designed to create an interest in investing in Momentas and, taken as a whole, go beyond recommending or commenting about the Convertible Debentures. Conduct which goes beyond "recommending or commenting about an investment" and which are promotional rather than informational will generally constitute acts in furtherance of a trade (*Sussman* cited above at para. 49).

[85] In *Re Guard*, cited above, the Commission found that the preparation and dissemination of a newsletter which described the business of the company and its financing and which advised recipients of the opportunity to invest in the offering constituted acts in furtherance of a trade. The Commission found that the issuer's activities, taken as a whole, amounted to a preparation of the market by creating an interest in the company and its securities and a solicitation of potential investors. Considering Rash's activities set out above, we find that they amounted to a preparation of the market for the sale of securities of Momentas and constitute acts in furtherance of trading.

[86] We also found that Funt engaged in the following acts in furtherance of a trade by:

(a) hiring those employees within the sales organization;

(b) training the telemarketers/qualifiers;

(c) monitoring the sales calls; and

(d) as a member of management, meeting with potential investors as part of the "open door" policy; and

(e) providing ad hoc advice to the sales team regarding questions about the sales process and/or potential investors.

[87] Further, as determined by the Commission in *Re Anderson*, evidence that the respondent received consideration or some other benefit from an eventual sale would be an indication of a promotional purpose and thus an act in furtherance of a trade (*Re Anderson* (2004), 27 O.S.C.B. 7955 at para. 34). In the present case, Rash and Funt received together $2,560,000 in management draws from the proceeds of the sale of the Convertible Debentures.

[88] In *Re Lett*, cited above, investors transferred, deposited or caused to be deposited significant funds into the accounts of the corporate respondents which had been opened by the individual respondent Lett. By accepting investors' funds which were to be invested, the Commission held that all of the respondents had carried out acts in furtherance of trades. Similarly, Rash and Funt opened the Momentas bank accounts at TD Canada Trust where the funds from the sale of the Convertible Debentures were deposited. The evidence established that it was primarily Rash who received the funds from investors and forwarded the funds to Morrison for deposit in the accounts.

[89] When looking at the totality of the conduct and the effect of the conduct, we found that Momentas, Rash and Funt engaged in acts in furtherance of trading the Convertible Debentures.

(3) Have Rash and Funt acted in a similar capacity to officers and directors of Momentas and authorized, permitted or acquiesced to Momentas' conduct?

[90] In order to establish that Rash and Funt are *de facto* directors or officers, it must be shown that they exercised powers and authority normally possessed by director and officers.

[91] If Rash and Funt are found to be *de facto* directors and officers of Momentas, they can be liable for Momentas' conduct.

Parties' Submissions

[92] Staff allege that Rash and Funt are *de facto* directors and officers of Momentas. Staff allege that between August 2003 and June 2005, significant funds from the sale of Convertible Debentures were raised by Momentas, its officers and directors. Staff submit that a *de facto* officer or director are liable for the issuer's conduct if the individual permitted, authorized or acquiesced in the conduct of the issuer that amounted to a violation of Ontario securities law.

[93] Rash submitted that Momentas' officers and directors were Morrison and Rogers. He further submitted that Morrison and Rogers abdicated their responsibilities in the capacity of officers and directors of Momentas and that, accordingly, Rash had to assume the role of a *de facto* representative of Momentas in an effort to protect the security-holders and investors of Momentas.

[94] Counsel for Funt submitted that Funt was not a *de facto* director or officer of Momentas. In the alternative that Funt is found to be a *de facto* director or officer of Momentas, counsel submitted that he ceased to occupy that position after May 2004, when he had surgery and experienced other health problems. Counsel submitted that, thereafter, Funt did not participate in any significant manner in the decision-making of Momentas. If Funt was a *de facto* director or officer of Momentas during the time that Momentas sold its Convertible Debentures and if Momentas was a market intermediary at the time, then Funt should not be liable for Momentas' breach of securities law as he took reasonable steps to ensure that Momentas operated in compliance with Ontario securities law.

