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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
IMAGIN DIAGNOSTIC CENTRES INC., PATRICK J. ROONEY,
CYNTHIA JORDAN, ALLAN McCAFFREY, MICHAEL SHUMACHER,
CHRISTOPHER SMITH, MELVYN HARRIS and MICHAEL ZELYONY

REASONS AND DECISION

Hearing:	May 19, 20 and 21, 2009 June 16, 17, 18 and 19, 2009 September 8, 9, and 10, 2009 November 11, 2009	
Decision:	August 31, 2010	
Panel:	Mary G. Condon	- Commissioner and Chair of the Panel
	Margot C. Howard	- Commissioner
Appearances:	Jon Feasby	- For the Ontario Securities Commission
	Patrick J. Rooney	- For himself and IMAGIN Diagnostic Centres Inc.

TABLE OF CONTENTS

REASONS AND DECISION

A. OVERVIEW

1. History of the Proceeding

[1] This was a hearing before the Ontario Securities Commission (the "Commission") pursuant to section 127 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "Act"), to consider whether IMAGIN Diagnostic Centres Inc. ("IMAGIN") and Patrick J. Rooney ("Mr. Rooney") (collectively, the "Respondents") breached subsection 25(1)(a) of the Act and engaged in conduct contrary to the public interest.

[2] This proceeding was commenced by a Statement of Allegations dated September 27, 2007 and a Notice of Hearing dated September 28, 2007. The Statement of Allegations and Notice of Hearing list the following respondents: IMAGIN, Mr. Rooney, Cynthia Jordan ("Ms. Jordan"), Allan McCaffrey ("Mr. McCaffrey"), Michael Shumacher ("Mr. Shumacher"), Christopher Smith ("Mr. Smith"), Melvyn Harris ("Mr. Harris") and Michael Zelyony ("Mr. Zelyony"). Prior to the hearing on the merits, Ms. Jordan, Mr. McCaffrey, Mr. Shumacher, Mr. Smith and Mr. Zelyony settled with the Commission (collectively, the "Settling Respondents") (*Re IMAGIN et al.* (2009), 32 O.S.C.B. 1441 (oral reasons)). Mr. Harris passed away prior to the commencement of the merits hearing and Staff of the Commission ("Staff") did not proceed with the allegations against this individual.

[3] This case involves allegations by Staff that during the period from early 2003 to early 2006, IMAGIN was engaged in the business of trading its securities in Ontario. Staff alleges that IMAGIN acted as a market intermediary and was required to be registered pursuant to subsection 25(1)(a) of the Act. According to Staff, IMAGIN raised approximately $14 million from the sale of its securities to Canadian investors and approximately $3.5 million of this amount was raised from Ontario investors. Staff also alleges that at the material time, Mr. Rooney was the directing mind and management of IMAGIN, that all of IMAGIN's activities took place under Mr. Rooney's close supervision and direction, and that Mr. Rooney oversaw the sales of IMAGIN securities by IMAGIN employees.

[4] The Respondents take the position that their conduct did not breach subsection 25(1)(a) of the Act because IMAGIN was not acting as a market intermediary, selling securities was not its primary activity and there were registration exemptions available to the Respondents.

[5] During the course of this proceeding, Mr. Rooney represented himself and IMAGIN. We heard the evidence in this matter on May 19, 20 and 21, 2009; June 16, 17, 18 and 19, 2009; and September 8, 9, and 10, 2009. Staff called six witnesses to provide evidence: Tom Anderson, a senior investigator with the Commission, and the five Settling Respondents. Mr. Rooney testified on his own behalf. Closing submissions on the merits were heard on November 11, 2009. Staff and the Respondents provided oral and written submissions.

[6] For the reasons set out below, we conclude that IMAGIN and Mr. Rooney breached subsection 25(1)(a) of the Act and engaged in conduct contrary to the public interest.

2. The Respondents

[7] IMAGIN was incorporated pursuant to the laws of Ontario under the original name of Scanquest Imaging Centres Inc. ("Scanquest") on December 3, 2002. On January 27, 2003, Scanquest was renamed IMAGIN Diagnostic Centres Inc. On April 1, 2004, IMAGIN was continued as a company incorporated pursuant to the laws of Canada.

[8] During the material time, IMAGIN's head office and operations were located in Toronto at a series of different addresses. In February 2006, IMAGIN's operations were moved to Vancouver.

[9] IMAGIN's business was to advance the use of Positron Emission Tomography ("PET") technology in cancer diagnosis in Canada. Staff's allegations do not relate to the cancer diagnosis technology aspect of IMAGIN's business or the use of proceeds derived from the distribution of IMAGIN's securities. Staff's allegations relate only to registration issues.

[10] Mr. Rooney was a Managing Director of Corporate Development of IMAGIN. In their written submissions at paragraph 4, the Respondents state that "Rooney was in fact a defacto [*sic*] officer of IMAGIN and since February of 2007 the sole director and CEO of IMAGIN".

[11] The Settling Respondents were involved with IMAGIN as follows: Ms. Jordan was the President of IMAGIN; Mr. Shumacher, Mr. Smith and Mr. Zelyony were Managing Directors of Corporate Development and Mr. McCaffrey was the Executive Director of Corporate Development and managed the sales team at IMAGIN.

3. The Allegations

[12] In the Statement of Allegations, Staff alleges at paragraph 17 that:

> By trading in securities without registration, the actions of Imagin, Rooney, Jordan, McCaffrey, Shumacher, Smith, Harris and Zelyony were contrary to s. 25 of the Act and to the public interest.

[13] In this matter we are concerned with the conduct of Mr. Rooney and IMAGIN who are the remaining Respondents.

[14] In addition, Staff alleges that Mr. Rooney was a *de facto* officer and director of IMAGIN who authorized, permitted or acquiesced in IMAGIN's breaches of Ontario securities law under section 129.2 of the Act. At the hearing on the merits, Staff took the position that Mr. Rooney was in control and was the directing mind and management of IMAGIN. Staff alleges at paragraph 14 of the Statement of Allegations that:

At all material times, Rooney controlled Imagin and oversaw the sales of its securities by its employees including McCaffrey, Shumacher, Smith, Harris, Zelyony and other members of the Corporate Development group.

B. ISSUES

[15] This case raises the following issues for our consideration:

1. Did the Respondents breach subsection 25(1)(a) of the Act?

    i. Did the Respondents trade IMAGIN securities?

    ii. Were the Respondents registered under the Act?

    iii. Were there any exemptions available to the Respondents to facilitate their trading without registration?

2. Pursuant to section 129.2 of the Act, was Mr. Rooney a *de facto* officer and director of IMAGIN who authorized, permitted or acquiesced in IMAGIN's breaches of Ontario securities law?

[16] We need to assess each of these issues by examining the evidence in this matter and determining whether on a balance of probabilities "…it is more likely than not that the event occurred" (*F.H. v. McDougall*, [2008] 3 S.C.R. 41 at para. 44). As stated by the Supreme Court of Canada, "…evidence must always be sufficiently clear, convincing and cogent to satisfy the balance of probabilities test" (*F.H. v. McDougall*, *supra* at para. 46).

C. ANALYSIS

1. Did the Respondents Breach Subsection 25(1)(a) of the Act?

[17] Subsection 25(1)(a) of the Act states the following:

> No person or company shall,
>
> (a) trade in a security or act as an underwriter unless the person or company is registered as a dealer, or is registered as a salesperson or as a partner or as an officer of a registered dealer and is acting on behalf of the dealer;
>
> […]
>
> and the registration has been made in accordance with Ontario securities law and the person or company has received written notice of the registration from the Director and, where the registration is subject to

terms and conditions, the person or company complies with such terms and conditions.

[18] Accordingly, the elements of a breach of subsection 25(1)(a) of the Act are findings that:

1. a respondent traded, which includes any act in furtherance of a trade of a security as defined in the Act; and

2. the person or company was unregistered at the time of the trade.

