Ontario Securities Commission
Commission des valeurs mobilières de l'Ontario
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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

GROUND WEALTH INC., MICHELLE DUNK, ADRION SMITH, JOEL WEBSTER, DOUGLAS DEBOER, ARMADILLO ENERGY INC., ARMADILLO ENERGY, INC. AND ARMADILLO ENERGY, LLC (aka ARMADILLO ENERGY LLC)

REASONS AND DECISION ON SANCTIONS AND COSTS
(Sections 127 and 127.1)

Hearing:	In writing		
Decision:	November 18, 2015		
Panel:	Christopher Portner	-	Commissioner
Submissions:	Jonathon T. Feasby Malinda N. Norman	-	For Staff of the Commission

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REASONS AND DECISION

I. OVERVIEW

[1] This was a hearing (the "**Sanctions and Costs Hearing**") before the Ontario Securities Commission (the "**Commission**") pursuant to sections 127 and 127.1 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "**Act**") to determine whether it is in the public interest to issue an order with respect to sanctions and costs against Armadillo Energy Inc. ("**Armadillo Texas**"), Armadillo Energy, Inc. ("**Armadillo Nevada**") and Armadillo Energy, LLC, also known as Armadillo Energy LLC ("**Armadillo Oklahoma**" and, collectively with Armadillo Texas and Armadillo Nevada, the "**Respondents**").

[2] The proceeding arose from a Notice of Hearing issued by the Commission on February 1, 2013, as amended on October 31, 2013, and a Statement of Allegations filed by Staff of the Commission ("**Staff**") on February 1, 2013, as amended on October 31, 2013 (the "**Amended Statement of Allegations**").

[3] In the Amended Statement of Allegations, Staff alleged that, from October 2010 through April 2011 (the "**Material Time**"), the Respondents, together with Ground Wealth Inc. ("**GWI**"), Michelle Dunk, Adrion Smith, Joel Webster and Douglas DeBoer (collectively, the "**Settling Respondents**") traded securities without being registered to do so and illegally distributed securities to Ontario investors. The securities entitled investors to the proceeds derived from the extraction and sale of oil that was subject to oil leases located in the State of Oklahoma in the United States of America (the "**Armadillo Securities**"). Approximately $5,061,979[1] and US$319,567 was raised from distributing the Armadillo Securities to more than 130 Canadian investors. Of the foregoing amounts, approximately $2.8 million was raised from 68 investors who were Ontario residents.

[4] All of the Settling Respondents entered into settlement agreements which have been approved by the Commission and, as a result, they are no longer parties to this proceeding.

[5] The hearing on the merits in this proceeding was converted to a hearing in writing by Order of the Commission dated January 7, 2015. I issued reasons and a decision on the merits on August 24, 2015, *Re Ground Wealth et al.* (2015) 38 O.S.C.B. 7377 (the "**Merits Decision**"). In the Merits Decision, I found that:

(a) The Respondents had engaged in unlawful trading contrary to subsection 25(1) of the Act; and

(b) The Respondents illegally distributed securities contrary to subsection 53(1) of the Act.

[6] The Respondents have not appeared or made submissions and have not objected to the Sanctions and Costs Hearing being determined on the basis of the written record.

[7] Pursuant to subsection 7(2) of the *Statutory Powers Procedure Act*, R.S.O. c. S. 22, the Commission has jurisdiction to proceed with a hearing in the absence of the Respondents when they have been given notice but have not appeared. I am satisfied that the

[1] Unless otherwise indicated, all currency amounts referred to in these reasons are stated in Canadian Dollars.

Respondents have either been given notice or, in the case of Armadillo Oklahoma, that notice was waived by Order of the Commission dated June 2, 2014.