[95] Counsel for Funt submitted that Funt occupied the position of sales manager and was consulted by Rash and others regarding other business decisions and was not a *de facto* director or officer by virtue of occupying that position or being consulted about those business decisions.

[96] Counsel further submitted that, even if Funt was at one time a *de facto* director or officer of Momentas, he ceased to occupy that position after May of 2004, when Funt had hip surgery. Counsel submitted that from that time, Funt was not involved with Momentas in any significant way.

Discussion

[97] Pursuant to subsection 122(3) and section 129.2 of the Act, a director or officer is deemed to be liable for a breach of securities law by the issuer where the director or officer authorized, permitted or acquiesced in the issuer's non-compliance with the Act.

[98] A "director" which is defined at subsection 1(1) of the Act includes a person acting in a capacity similar to that of a director of a company. An "officer" is defined as including any individual acting in a similar capacity on behalf of an issuer or registrant.

[99] In *Re Press* (1998), 7 A.S.C.S. 2178 at p. 7, the Alberta Securities Commission (ASC) reviewed the purpose of the definition of directors and officers, which uses similar language as that used in subsection 1(1) of the *Canadian Business Corporations Act*. The ASC concluded that the aim of the definition was to prevent persons who exercise the powers of a director from avoiding liability by arranging for others to be named under the formal position, while maintaining their control over the affairs of the company.

[100] A "de facto" director has been characterized in the case law defined as "one who intermeddles and who assumes office without going through the legal formalities of appointment." (see *Canadian Aero Services Ltd. v. O'Malley* (1969), 61 C.P.R. 1 (Ont. H.C.) cited in *R. v. Boyle*, [2001] Carswell Alta. 1143 at para. 99).

[101] The test for determining if a person is a *de facto* director or officer is "whether, under the particular circumstances, the alleged director is an integral part of the mind and management of the company," taking into consideration the entirety of the alleged director's involvement within the context of the business activities at issue (*Re World Stock Exchange* (2000), 9 A.S.C.S. 658 at 18).

[102] In *World Stock Exchange*, the ASC also identified relevant factors for the determination of whether a representative is a *de facto* director or officer:

a) appointed nominees as directors;

b) responsible for the supervision, direction, control and operation of the company;

c) ran the company from their office;

d) negotiated on behalf of the company;

e) company's sole representative on a trip organized to solicit investments;

f) substantially reorganized and managed the company;

g) selected the name of the company;

h) arranged a public offering; and or

i) made all significant business decisions.

[103] A further factor that can be helpful in determining that a person acted as a *de facto* officer is whether the person acted in a position with similar remuneration and responsibility as an officer within the company (see *Canadian Aero Services Ltd. v. O'Malley* (1974), 40 D.L.R. (3d) 371 at para. 22.)

[104] In *Rhône v. Peter A.B. Widener* (1993), 101 .L.R. (4th) 188, the Supreme Court of Canada dealt with the issue of corporate liability (*de facto* or otherwise) and clarified the rationale underlying this concept, and thus is helpful in analyzing the definition of "officer" and "director" in the Act. At paras. 28, 31-32, the Supreme Court of Canada stated:

> 28 In *H.L. Bolton (Engineering) Co. v. T.J. Graham & Sons Ltd.*, [1957] 1 Q.B. 159 , the Court of Appeal compared a corporation to a human body, describing those who control what a company does (and who therefore are the directing mind and will of a company) as the brain of an individual. Denning L.J. rejected the argument that only actions arising from a meeting of a company's board of directors can form the intention of a company. Rather, he accepted that the intention of a company can be derived from its officers and agents in some instances depending on the nature of the matter in consideration and their relative position within the company. Denning L.J. observed at p. 172:
>
> > A company may in many ways be likened to a human body. It has a brain and nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such.
>
> 31 This Court considered the issue of corporate identification in *Canadian Dredge & Dock Co. v. The Queen*, [1985] 1 S.C.R. 662 . Estey J. found that in order for a corporation to be criminally liable under the "identification" theory, the