[19] In the sections below, we will first address the law regarding the definition of a trade and acts in furtherance of trades. We will also examine the elements required for a breach of subsection 25(1)(a) of the Act and the evidence that supports a finding of a breach of subsection 25(1)(a) of the Act. In addition, we will also address the rationale for a registration requirement, whether the Respondents were registered and whether there were any registration exemptions available to the Respondents.

i. Did the Respondents Trade IMAGIN Securities?

a. The Law – Trades and Acts in Furtherance of Trades

[20] As stated above, for a breach of subsection 25(1)(a) of the Act, a trade in securities is required. In this case there was no dispute regarding the existence of a security. The dispute is whether the Respondents engaged in trading without proper registration. Under subsection 1(1) of the Act, "trade" includes:

(a) any sale or disposition of a security for valuable consideration, whether the terms of payment be on margin, instalment or otherwise, but does not include a purchase of a security or, except as provided in clause (d), a transfer, pledge or encumbrance of securities for the purpose of giving collateral for a debt made in good faith,

(b) any participation as a trader in any transaction in a security through the facilities of any stock exchange or quotation and trade reporting system,

(c) any receipt by a registrant of an order to buy or sell a security,

(d) any transfer, pledge or encumbrancing of securities of an issuer from the holdings of any person or company or combination of persons or companies described in clause (c) of the definition of "distribution" for the purpose of giving collateral for a debt made in good faith, and

(e) any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the foregoing.

[Emphasis added]

[21] For the purposes of the present case, we are concerned with the definitions of a "trade" set out in paragraphs (a) and (e).

[22] The Commission has interpreted the term "trade" in many previous decisions. The Commission has established that trading is a broad concept that 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. This interpretation has also been confirmed by the Ontario courts in their acknowledgement that "[r]egarding "trade", the legislature has chosen to define the term and they have chosen to define it broadly in order to encompass almost every conceivable transaction in securities" (*R v. Allan Sussman* (1993), 16 O.S.C.B. 1209 (Ont. Ct.) at 1230).

[23] The inclusion of the word "indirectly" in the definition of "acts in furtherance" (cited above in paragraph (e) of the definition of a trade) reflects an express intention on the part of the Legislature to capture conduct which seeks to avoid the registration requirement by doing indirectly that which is prohibited directly.

[24] Any act in furtherance of a trade that occurs in Ontario constitutes trading in securities under the definition in the Act (*Re Lett* (2004), 27 O.S.C.B. 3215 at para. 64). Whether an act is in furtherance of a trade is a question of fact, to be determined in each case, based on whether there is a sufficiently proximate connection to the trade (*Re Costello* (2003), 26 O.S.C.B. 1617 at para. 47).

[25] The Commission has found that a variety of activities constitute acts in furtherance of trades. For example, the Commission has found that accepting money from investors and depositing investor cheques for the purchase of shares in a bank account constitute acts in furtherance of trades (*Re Limelight Entertainment Inc.* (2008), 31 O.S.C.B. 1727 ("*Limelight*") at para. 133). Other examples of activities that have been considered acts in furtherance of trades by the Commission include, but are not limited to:

(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.

(*Re Momentas Corporation* (2006), 29 O.S.C.B. 7408 ("*Momentas*") at para. 80)

[26] Activities such as preparing a market can 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* (1996), 19 O.S.C.B. 3737 at para. 77).

b. Discussion

Overview of the Parties' Positions

[27] A basic element in dispute in this hearing is whether IMAGIN and its employees were trading in IMAGIN securities. Staff takes the position that IMAGIN traded in securities and that the Respondents admitted to this in the course of the proceeding. Staff submits that the evidence also establishes that Mr. Rooney directly engaged in acts in furtherance of trades sufficient to ground liability without reliance on section 129.2 of the Act. In the alternative, Staff argues Mr. Rooney can be held liable for IMAGIN's breaches of the Act under section 129.2 (we deal with the issue of section 129.2 of the Act separately in Part 2 of our Reasons).

[28] Although at certain points during the proceeding, the Respondents admitted that they did engage in trading, at other points the Respondents changed their view and stated that they were not engaged in trading.

[29] Specifically, at the hearing, the Respondents submitted in their opening statement that IMAGIN employees:

> …would have the title and functionality of managing directors of corporate development. Those titles would allow them to seek a level of respect with business owners and would allow the managing directors to receive commitments on the sale and issuance of treasury shares.
>
> We will contend, of course, those aren't trades, and that's common practice in the brokerage business. [Emphasis added]
>
> (Transcript, May 19, 2009, 83:21-84:3)

[30] Since the Respondents dispute that their issuing of shares from treasury constituted trading, in the sections below we address the Respondents' admissions and the evidence regarding trading in securities in this matter.

The Testimony of the Settling Respondents

[31] As a preliminary matter, we note that the Respondents encouraged the Panel not to rely on the settlement agreements concluded by the Settling Respondents and their testimony. The Respondents state at paragraph 49 of their written reply submissions:

> The OSC did not produce one witness in their case other than witnesses that have made statements contrary to their written signed settlement agreements wherein they attested that settlements were made on a voluntary basis and then recanted that position. The Respondents contend that the testimony of the OSC witnesses must be discarded since they were intimidated to give testimony favorable to the OSC Staff.

[32] We note that the Respondents do not take issue with the agreed facts listed in the settlement agreements. They take issue with the conclusion about the conduct in the settlement agreements that IMAGIN was a market intermediary. The Respondents also take the position that all of the Settling Respondents were forced to testify against them as part of their settlement agreements, and as a result, the Respondents argue that we should reject the testimony of the Settling Respondents. The Respondents also submit that the Settling Respondents never wanted to settle and they allege that Staff coerced the Settling Respondents into settlement agreements.

[33] We note that none of the settlement agreements or orders approving the settlement agreements contain any conditions or requirements to testify at the hearing on the merits. All of the Settling Respondents appeared at the hearing on the merits in conformity with summonses issued pursuant to the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22.

[34] We find that the Settling Respondents were credible witnesses with respect to their description of IMAGIN's day-to-day operations (see: *Springer v. Aird & Berlis LLP* (2009), 96 O.R. (3d) 325 (Sup. Ct.) at paras. 13 to 17). The Settling Respondents gave their testimony under oath at the hearing and they understood that they were required to tell the truth when testifying and agreed to tell the truth when they took that oath.

[35] The Settling Respondents were credible witnesses. The testimony of each settling respondent was consistent with that of the other Settling Respondents and with the testimony provided by Mr. Rooney. Their testimony was also consistent with the evidence put forth by Staff. The only difference was that Staff and the Respondents interpreted the same evidence differently as it relates to the definition of a market intermediary.

[36] Our decision is based on the evidence presented to us at this hearing. We did not rely on the settlement agreements themselves in coming to our determination of this

matter. In our view, it is not for this Panel to examine the circumstances surrounding the negotiation of the settlement agreements or to reopen the settlement agreements. We relied on the testimony of the Settling Respondents in relation to their role and job description at IMAGIN, Mr. Rooney's role at IMAGIN and IMAGIN's daily operations. In addition, the documentary evidence as to the job descriptions of various employees corroborates the testimony of the Settling Respondents.

IMAGIN Engaged in Trading of its own Securities

[37] The evidence called by Staff and provided by Mr. Rooney demonstrates that trades by IMAGIN in its own securities took place.

[38] Between early 2003 and July 2006, IMAGIN distributed its securities raising an amount totaling over $14 million from Canadian investors from the sale of its common and preferred shares, and specifically $3.5 million came from Ontario investors. Mr. Rooney's testimony clarified that these facts are not in dispute:

> Q. Do you take any issue with the suggestion that Imagin raised $14 million from the sale of securities between 2003 and July 13, 2006?
>
> A. No.
>
> Q. So you agree with that?
>
> A. Yes.
>
> Q. And you agree that three-and-a-half million of that was from Ontario investors?
>
> A. Yes.
>
> (Transcript, September 9, 2009, 109:14-23)

[39] Mr. Rooney made submissions on behalf of the Respondents admitting to certain conduct. Specifically, Mr. Rooney stated that IMAGIN sold securities to accredited investors. This admission was made at the hearing on the merits on September 10, 2009:

> I was conceding that we did obviously have an effort where we sold securities or our own stock from the treasury to accredited investors. However, I told you that we found those people for another purpose.
>
> (Transcript, Sept. 10, 2009, 27:7-11)

Issuing Shares from Treasury Constitutes a Trade in Securities

[40] The definition of a distribution in subsection 1(1) encompasses "a trade in securities of an issuer that have not been previously issued".