II. SANCTIONS ANALYSIS

A. Sanctions Requested By Staff

[8] Staff submits that, given the findings in the Merits Decision, the following sanctions are appropriate and in the public interest:

(a) An order pursuant to clause 2 of subsection 127(1) of the Act that trading in any securities by the Respondents cease permanently;

(b) An order pursuant to clause 2.1 of subsection 127(1) of the Act that the acquisition of any securities by the Respondents cease permanently;

(c) An order pursuant to clause 3 of subsection 127(1) of the Act that any exemptions contained in Ontario securities law do not apply to the Respondents permanently;

(d) An order pursuant to clause 9 of subsection 127(1) of the Act that each of the Respondents pay an administrative penalty of $300,000, to be allocated to or for the benefit of third parties in accordance with subsection 3.4(2)(b) of the Act;

(e) An order pursuant to clause 10 of subsection 127(1) of the Act that the Respondents jointly and severally disgorge to the Commission a total of $2,761,979 and US$319,597, to be designated for allocation to or for the benefit of third parties in accordance with subsection 3.4(2)(b) of the Act; and

(f) An order pursuant to section 127.1 of the Act that the Respondents pay, jointly and severally, investigation and hearing costs incurred in this matter in the amount of $363,146.87.

[9] Staff submits that the Respondents' conduct involved breaches of securities law which caused significant harm to investors in Ontario, and that the proposed sanctions are proportionate to the seriousness of the Respondents' misconduct and will serve as a specific and general deterrent. The breaches included unlawful trading, the illegal distribution of securities and conduct contrary to the public interest. Staff further submits that the Respondents' breached securities laws in multiple jurisdictions and failed to call any evidence suggesting they had a business purpose that did not involve breaking securities laws.

III. THE LAW

[10] When exercising its public interest jurisdiction under section 127 of the Act, the Commission must consider the purposes of the Act which, as set out in section 1.1 of the Act, are to (i) provide protection to investors from unfair, improper or fraudulent practices; and (ii) foster fair and efficient capital markets and confidence in the capital markets.

[11] In pursuing the purposes of the Act, subsection 2.1(2) of the Act requires that the Commission have regard to a number of fundamental principles including the following primary means for achieving the purposes of the Act:

i. requirements for timely, accurate and efficient disclosure of information,

ii. restrictions on fraudulent and 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.

[12] The sanctions imposed by the Commission must be protective and preventive to maintain high standards of behavior and to preserve the integrity of Ontario's capital markets. The role of the Commission is to impose sanctions that will protect investors and the capital markets from exposure to similar conduct in the future. As stated by the Commission in *Re Mithras Management Inc.,* (1990), 13 O.S.C.B. 1600 ("***Mithras***"):

> …the role of this Commission is to protect the public interest by removing from the capital markets -- wholly or partially, permanently or temporarily, as the circumstances may warrant -- those whose conduct in the past leads us to conclude that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct; that is the role of the courts, particularly under section 118 [now 122] of the Act. We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient. In so doing we must, of necessity, look to past conduct as a guide to what we believe a person's future conduct might reasonably be expected to be; we are not prescient, after all.[2] [Emphasis added.]

[13] As stated by the Supreme Court of Canada in *Committee for Equal Treatment of Asbestos Minority Shareholders v. Ontario Securities Commission*, [2001] 2 S.C.R. 132 ("***Asbestos***"), the Commission's public interest mandate is neither remedial nor punitive; instead, it is protective and preventive, and it is intended to prevent future harm to Ontario's capital markets.[3] More specifically, the Court stated that "[t]he role of the OSC under s. 127 is to protect the public interest by removing from the capital markets those whose past conduct is so abusive as to warrant apprehension of future conduct detrimental to the integrity of the capital markets."[4]

[14] The sanctions imposed must be appropriate and proportionate to the circumstances of the case and the conduct of the Respondents. The Commission has enumerated a number of factors that it considers in determining sanctions including the seriousness of the allegations, recognition of the seriousness of the improprieties, deterrence and whether there are any mitigating factors present in the case.[5] In exercising its discretion, the Commission should consider the protection of investors and the efficiency of, and public confidence in, capital markets generally.

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[2] *Mithras, supra* at paras. 1610 and 1611.
[3] *Asbestos, supra* at para. 42.
[4] *Asbestos, supra* at para. 43.
[5] For a non-exhaustive list of sanctioning factors that the Commission may consider, see *Re Belteco Holdings Inc.* (1998), 21 O.S.C.B. 7743 at 7746; *Re M.C.J.C. Holdings Inc.* (2002), 25 O.S.C.B. 1133 at 1136.