> employee who physically committed the offence must be "the 'ego', the 'centre' of the corporate personality, the 'vital organ' of the body corporate, the '*alter ego*' of the employer corporation or its 'directing mind'" (p. 682). However, he also acknowledged that there may be more than one directing mind and highlighted that there may exist the "delegation and sub-delegation of authority from the corporate centre" and the "division and subdivision of the corporate brain" …
>
> 32 As Estey J.'s reasons demonstrate, the focus of inquiry must be whether the impugned individual has been delegated the "governing executive authority" of the company within the scope of his or her authority. I interpret this to mean that one must determine whether the discretion conferred on an employee amounts to an express or implied delegation of executive authority to design and supervise the implementation of corporate policy rather than simply to carry out such policy. In other words, the courts must consider who has been left with the decision-making power in a relevant sphere of corporate activity.

[105] When reviewing the evidence with respect to the alleged conduct of Rash, we found that despite representations by Momentas in the new bulletins it circulated to potential investors as part of the promotional brochure, no decisions were either made or ratified by the formally appointed directors. Rather, all of the business decisions of the corporation were made with the authority of Rash and Funt.

[106] Momentas, through its solicitor Harry G. Black, Q.C., admitted that Rash and Funt formed part of the management of the company.

[107] Furthermore, Morrison, as the CFO and President of Momentas, also testified that she "reported" to Rash and Funt, as did every other employee of the company, either directly or indirectly.

[108] With respect to Rash, we found that:

> He had broad duties related to the business development and growth of Momentas;
>
> He authorized the content of promotional brochure;
>
> He gave instructions to the law firm of Sheldon Huxtable to prepare the Offering Memorandum;
>
> He opened the account at Interactive Brokers through which Momentas traded using ARF. He used a company that he controlled, Panterra Offshore Financial, (Panterra) to open the account with Interactive Brokers as trustee for Momentas;
>
> Rash (Morrison and Augustine) had trading authorization over the account with Interactive Brokers;

Rash (and Peter Kostantakos and Rogers) had the user name and password required to access the account through which Momentas traded foreign currencies;

Rash was indicated to be the "account representative" on the Closing (Settlement) Statement for the purchase of Convertible Debentures by both Rogers and Matteo Delduca. The "account representative" is indicated on that form so that investor knows who they spoke to regarding the purchase;

Rash was provided with all mail addressed to Momentas (including cheques from investors representing the purchase funds for Convertible Debentures);

Rash prepared the notes that were incorporated into and formed the majority of the reply under the cover of Harry G. Black, Q.C., then counsel to Momentas, to a query by Michelle Hammer, Commission Staff;

Rash negotiated the Trust Indenture dated March 30, 2004 between Momentas and Heritage Trust Company;

Rash prepared and authorized the content of the media releases regarding (i) Momentas' strategic alliance with MedCanRX Corp. dated June 29, 2004, and (ii) the formation of Momentas Realty Corporation by Momentas dated January 27, 2005. These information releases were sent to potential investors and may have been posted on Momentas' website;

Rash retained the accounting firm of Layman & Company to prepare Momentas' financial statements for the period ending June 30, 2004;

Rogers resigned his position as CEO and Director of Momentas to Rash and Morrison because they are the principal officers involved in Momentas; and

Morrison described Rash as the person who is "basically in charge" and is the "main decision-maker".

[109] With respect to Funt, we find that his day to day role and responsibilities were essentially that of a sales manager at Momentas. The evidence of Morrison is that Funt primarily supervised and monitored the qualifiers and salespeople – that is the only area of Momentas' operations where Funt is indicated to have exercised any form of control independent of Rash or others. However, even in the role as sales manager, Funt's responsibility was limited to monitoring qualifiers and salespeople to ensure that they followed a script that was prepared by Rash. Other responsibilities as sales manager were as followed: (i) the qualifiers were trained and supervised by a qualifying manager, who in turn reported to Funt, (ii) both Rash and Funt were involved in hiring qualifiers and salesmen, (iii) both Rash and Funt provided training to salespeople, (iv) the salespeople reported to

both Rash and Funt, and (v) both Rash and Funt determined the compensation to be paid to qualifiers and salespeople.