[41] As stated above in paragraph 29 of our Reasons, the Respondents take the position that they were not trading, because IMAGIN shares were issued from treasury.

[42] The Respondents are of the view that selling shares from treasury is not trading as defined by the Act because it is the corporation making the commitment to sell securities as opposed to shareholders of that corporation trading with other purchasers. In their closing submissions, the Respondents emphasized that:

> Imagin started in 2003, and you sold only your issuer's securities, that's all they sold, from treasury.
>
> In 2009 not one, not one, shareholder has ever sold one share - not insiders, nobody. Zero. So that has to tell you that it wasn't for distribution. …
>
> (Transcript, Nov. 11, 2009, 90:19-25)

[43] Moreover, in their written reply submissions at paragraph 58, the Respondents state that:

> …The rules of the OSC use the word "trade" to mean issue, buy, sell, purchase etc. What the regulators did is introduce the concept that a company can trade if they don't deal with securities as if they are like inventory. The point however is that treasury shares are not inventory they are sold from the treasury and represent the evidence of store of value of a company's future. …

[44] The evidence shows that IMAGIN sold securities and the Respondents admit to the sale of securities as discussed above. As established by the definition of a trade set out in subsection 1(1) of the Act, any sale or disposition of a security for valuable consideration constitutes a trade. In this case, it is not disputed that investors paid for IMAGIN securities.

[45] We disagree with Mr. Rooney's submission that a distribution of securities from treasury is not a trade. A distribution of securities is a subset of the broader category of "trade" in subsection 1(1) of the Act, but the plain language of the statute makes it clear that distributions are trades. As a result, we find that IMAGIN securities were traded and that the evidence demonstrates that these securities were sold to investors to raise a total of $14 million, of which $3.5 million was sold to Ontario residents.

Mr. Rooney Engaged in Acts in Furtherance of Trades

[46] In addition, Mr. Rooney's individual actions also establish that he was involved in acts in furtherance of trades of IMAGIN's securities. Many of Mr. Rooney's actions made it possible for IMAGIN to actively sell its securities and helped to prepare a market for the sale of IMAGIN securities. Specifically, Mr. Rooney:

- was responsible for hiring members of IMAGIN's sales team. For example, Mr. McCaffrey testified that Mr. Rooney hired him to work at IMAGIN as Executive Director of Corporate Development (Transcript, May 21, 2009, 14:23 to 15:16).

- was very involved as a manager in IMAGIN's day-to-day business and remained "… completely aware of what was going on in the sales department at all times" (Transcript, May 21, 2009, 40:3-11).

- conducted weekly meetings at which he instructed the sales team, provided updates on IMAGIN and its operations and provided them with fresh material to discuss with potential purchasers of IMAGIN's securities. For example, Mr. Shumacher testified that Mr. Rooney "… would explain developments, good and bad. And he also had a vast amount of experience on Wall Street, and he would -- he would be very much in an advisory capacity as far as […] the sale of the securities was concerned in the beginning" (Transcript, June 16, 2009, 39:5-11).

- drafted materials that were sent to investors or issued to the public on behalf of IMAGIN such as subscription agreements (Transcript, May 21, 2009, 25:15 to 26:9).

- met with investors (Transcript, June 16, 2009, 86:9 to 87:16).

[47] Mr. Rooney submits that weekly meetings held at IMAGIN were focused on cancer diagnostic technology developments as they related to IMAGIN and were therefore not acts in furtherance of trades. However, we find that keeping sales persons informed about the company whose securities they are selling is consistent with regular practices in the industry and likely necessary to sell securities of a company. Mr. Rooney's actions as a whole were directed towards promoting IMAGIN and providing education about IMAGIN's activities in order to solicit sales of IMAGIN securities.

c. Findings

[48] Therefore, we find that through the work of its representatives, IMAGIN engaged in acts in furtherance of trades of IMAGIN securities and actual sales of IMAGIN securities raising a total of $14 million, of which $3.5 million was sold to Ontario residents.

[49] We also find that Mr. Rooney engaged in acts in furtherance of trades of IMAGIN securities by supervising, assisting and managing IMAGIN's sales team in preparing a market for the sale of IMAGIN securities. Therefore, we find that Mr. Rooney engaged in acts in furtherance of trades.

ii. Were the Respondents Registered Under the Act?

a. The Law and Policy with Respect to Registration

[50] The Commission's mandate set out in section 1.1 of the Act is:

> (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.

[51] As explained by the Supreme Court of Canada in *Brosseau v. Alberta*, [1989] 1 S.C.R. 301, securities laws "…in general can be said to be aimed at regulating the market and protecting the general public" (at para. 35).

[52] Registration requirements are one of the means for achieving the purposes of the Act. As set out in section 2.1 of the Act:

> 2.1 The primary means of achieving the purposes of this Act are:
>
> i. requirements for timely, accurate and efficient disclosure of information;
>
> ii. restrictions on fraudulent or unfair market practices and procedures; and
>
> iii. requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants.

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

[54] There are different registration categories for dealer entities and individuals and different types of market activities. These registration requirements play a key role in Ontario securities law. They impose requirements of proficiency, good character and ethical standards on those people and companies trading in and advising on securities. As the Commission stated in *Limelight, supra* at para. 135:

> Registration serves as an important gate-keeping mechanism ensuring that only properly qualified and suitable individuals are permitted to be registrants and to trade with or on behalf of the public. Through the registration process, the Commission attempts to ensure that those who trade in securities meet the applicable proficiency requirements, are of good character, satisfy the appropriate ethical standards and comply with the Act.

[55] Therefore, the requirement that individuals and companies be registered to trade and advise in securities is an essential element of the regulatory framework put in place to achieve the purposes of the Act.

b. Discussion

[56] The evidence before us in this matter reveals that neither of the Respondents were registered in any capacity with the Commission. All of the Settling Respondents testified that when the conduct at issue took place, they were not registered with the Commission. Mr. Rooney also admitted to this during the hearing when he was questioned on this issue by Staff:

> Q. And you agree that Imagin never filed a prospectus?
>
> A. Correct.
>
> Q. You also agree that Imagin has never been registered with the Commission?
>
> A. Yes.
>
> Q. And that you yourself are not now and nor have you ever been registered with the Commission?
>
> A. That's correct.
>
> Q. And that during the time of 2003 to 2007, none of your employees at Imagin were registered either?
>
> A. That is correct.
>
> (Transcript, September 9, 2009, 109:24 to 110:12)

[57] In addition, Staff provided section 139 certificates which provide a statement as to "the registration or non-registration of any person or company" (subsection 139(a) of the Act). These section 139 certificates, which were prepared by the Assistant Manager of Registrant Regulation at the Commission, confirmed that there is no record of the Respondents ever being registered under the Act.

c. Findings

[58] We find that none of the Respondents in this matter was registered in any capacity with the Commission.

[59] The next section will now examine whether there were any exemptions available to the Respondents to relieve them from the registration requirements under the Act while trading in securities.

iii. Were There Any Exemptions Available to the Respondents?

a. The Law – Availability of Exemptions

The Onus is on the Respondents to Prove They Qualified for an Exemption

[60] As specified in subsection 25(1)(a) of the Act cited above, no person or company shall "trade in a security" unless the person or company "is registered as a salesperson or as a partner or as an officer of a registered dealer and is acting on behalf of the dealer".

[61] However, there are numerous exemptions from the registration requirement. Many of these exemptions for registration also have parallels in the exemptions from the prospectus requirement. Some exemptions are explicitly set out in securities legislation or rules, while other exemptions are granted on a discretionary basis by the Commission.

[62] Once Staff has shown that the Respondents have traded without registration, the onus shifts to the Respondents to establish that one or more exemptions from the registration requirements was available to them (*Limelight, supra* at para. 142 and *Re Ochnik* (2006), 29 O.S.C.B. 3929 at para. 67).

[63] During the time when the majority of the conduct in this matter took place, from early 2003 to July 2006, Rule 45-501 *Exempt Distributions* ("Rule 45-501") was in place. This rule provided general exemptions from the registration and prospectus requirements found in sections 25 and 53 of the Act.

[64] Rule 45-501, as it existed during the time when the conduct in this matter occurred, provided different exemptions from registration for issuers themselves as opposed to purchasers of an issuer's securities. In other words, some exemptions were available based on the identity or characteristics of the seller, while other exemptions were available based on the identity or characteristics of the purchaser. The structure of the rule makes it clear that because a registration exemption was available for a sale to a particular purchaser does not by definition mean that the issuer may avail itself of that exemption in all circumstances. As we will see below, certain types of issuers were precluded from using these exemptions to sell their securities (i.e. where the issuer was a market intermediary).

[65] The exemptions which are relevant to the present matter are the accredited investor exemption and the closely-held issuer exemption. These are the exemptions that the Respondents purport to rely on to sell securities of IMAGIN.

[66] The accredited investor exemption is found at section 2.3 of Rule 45-501. Specifically, this section states:

> Sections 25 and 53 of the Act do not apply to a trade in a security if the purchaser is an accredited investor and purchases as principal.

[67] As set out in Rule 45-501, the accredited investor exemption was a frequently used exemption for private placements. Accredited investors do not have the protection of prospectus or registration requirements imposed on sellers when they are purchasing securities.

[68] The term accredited investor (as it existed at the time when the conduct in this matter took place, which is set out in section 1.1 of Rule 45-501), to whom securities may be lawfully distributed without the registration and prospectus requirements, encompasses the following types of buyers: (1) designated institutions, (2) governments (3) persons or companies who meet income or asset tests or who are recognized by the Commission as accredited investors, (4) a promoter of an issuer or a spouse, parent or grandchild, or child of an officer, director or promoter, and (5) control persons of the issuer itself or of affiliates of the issuer. The type of accredited investor whom IMAGIN solicited and to whom it sold securities to was the third type mentioned above.

[69] The closely-held issuer exemption (as it existed at the time when the conduct in this matter took place), was found at section 2.1 of Rule 45-501 and the term closely-held issuer is defined in section 1.1 of Rule 45-501. This exemption was available if the securities of an issuer were beneficially owned, directly or indirectly, by not more than 35 persons or companies (with some other limited exceptions). The rationale for this exemption was that a closely-held issuer may raise capital from a limited class of investors without the cost burden of preparing a prospectus. Accordingly, there was an exemption from the prospectus and registration requirements for closely-held issuers.

Removal of Exemptions for Market Intermediaries

[70] While Rule 45-501 provided the exemptions identified above from sections 25 and 53 of the Act when securities are being traded, it also removed those exemptions in certain circumstances.

[71] In particular, section 3.4 of Rule 45-501 specified that exemptions were not available to market intermediaries:

3.4 Removal of Registration Exemptions for Market Intermediaries

(1) The exemptions from the registration requirement in sections 2.1, 2.2, 2.3, 2.5, 2.6, 2.7, 2.8, 2.9, 2.12, 2.13, 2.14, 2.15 and 2.16 are not available to a market intermediary.

(2) A limited market dealer may act as a market intermediary in respect of a trade referred to in subsection (1).

[72] The core of the allegations made by Staff is that IMAGIN was acting as a market intermediary, and as such, did not have the enumerated registration exemptions available to it when it sold IMAGIN securities to accredited investors.

[73] When the conduct in this matter took place, early 2003 to July 2006, the definition of a market intermediary was set out in section 204 of the Regulation to the Act. It states:

> "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.

[74] According to this definition, a person is a market intermediary if he, she or it was engaged in or held himself, herself or itself out as engaging in the business of trading in securities in Ontario as principal or agent. As a result, such an issuer (seller of securities) does not have an available exemption, even though the purchasers of the securities that are sold may qualify as accredited investors.

[75] The removal of the registration exemption for market intermediaries is important because the Commission wants to ensure that entities in the business of trading securities repeatedly are subject to ongoing registration requirements.

b. Discussion

Overview of the Parties' Positions

[76] Staff takes the position that IMAGIN was conducting itself as a market intermediary and therefore did not have access to the accredited investor exemption and/or closely-held issuer exemption for the sale of securities.

[77] Staff does not dispute the admission that IMAGIN dealt with accredited investors. Staff contends that the accredited investor exemption from registration was not available to IMAGIN because it was a market intermediary, in that it retained employees whose primary job function was to actively solicit investors for the purpose of selling securities to them.

[78] According to Staff, IMAGIN was captured by the definition of a market intermediary as set out in section 204 of the Regulation and interpreted in *Momentas* and section 3.2 of the Commission's Companion Policy 45-106 CP ("45-106 CP").

[79] Staff submits that in order to determine whether an issuer fulfills the criteria of a market intermediary, the Commission must find that the issuer's "core business" dealt with the distribution of its securities. Accordingly, Staff submits it is necessary to look at how the issuer markets and sells its securities, and how the marketing and selling of securities fits into the overall activities of the issuer.

[80] Staff acknowledges that IMAGIN may have some aspects of its business that did not involve the distribution of securities (such as IMAGIN's cancer diagnostic technology related activities), however, Staff emphasizes that IMAGIN was focused on selling securities as a core part of its activities, and consequently IMAGIN was a market intermediary and could not access the accredited investor exemption to distribute securities to accredited investors without being registered as a Limited Market Dealer ("LMD").

[81] The Respondents take the position that IMAGIN was not a market intermediary, and they disagree with Staff's characterization that their core business was selling securities. The Respondents submit in paragraph 58 of their written reply submissions that "Raising capital is not a business unless you are an agent raising it for someone else". According to the Respondents, since they were issuing shares from treasury, they were not raising money on behalf of another person/entity and therefore they were not acting as a market intermediary.

[82] In particular, the Respondents attempt to distinguish themselves from the facts at issue in the *Momentas* case by stating that they did not operate a brokerage house and therefore they cannot be categorized as market intermediaries. The Respondents point

out that they operated a company which promoted cancer awareness and cancer diagnosis technology. According to the Respondents, cancer education and awareness was the main job focus of the employees at IMAGIN, not the sale of IMAGIN securities.

[83] Specifically, the Respondents submit that IMAGIN was not involved in the business of selling securities, instead IMAGIN was involved in cancer patient acquisition and cancer education. In their written submissions at paragraph 80, the Respondents take the position that:

> …There were many more call centre people than salesmen and the qualifiers knew nothing about selling securities. They all had a substantial knowledge base about cancer and cancer diagnosis. They would later learn about cardiac disease, diagnosis and prevention and then about Alzheimer's and dementia diagnosis using PET. But never were they taught about securities. The call centre was the front line of the cancer awareness, navigation and advocacy campaigns. …

[84] Further, in their written reply submissions at paragraph 62, the Respondents state that "Neither IMAGIN or its employees were in the business of trading in securities".

[85] The Respondents also take the position that they had a registration exemption because they issued shares from treasury and this was not for investment purposes and not for resale. In their written submissions at paragraph 101, the Respondents emphasize that "As of 2009, not one IMAGIN shareholder has ever "re-sold" one IMAGIN share". Further, in their written reply submissions at paragraph 57, the Respondents argue that there is an:

> …exception which allows an entity not to be deemed a market intermediary [which] states "other than trading in securities purchased for (the entity's) own account for investment only and not with a view to resale or distribution". This position defines an activity which standing alone would not position an entity into a characterization as a market intermediary.

[86] Further, the Respondents argue that they were under the impression that they were acting properly since the Commission accepted their private placement filings and fees.

[87] In the alternative, the Respondents argue that even if they had to register, the requirement to register as an LMD was inappropriate. The Respondents contend that LMDs had reputation and compliance problems and that registering as an LMD or working with an LMD would hinder IMAGIN's capital raising activities. Specifically, the Respondents state at paragraphs 12 and 14 of their written submissions that:

> IMAGIN made a conscious decision not to become an LMD because the rules were not designed such that it was practical and did not appear to be the intent that a private start-up company should become an LMD in order

> to raise capital. An outside LMD is okay to help but finding a qualified, compliant LMD in Ontario was like finding a needle in a haystack. Besides under 45-501 exemption [*sic*], an LMD is redundant and perhaps a major negative.
>
> …
>
> It was determined at an early stage after the founding of IMAGIN that rules [*sic*] as they related to IMAGIN becoming an LMD would eliminate the ability of IMAGIN to rely on the accredited investor exemption. It is unacceptable [*sic*] and unnatural structure for everybody in a start-up to work for an LMD. That structure would eliminate the ability of any start-up to arise [*sic*] capital with disclosure of a corporate structure as an LMD first and an operating company second.