[110] However, the evidence discloses that Funt was also involved in decision-making with respect to other aspects of Momentas' operations. For example, Morrison's evidence is that Funt was "involved" with Rash in making the following decisions: (i) the decision to appoint Morrison as a director, (ii) the decision to compensate Morrison with share capital, (iv) the decision to hire Kostantakos, (v) the decision to approve the "management draws" to Rash and Funt.

[111] Rogers testified that most business decisions were made by consensus following discussions amongst Rash and Funt, Rogers and sometimes Morrison. Rogers also testified that he was responsible for the consensus decisions and that he acceded to business advice from Rash and Funt because they were the controlling shareholders and were the ones most familiar with the business.

[112] In addition to monitoring and supervising the qualifiers and salespeople, the evidence discloses that Funt discussed matters regarding the operation of Momentas with Rash and was involved in the decision-making process of Momentas.

Conclusion

[113] When applying the legal principles set out above, we are satisfied that, since its incorporation, Rash and Funt have acted in a capacity similar to that of officers and directors of Momentas.

[114] Rash and Funt made, or were substantially involved in, every major decision of Momentas and, as such, were clearly the "controlling minds" of Momentas. As Rogers testified, they were the "two key individuals in the company that could make decisions". Much of the executive authority for the operation of Momentas was effectively delegated to Rash and Funt. Pursuant to the Act, Rash and Funt share responsibility for the acts of Momentas.

[115] We find that although Rash and Funt were not formally appointed as officers and directors of Momentas, they participated in all of the major business decisions in the corporation. One of the major initiatives undertaken by them was their decision to raise capital by way of a securities offering to members of the public in order to finance the company.

[116] We conclude that Rash and Funt were the directing mind and management of Momentas, that they authorized the issuance of the Convertible Debentures and were responsible for ensuring compliance with Ontario Securities law.

[117] Should the liability of Rash and Funt be diminished by virtue of a cautious conduct? Counsel for Funt submitted that if Funt is found to be a *de facto* director or officer of Momentas, he exercised the required degree of prudence in discharging his duties as a *de facto* director and/or officer of Momentas. Counsel submitted that Funt obtained a legal advice from the law firm of Sheldon Huxtable regarding the manner and form of its Offering Memorandum.
[118]

Although these terms have been interpreted to include some form of knowledge or intention, the threshold for liability under section 122 and 129.2 is a low one, as merely acquiescing the conduct or activity in question will satisfy the requirement of liability. The degree of knowledge of intention found in each of the terms "authorize", "permit" and "acquiesce" varies significantly. "Acquiesce" means to agree or consent quietly without protest. "Permit" means to allow, consent, tolerate, give permission, particularly in writing. "Authorize" means to give official approval or permission, to give power or authority or to give justification.

[119] Accordingly, we find that Rash and Funt planned and authorized the impugned sales conduct which exceed the minimum requirement of acquiescence.

CONCLUSION

[120] Momentas was a market intermediary.

[121] Momentas, Rash and Funt engaged in acts in furtherance of trading the Convertible Debentures.

[122] Rash and Funt are liable for Momentas' breaches of the Act as *de facto* officers and directors of Momentas. Rash and Funt founded Momentas and were its managing directors. They were significantly involved in every major business decision of the company and were solely responsible for overseeing Momentas' core business of selling its securities. As the directing minds of the company, Rash and Funt were *de facto* officers and directors of Momentas and are deemed to be liable for Momentas' breaches of Ontario securities law.

[123] Having come to these conclusions, we will need to resume the hearing to hear evidence and submissions as to appropriate sanctions against the Respondents. Accordingly, Staff shall forthwith consult the Respondents and communicate to the Secretary to the Commission the earliest date possible for the hearing.

DATED at Toronto this 5th day of September, 2006.

"Wendell S. Wigle" "Robert W. Davis"

Wendell S. Wigle, Q.C. Robert W. Davis, FCA

“Carol S. Perry”

Carol S. Perry