IMAGIN is a Market Intermediary

[88] In our view, IMAGIN fell into the category of a market intermediary. Therefore, it was unable to benefit from the accredited investor exemption and closely-held issuer exemption (and other exemptions provided in section 3.4 of Rule 45-501) to distribute its securities without being registered.

[89] The definition of a market intermediary has a number of components. There is an exception contained within the definition which allows an entity not to be deemed a market intermediary in circumstances where there is "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…". The Respondents argue that they were not captured by the definition of a market intermediary based on these words. We note that this exception from the definition of a market intermediary applies only in circumstances where the entity purchases securities not when they sell them. As a result, the Respondents, who sold securities, cannot use this exception.

[90] In order to come to our conclusion that IMAGIN was acting as a market intermediary at the relevant time, we assessed the extent to which IMAGIN was "engaging in Ontario in the business of trading in securities as principal" (section 204 of the Regulation to the Act) of its own securities.

[91] We reviewed the case law referred to us by the parties in their oral and written submissions. Both Staff and the Respondents referred us to the *Momentas* case. The Commission has interpreted the definition of a market intermediary (in section 204 of the Regulation to the Act) in the *Momentas* case and concluded that where an issuer retains an employee primarily for the purpose of soliciting purchasers for the issuer's securities, both the issuer and the employee are considered to be in the business of selling securities and as such both are market intermediaries.

[92] The facts were as follows in *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, Momentas acted as a market intermediary, and was required to be registered pursuant to subsection 25(1)(a) of the Act. Momentas employed and paid its staff to sell its own securities, and this made Momentas a market intermediary regardless of its other businesses.

[93] Momentas had an internal department employing a significant number of employees for raising capital. As stated in *Re Momentas* (2005), 28 O.S.C.B. 6493 ("*Momentas TCTO*") at paragraph 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.

[94] In order to determine if IMAGIN was captured by the definition of a market intermediary, we assessed how IMAGIN was organized and the role played by the selling of securities in that business. This approach requires an examination of the totality of the evidence provided to us in relation to the issuer to determine how the business of the issuer was organized.

[95] In our view, some indicators that are very helpful to illustrate the business functions of an issuer include: the number of employees engaged in a certain activity, the amount of time spent on a certain activity, the job descriptions of employees and the way employees are compensated for their work.

[96] The way IMAGIN structured its activities demonstrates that employees were instructed to contact companies and individuals to solicit investment in IMAGIN shares. We received in evidence a document entitled "Employee List and Job Descriptions" which provided helpful insight. The "Employee List and Job Descriptions" states that as of February 23, 2006, IMAGIN had 23 employees. Ten of these employees were listed as working full-time in the "Shareholder Relations and Patient Acquisition Department". According to the job description document provided in evidence, one of the tasks of these employees was described as follows:

> …this department currently qualifies primarily business owners and CEO's as accredited and/or eligible investors for individuals outside of Ontario.

[97] The "Employee List and Job Descriptions" also states that IMAGIN had five individuals working in the "Corporate Development Department". It also provides a job description for each individual in that department and states that Mr. Rooney, Mr. Smith, Mr. Zelynony and Mr. Harris had the title "Managing Director of Corporate Development" and Mr. Schumacher had the title "Supervisor of Shareholder Relations Dept" and Mr. McCaffrey had the title "Executive Director of Corporate Development".

[98] Taking into consideration the role and job description of the "Shareholder Relations and Patient Acquisition Department" employees and the "Corporate Development" employees, the evidence demonstrates that 15 out of 23 employees of IMAGIN's Toronto staff were employed to assist in the sale of IMAGIN securities.

[99] The evidence demonstrates that certain steps were involved in the process of selling securities: first, qualifiers cold-called potential investors, then sales persons requalified potential investors contacted by the qualifiers, then sales persons would sell IMAGIN securities to the investors. Afterwards, other sales persons would follow up with IMAGIN investors to sell them additional IMAGIN securities. We heard detailed evidence about the different steps in this process. In addition, we note that in documents produced for the Government of Canada, IMAGIN described the occupation of departing members of its sales staff as "Sales Person".

[100] The testimony of the Settling Respondents demonstrates that IMAGIN's distribution of securities was accomplished using a cold-call system of telephone solicitation executed by qualifiers and a sales team. For the majority of the relevant time, this team operated out of IMAGIN's Toronto offices until moving to Vancouver in February 2006. It is evident from the testimony of the Settling Respondents that this was a systematic process put into place to solicit sales of IMAGIN securities (to new and existing IMAGIN shareholders) and this was their main job function.

[101] Qualifiers would use purchased lists such as infoCANDA.ca and Scott Directories which contained names of companies, information regarding the size of companies, individual names and phone numbers to contact potential investors. Mr. Shumacher testified that when he took on the qualifying management role in June 2005, there were approximately 14 qualifiers, and later this number dropped to about seven qualifiers. These qualifiers would determine: (1) whether investors were accredited investors, and if so, (2) whether they were interested in purchasing IMAGIN securities. Potential investors who met both criteria were advised by the qualifier that a sales person would contact them. Mr. Shumacher testified that he was asked to manage the qualifying room in June 2005.

[102] Sales persons would then follow up, requalify the investors and attempt to complete a sale of IMAGIN securities. Four employees were given the title of "Managing Director of Corporate Development". These employees would take over where the qualifiers left off, and would sell IMAGIN securities to interested accredited investors.

[103] Further, as we heard from the testimony of Mr. Zelyony, some of the "Managing Directors of Corporate Development" conducted further sales to existing investors. This formed an important component of the work Mr. Zelyony did for IMAGIN. His testimony stated:

> Q. Did you conduct any transactions with any of these existing shareholders?

A. With some I did.

Q. And how frequently would that happen?

A. Like I've said before, it wasn't a frequency because there would be a week where -- no selling. But, you know, it's hard to give a number, how frequently. I was there for a year, so there was months you know, where there was --

Q. Okay.

A. Yeah.

Q. Let me put the question to you in different terms. If you could -- if you could give us a percentage of your time that you spent dealing with the sale of Imagin securities.

A. I believe the percentage -- like I said before when I spoke to you, it's hard to pinpoint a specific percentage, but I think 70/30 would be fair to say, and that 70, I would say, dealing with shareholders. Would be difficult -- I would struggle to say it's all selling, all selling.

Q. Some of it would be providing them with information about --

A. Correct.

Q. -- the company's activities, and sometimes that would lead to the sale of shares.

A. Could, yes.

Q. All right. And you spent approximately 70 percent of your time doing that.

A. I would say that.

(Transcript, June 18, 2009, 12:12 to 13:16)

[104] We see from Mr. Zelyony's testimony that although selling was not the only activity taking place, for a portion of time, "Managing Directors of Corporate Development" focused on providing information about the company to existing shareholders not only to keep them abreast of IMAGIN's activities in cancer diagnostic technologies but also with the objective that this continuing dialogue with current IMAGIN shareholders would result in further sales of IMAGIN securities.

[105] We were provided with evidence that the main focus of employee activity was completing sales of IMAGIN securities. We heard testimony that the sales persons did not want to "waste their time" with individuals who were not eligible to purchase IMAGIN securities. For example, Mr. Shumacher testified that:

> So the salesmen would want to make sure that they were not going to waste a whole lot of time on someone that ultimately would end up being not accredited.
>
> So the salesmen would want to find out themselves. They'd want to make sure themselves that that person was accredited. …
>
> (Transcript, June 16, 2009, 147:11-17)
>
> …but typically, salesmen would want to make sure that they weren't wasting their time on somebody who was interested -- potentially interested in buying stock but was not accredited.
>
> (Transcript, June 16, 2009, 148:1-4)

[106] In the sales team, certain individuals were classified as "openers" because they solicited the original purchase of IMAGIN shares. Other individuals on the sales team were classified as "up-sellers" because they were involved with soliciting additional purchases of IMAGIN shares from existing shareholders. This process was explained by Mr. Shumacher in his testimony as follows:

> Q. Okay. Now, did Mr. Smith and Mr. Harris and Mr. Zelyony and Mr. McCaffrey have the same kind of role, or did they fill different functions in the sales?
>
> A. Different functions. Mr. McCaffrey and Mr. Zelyony, they were involved in what's called up-selling.
>
> Q. Okay.
>
> A. So they spoke to existing Imagin shareholders.
>
> Q. Okay. With what intention?
>
> A. Well, with the intention of selling more stock if they were -- if the individuals were so disposed, but also -- but also in disseminating information about what was going on with the company. Whether these individuals were going to buy more stock or not, there was a communications function that was involved as well.

Q. You indicated Mr. McCaffrey and Zelyony were what you referred to as up-sellers. What about Mr. Smith and Mr. Harris?

A. No. They were not up-sellers. They continued to open accounts.

Q. Would you call them openers?

A. Yes -- yeah, I would. I would.

(Transcript, June 16, 2009, 32:16 to 33:15)

[107] Mr. McCaffrey, who held the title of "Executive Director of Corporate Development", confirmed in this testimony that he was "in charge of sales" (Transcript, May 21, 2009, 14:11-13) and supervised the sales team at IMAGIN.

[108] Staff also submits that some of IMAGIN's remaining eight employees were administrative staff who helped and supported the qualifiers and sales team and IMAGIN's overall marketing and selling activities. We find that this submission is supported by the documentary evidence. For example, some of IMAGIN's administrative support staff signed Compliance Records relating to the sale of IMAGIN securities and their names were listed as "Compliance Officers". In addition, we heard testimony from Mr. Rooney and the Settling Respondents that the administrative Staff assisted with preparing documents for IMAGIN relating to its securities.

[109] The Respondents submitted that when qualifiers and sales persons called potential investors and/or existing investors, they called to inform them about relevant cancer issues and not to sell securities to them. For example, at paragraph 25 of the Respondents' written submissions, the Respondents state that:

> "Cancer was first". Mr. Zelyony testified that cancer diagnosis was the most important element of what salesmen at IMAGIN sold.

[110] The Respondents characterized the cold-calls by IMAGIN employees as "cancer patient acquisition" and not sales and/or trades of IMAGIN securities. According to the Respondents, IMAGIN's employees were engaged in "cancer awareness" and were knowledgable about cancer and that was their job. As stated by the Respondents at the hearing:

> …our call centre people knew and know nothing about the sale of securities. You will hear -- but we will contend they're very educated and knowledgeable about cancer diagnosis.
>
> (Transcript, May 19, 2009, 83:15-18)

[111] Staff on the other hand take the position that IMAGIN employees cold-called individuals and companies to speak to them about cancer and cancer diagnostic

technology in order to create an interest in IMAGIN's business so as to subsequently sell IMAGIN securities.

[112] We note that the evidence in this matter shows that until November 2005, IMAGIN employees never followed up with people who were interested in learning about cancer diagnostic technologies but not interested in investing. This demonstrates that IMAGIN's employees were paying attention to people with an interest in investing in IMAGIN securities.

[113] We agree with Staff's submission that IMAGIN's "cancer awareness campaign" was a campaign that prepared a market for the sale of IMAGIN's securities. This is evident from Mr. Shumacher's testimony:

> When I started, I was involved in the selling of securities. The thing is that I would say that we had a massive education process in front of us at the time because the vast majority of people in Canada did not know what PET was, and I think that many of us felt that while the selling of securities was the means to the end, that we had to educate the public…
>
> (Transcript, June 16, 2009, 21:15-21)

[114] At marketing meetings led by Mr. Rooney, IMAGIN employees discussed company updates to gain in-depth knowledge of IMAGIN's work related to cancer diagnostic technology. Mr. Rooney submits that the sales persons knew "… nothing about the sale of securities. … but … they're very educated and knowledgeable about cancer diagnosis" (Transcript, May 19, 2009, 83:15-18) and as a result the core business of IMAGIN was cancer diagnostic technology and not selling securities. However, knowing about cancer diagnostic techniques is consistent with qualifiers and sales persons marketing and selling their product, that is, IMAGIN securities. Successful sellers know and understand their products well, and by being trained in the use of cancer diagnostic technology, IMAGIN qualifiers and sales persons were able to successfully target potential investors, educate them about IMAGIN and sell them IMAGIN securities.

[115] In our view, providing educational information about IMAGIN to individuals furthered or promoted the sale of IMAGIN's securities. This is evident from Mr. McCaffrey's answers to Staff's questions during direct examination:

> Q. If one of those salespeople or if you called an investor and made a presentation to that investor and did not ultimately made a sale, were you compensated in any way for that presentation?
>
> A. No. No. The process of sales required educating people about what we were doing, about what the company was about, about building a company that could bring PET scanning into Canada. Most Canadians did not know what a PET scan was.

Q. They wouldn't buy the securities unless you explained all that to them in advance.

A. I don't know why they would.

(Transcript, May 21, 2009, 24:16 to 25:3)

[116] In addition, IMAGIN's compensation structure demonstrates that IMAGIN employees were remunerated based on the sale of IMAGIN securities.

[117] Until November 2005, members of IMAGIN's sales team were compensated on the basis of a commission of 10% of the total value of the securities they sold. This was confirmed by documentary and oral evidence regarding the incomes earned by the Settling Respondents. For example, Mr. Smith testified that his income was "…commission based. It was 10 percent. So 10 percent of whatever the total was that the client invested" (Transcript, June 18, 2009, 135:12-14). This was also confirmed by the testimony of Mr. Zelyony and Mr. McCaffrey. However, Mr. McCaffrey also explained that some time later (December of 2006), there was a change in his remuneration and that he was compensated on a salary basis of $5,000 per week from then on.

[118] The Respondents submit that the payment of a 10% Commission was a coincidence and that in any event, the commission payment structure at IMAGIN was changed in November 2005. However, we find that the evidence demonstrates that although the remuneration structure was changed, the remuneration still compensated employees based on their sales performance, and the salary was a draw from future commissions. This is evident from Mr. Shumacher's answers to Staff's questions about his compensation after November 2005:

Q. Okay. Now, did that -- that commission structure, was that true all along for the sales staff, or did that ever change?

A. Well, there were some changes made after the rules changed. November '05, there was some rejigging of the structure.

Q. Can you explain what you mean by rejigging?

A. Well, what happened was that the salespeople receive an amount -- a standard amount. I think there were -- there were two -- if I remember correctly, there were two amounts decided upon, depending on what the salesperson's history was, and that is the amount they would receive on a weekly basis. And there would be adjustments made based on their sales record after that.

Q. And did that result in a significant pay difference from when people were working on commission?

A. No, I wouldn't say so. I guess the only real exception to that would be for those salesmen who weren't producing, because for a period of time, they would be paid not on the basis of a commission, but just paid a standard amount.

Q. And would their pay in weeks where they didn't sell much in the way of securities –

A. No, they would be paid -- weeks they sold no securities, they would still get that standard amount.

Q. And -- okay. Was that a salary, or was that something they would have to pay back later out of –

A. Yeah, I mean, I would -- the way I understood it, I would characterize it as a draw.

Q. But what do you mean by a draw?

A. A draw meaning a draw against future sales.

(Transcript, June 16, 2009, 35:1 to 36:11)

[119] Based on the evidence regarding compensation at IMAGIN, we find that the commission compensation structure demonstrates that there was an incentive for IMAGIN employees to sell IMAGIN securities. Especially, up until November 2005, if sales persons did not sell, then they were not paid, and after November 2005, the testimony at the hearing reveals that salary was treated as a draw against future sales. The evidence also shows that IMAGIN sales persons were not compensated for calls where they talked about cancer and did not achieve a sale of securities.

[120] To summarize, the evidence shows that IMAGIN was organized to distribute securities. We recognize that selling securities may not have been the only job function of IMAGIN employees, and they may not have engaged in selling IMAGIN securities 100% of the time. However, taken as a whole, there was a team of employees at IMAGIN that was involved in a systematic process to market and solicit sales in IMAGIN securities. As long as there is a predominant function at an entity to distribute securities in an organized fashion (even though the entity might also have other business purposes at the same time), that entity is captured by the definition of a market intermediary.

[121] As a result, we find that IMAGIN is captured by the definition of a market intermediary because it was "engaging in Ontario in the business of trading in securities as principal" (section 204 of the Regulation to the Act).

Further Arguments Concerning the Definition of an Accredited Investor

[122] The Respondents argue that they were not market intermediaries because they only sold IMAGIN securities to accredited investors. According to the Respondents, accredited investors do not form part of the public. They submit that Rule 45-501 created the category of accredited investors to hive them off from the general public. Specifically, the Respondents' written submissions on the merits at paragraph 60 state that:

> At no time has IMAGIN ever distributed securities to the public. The rules of the OSC are clear that accredited investors are not considered members of the public. The definition of the parties that qualify as accredited investors as laid out in Part 1 – Definitions in 45-501 and list 28 defined categories itemized by (a) to (z) plus (aa). 28 entities as Accredited investors, each entity is clearly not a member of the public.

[123] The Respondents take the position that since they never dealt with the public, they did not have to be registered and they could rely on the accredited investor exemption. The Respondents referred to 45-106 CP, which was introduced on September 14, 2005 (towards the end of the period at issue in this matter). The Respondents refer to section 3.2 of 45-106 CP, which addresses market intermediaries and states:

> ...
>
> 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.

[124] Staff disagrees with IMAGIN's position that accredited investors are not part of the public. In particular, Staff points out at paragraph 58 of their written reply submissions that "There is simply nothing in the *Act* to support the Respondents' contention that an accredited investor is not a member of the public". However, Staff argues that even if accredited investors were considered not to be part of the public, section 3.4 of Rule 45-501 (as it existed when the conduct in this matter took place) specified that exemptions (such as the accredited investor exemption found at section 2.3 of Rule 45-501) did not apply to market intermediaries.

[125] We have reviewed the wording of the Act and Rule 45-501, which were the relevant legal provisions in force during the period of time when the conduct in this matter took place. In the four corners of the Act and Rule 45-501, there is no definitive statement that provides that accredited investors are not part of the public. In any event, we emphasize that under the Act and Rule 45-501, businesses that fall into the category

of market intermediary may not use the accredited investor exemption to distribute securities without registration.

Limited Market Dealers

[126] Subsection 3.4(2) of Rule 45-501 created another exception to the prohibition on a market intermediary using the enumerated exemptions. An issuer could access the exemptions (including the accredited investor exemption), if they were registered as an LMD.

[127] However, IMAGIN was not registered as an LMD and the Respondents deliberately chose not to register as an LMD. As stated in their written submissions at paragraph 12:

> IMAGIN made a conscious decision not to become an LMD because the rules were not designed such that it was practical and did not appear to be the intent that a private start-up company should become an LMD in order to raise capital. An outside LMD is okay to help but finding a qualified, compliant LMD in Ontario was like finding a needle in a haystack. Besides under 45-501 exemption [*sic*], an LMD is redundant and perhaps a major negative.

[128] Further, at paragraph 14 of their written submissions the Respondents state:

> It is unacceptable and unnatural structure for everybody in a start-up to work for an LMD. That structure would eliminate the ability of any start-up to arise [*sic*] capital with disclosure of a corporate structure as an LMD first and an operating company second.

[129] Subsection 3.4(2) of Rule 45-501 created a mandatory requirement that market intermediaries needed to register as an LMD if they wanted to access the exemptions in Rule 45-501. This is consistent with the overall policy objective that those engaged in repeated trading of securities be registered in some capacity with the Commission.

[130] The Respondents cannot unilaterally decide that the LMD registration requirement should not have applied to them because it would hinder their ability to raise capital. Individuals who want to conduct business in Ontario's capital markets need to abide by the mandatory laws and rules put in place to govern Ontario's capital markets.

[131] As a result, we find that if IMAGIN, as a market intermediary, wanted access to the exemptions in Rule 45-501, it had to comply with subsection 3.4(2) of Rule 45-501 and register as an LMD. The Respondents' submission that LMDs did not have a good reputation is not an acceptable defence for not following the law.

c. Findings

[132] Based on the analysis in paragraphs 88 to 121 of our Reasons, we find that IMAGIN was a market intermediary. By examining the business of IMAGIN, we find that the majority of employees at IMAGIN were engaged in some aspect of selling securities to the public and their compensation was in the form of commission based on their sale of IMAGIN securities. Since during the relevant time, IMAGIN was a market intermediary, it could not access the accredited investor or closely-held issuer exemptions pursuant to section 3.4 of Rule 45-501.

2. Pursuant to section 129.2 of the Act, was Mr. Rooney a *de facto* Officer and Director of IMAGIN who Authorized, Permitted or Acquiesced in IMAGIN's Breaches of Ontario Securities Law?

i. The Law

[133] According to 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. Specifically, section 129.2 states:

> 129.2 For the purposes of this Act, if a company or a person other than an individual has not complied with Ontario securities law, a director or officer of the company or person who authorized, permitted or acquiesced in the non-compliance shall be deemed to also have not complied with Ontario securities law, whether or not any proceeding has been commenced against the company or person under Ontario securities law or any order has been made against the company or person under section 127.

[134] In subsection 1(1) of the Act, a "director" is defined as "a director of a company or an individual performing a similar function or occupying a similar position for any person" and an "officer" is defined as:

> (a) a chair or vice-chair of the board of directors, a chief executive officer, a chief operating officer, a chief financial officer, a president, a vice-president, a secretary, an assistant secretary, a treasurer, an assistant treasurer and a general manager,
>
> (b) every individual who is designated as an officer under a by-law or similar authority of the registrant or issuer, and
>
> (c) every individual who performs functions similar to those normally performed by an individual referred to in clause (a) or (b).

[135] A *de facto* director has been characterized by the case law as "one who intermeddles and who assumes office without going through the legal formalities of appointment" (*Canadian Aero Service Ltd. v. O'Malley* (1969), 61 C.P.R. 1 (Ont. H.C.)).

[136] The test for determining if a person is a *de facto* director or officer was referred to by the Alberta Securities Commission in the case *Re World Stock Exchange* (2000), 9 A.S.C.S. 658 (Alta. Sec. Com.):

> In each case, it is the entirety of the alleged director's involvement that must be considered in the context of the company's activities. No individual factors are necessarily determinative. The test is whether, under the particular circumstances, the alleged director is an integral part of the mind and management of the company.
>
> (*Re World Stock Exchange, supra* cited in *R. v. Boyle,* [2001] Carswell Alta. 1143 (Prov. Ct.) at para. 98)

[137] *Re World Stock Exchange* also lists several factors that have been identified as relevant to the determination of whether an individual is a *de facto* officer or director such as:

(a) appointing nominees as directors;

(b) being responsible for the supervision, direction, control and operations of the company;

(c) running the company from their office;

(d) having signing authority over the company's bank account(s);

(e) negotiating on behalf of the company;

(f) being the company's sole representative on a trip organized to solicit investments;

(g) substantially reorganizing and managing the company;

(h) selecting the name of the company;

(i) arranging a public offering; and/or

(j) making all significant business decisions.

[138] Essentially, the term *de facto* officers and directors is meant to capture persons who have avoided liability by arranging for others to be named under the formal title of officer and/or director. All the while, it is the *de facto* officer and/or director who

maintains control over the affairs of the company and exercises the powers of a director and/or officer.

[139] The language of section 129.2 also uses the terms "authorize", "permit" and "acquiesce". "Acquiesce" means to agree or consent quietly without protest. "Authorize" means to give official approval or permission, to give power or authority or to give justification. "Permit" means to allow, consent, tolerate, give permission or authorize permission particularly in writing.

ii. Discussion

[140] Staff takes the position that Mr. Rooney is responsible under section 129.2 of the Act as a *de facto* officer and director who authorized, permitted or acquiesced in IMAGIN's breaches of the Act.

[141] In their written submissions the Respondents admit that Mr. Rooney was in charge at IMAGIN and that he was a *de facto* officer and director. Specifically, the Respondents' written submissions state:

> The Respondents start by conceding that Rooney was in fact a defacto [*sic*] officer of IMAGIN and since February of 2007 the sole director and CEO of IMAGIN.
>
> (Respondents' written submissions at para. 4)
>
> Patrick Rooney grew over time to become the most prominent "directing mind and visionary" behind every aspect of IMAGIN's business including the sale of its securities to accredited angel investors.
>
> (Respondents' written submissions at para. 42)

[142] In addition, we note that in paragraphs 35 and 75 of the Respondents' written submissions, Mr. Rooney is referred to as the "mind and management of IMAGIN" and in paragraph 65, Mr. Rooney is referred to as the CEO of IMAGIN. Also, in paragraphs 145 and 250 of the Respondents' written submissions, it states that Mr. Rooney was a *de facto* officer and director of IMAGIN.

[143] Further, the evidence in this matter overwhelmingly demonstrates that Mr. Rooney was a *de facto* officer and director of IMAGIN and this evidence fulfills the factors listed for a *de facto* officer and director set out in *Re World Stock Exchange*.

[144] First of all, Mr. Rooney appointed nominees and directors. For example, Mr. Rooney appointed Ms. Jordan as the signing authority of IMAGIN. While Ms. Jordan held the title of CEO of IMAGIN, it is clear she was not the mind and management behind the company. This is evident from the following testimony of Mr. Shumacher:

Q. What sort of role did you observe [Ms. Jordan] in as the CEO?

A. Well, in my view, it was a somewhat cursory one. It's not the way -- it's not what I would envisage a typical CEO doing. I mean, she signed -- she signed the cheques. When press releases went out, quotes were attributed to her. There may have been some -- and she did attend -- she did attend some IMAGIN functions.

There may have been things that she did behind the scenes that I wasn't -- that I wasn't aware of. I'll just say the general perception certainly was always that Mr. Rooney was the one who was in charge.

(Transcript, June 16, 2009, 41:4-15)

[145] Mr. Schumacher's testimony was also consistent with the testimony given by the other Settling Respondents on this issue.

[146] Ms. Jordan's testimony revealed that she often did not have knowledge of what was happening at IMAGIN and did not have knowledge of statements that were attributed to her in press releases regarding IMAGIN's business activities.

[147] In fact, Mr. Rooney was the directing mind and management of IMAGIN and responsible for the supervision, direction, control and operation of IMAGIN. For example, Mr. Shumacher described Mr. Rooney's role as follows:

> Well, Mr. Rooney was the visionary. He was the individual who – whose concept this was, that the company was fulfilling. So I would describe him as performing the duties that you would expect from a CEO.
>
> (Transcript, June 16, 2009, 27:17-21)
>
> [Mr. Rooney was] Very hands-on. Wanted to know what was going on in every function and department of the company, although I would say that with respect to the sales and qualifying operation, although he was keenly interested in what was going on, and the view was always he was the ultimate one in authority, that he delegated much of that responsibility in terms of sales and qualifying to Allan McCaffrey.
>
> (Transcript, June 16, 2009, 28:18-25)

[148] Further, Mr. Smith testified that "Pat Rooney was definitely the directing mind" (Transcript, June 18, 2009, 137:24-25), and Mr. McCaffrey testified that Mr. Rooney was "very involved in the day-to-day affairs of the company" (Transcript, May 21, 2009, 40:7-8) and "was completely aware of what was going on in the sales department at all times" (Transcript, May 21, 2009, 40:10-11).

[149] Mr. McCaffrey's testimony also confirmed that Mr. Rooney had the ultimate authority at IMAGIN:

> Q. So who did Mr. Rooney report to?
>
> A. Himself.
>
> Q. Did Mr. Rooney ever report to you about anything in terms of --
>
> A. I think the word "report" is wrong. We discussed situations and aspects of the business.
>
> Q. Who had the higher authority in the company, you or Mr. Rooney?
>
> A. Mr. Rooney.
>
> (Transcript, May 21, 2009, 36:3-12)

[150] Based on this evidence, we reject Mr. Rooney's submission that he and Ms. Jordan were equal partners. The testimony of the individuals who worked at IMAGIN established that Mr. Rooney was in charge at IMAGIN and had control of IMAGIN's activities.

[151] Mr. Rooney also had control of the company's finances, and in fact it was Mr. Rooney who delegated his signing authority to Ms. Jordan, his nominee CEO. As explained in Mr. Shumacher's testimony during the hearing:

> … [Mr. Rooney] exercised control over the finances. I don't believe during my time there that he actually had signing authority as far as the cheques were concerned, but he did exercise control.
>
> (Transcript, June 16, 2009, 28:1-4)

[152] In addition, Mr. Rooney granted stock options to employees under his own authority. Mr. McCaffrey testified that his options were issued on Mr. Rooney's authority (Transcript, May 21, 2009, 45:1-4).

[153] Mr. Rooney also negotiated on behalf of IMAGIN. This is evident from Mr. Rooney's answers during Staff's cross-examination:

> Q. Mr. Rooney, you've throughout our evidence in this proceeding talked about many, many transactions and you've referred to them as deals you made on behalf of Imagin, whether it's buying other companies, buying shares of other companies, joint ventures, buying facilities, building facilities. I'm speaking in generalities but I think you understand what I'm talking about.

A. Right.

Q. It was you who went out and arranged them. You said that was your job to find those deals?

A. That was my job. That's what the director of corporate development does, whether it's for General Motors or anybody else. They make the deals and the CEO usually makes speeches, …

(Transcript, Sept. 9 2009, 90:4-19)

[154] Mr. Rooney also testified that he was responsible for substantially reorganizing and moving the company to Vancouver:

Q. And in February 2006 you moved the sales office to Vancouver, didn't you?

A. Well, I moved the entire company. I re-filed, at some point re-filed as a federal company. …

(Transcript, Sept. 10 2009, 18:11-15)

[155] Overall, the testimony in this matter demonstrates that Mr. Rooney authorized, permitted and acquiesced in many of IMAGIN's activities relating to IMAGIN's finances. All the Settling Respondents confirmed during their testimony that Mr. Rooney was in charge of significant business decisions for IMAGIN (such as moving the office) and was the directing mind and management behind IMAGIN's activities. Mr. Rooney was recognized as the ultimate authority by everyone at IMAGIN.

[156] As set out in paragraphs 46 and 47 of our Reasons, Mr. Rooney was completely aware of and keenly interested in the sale of IMAGIN securities, and he was very involved with the promotion, solicitation and sale of IMAGIN securities. He authorized, permitted and acquiesced in the conduct of IMAGIN's employees to solicit and sell IMAGIN securities. In addition, Mr. Rooney also supervised, assisted and managed IMAGIN's sales team.

iii. Findings

[157] We find that Mr. Rooney made, or was substantially involved in, every major decision of IMAGIN, and as such, he was clearly the centre of the corporate personality of IMAGIN and its controlling mind. Much of the executive authority for the operation of IMAGIN was effectively delegated to Mr. Rooney.

[158] Therefore, pursuant to section 129.2 of the Act, Mr. Rooney was a *de facto* officer and director of IMAGIN who authorized, permitted and acquiesced in IMAGIN's conduct and is liable for IMAGIN's breaches of Ontario securities law.

D. CONCLUSION

[159] For the reasons stated above we find that:

1. IMAGIN and Mr. Rooney breached subsection 25(1)(a) of the Act because they:

   i. engaged in trading and acts in furtherance of trades;

   ii. were not registered; and

   iii. did not qualify for any of the registration exemptions under the Act.

2. Mr. Rooney was a *de facto* officer and director of IMAGIN who authorized, permitted and acquiesced in IMAGIN's breaches of Ontario securities law pursuant to section 129.2 of the Act.

[160] The parties are directed to contact the Office of the Secretary within the next 10 days to set a date for a sanctions hearing, failing which a date will be set by the Office of the Secretary.

Dated at Toronto this 31st day of August, 2010.

"*Mary G. Condon*"	"*Margot C. Howard*"
Mary G. Condon	Margot C. Howard