A. Application of the Factors

[15] Having regard to the factors referred to in paragraph [14] above, I consider the following to be of particular relevance to the Respondents:

1. The Seriousness of the Conduct

[16] The registration requirements found at section 25 of the Act are an essential element of the regulatory framework and serve as an important gate-keeping function to ensure that only properly qualified and suitable individuals are permitted to be registrants and to trade with or on behalf of the public.[6] The Respondents failed to comply with this fundamental requirement of Ontario securities law, thereby bypassing a crucial means by which investors in Ontario are protected.

[17] The delivery of a prospectus, as required by section 53 of the Act, ensures that prospective investors have sufficient information to ascertain the risk level of their investment and to make informed investment decisions. In failing to provide investors and potential investors with a prospectus and the information that such a prospectus would have included, the Respondents deprived investors of a critical source of information about the nature of the investment being made, the risk involved and a thorough explanation of the manner in which investor funds would be employed.

2. Respondents' Experience in the Marketplace

[18] None of the Respondents was registered with the Commission during the material time and there is no evidence that the Respondents engaged in any legitimate market activity. On the contrary, the Respondents' experience appears to be limited to activities of the type found to have breached the Act in this matter.

3. Mitigating Factors

[19] The Respondents did not participate in the Sanctions and Costs Hearing and, as a result, the Commission was not presented with any evidence of mitigating factors.

4. General and Specific Deterrence

[20] The Supreme Court of Canada has held that general and specific deterrence are appropriate considerations when determining orders that are prospective in nature (*Re Cartaway Resources Corp.*, [2004] 1 S.C.R. 672). General deterrence requires the imposition of sanctions that will send a strong message to other individuals inclined to engage in similar conduct, that this type of behaviour will result in serious consequences. Specific deterrence requires the imposition of sanctions that will discourage the Respondents from engaging in further misconduct.

[21] The conduct engaged in by the Respondents involved serious breaches of fundamental provisions of the Act. It is, therefore, the Commission's responsibility to sanction the Respondents in such a manner that carries out the purposes of the Act and the goals of both general and specific deterrence.

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[6] *Re Limelight Entertainment Inc.* (2008), 31 O.S.C.B. 1727 at para. 135.

B. **Previous Sanctions Decisions**

[22] Staff refers to a number of previous Commission decisions that Staff submits provide guidance as to the appropriate sanctions in this matter. Staff further submits that the previous decisions of the Commission support that the Respondents' misconduct warrants severe sanctions.

[23] In *Re Majestic Supply Co.* (2013), 36 O.S.C.B. 11642 ("***Majestic***"), the Commission held that permanent cease trade orders are warranted for parties involved in repeated illegal distributions over a prolonged period of time without being registered as such parties cannot be trusted to participate in the capital markets.

[24] Staff submits that *Re Al-Tar Energy Corp.* (2011), 34 O.S.C.B. 447 and *Re Richvale Resource Corp.* (2012), 35 O.S.C.B. 10699 should also be considered in light of the serious misconduct in this matter and that there is serious risk to the capital markets if the Respondents are not subjected to a permanent prohibition.

[25] Staff submits that the conduct of the Respondents was consistent with the factors that justify the imposition of administrative penalties established by the Commission in *Re Limelight Entertainment Inc.* (2008), 31 O.S.C.B. 12030 ("***Limelight***") and *Re Rowan* (2010), 33 O.S.C.B. 91 ("***Rowan***").

[26] Staff also submits that the Respondents' conduct also meets the test laid out by the Commission in *Limelight* for determining whether a disgorgement order is warranted.

[27] In *Limelight*, the Commission also enumerated the following non-exhaustive list of factors that should be considered when determining whether an order for disgorgement is appropriate:

(a) Whether an amount was obtained by a respondent as a result of non-compliance with the Act;

(b) The seriousness of the misconduct and the breaches of the Act and whether investors were seriously harmed;

(c) Whether the amount that a respondent obtained as a result of non-compliance with the Act is reasonably ascertainable;

(d) Whether the individuals who suffered losses are likely to be able to obtain redress; and

(e) The deterrent effect of a disgorgement order on the respondents and other market participants.

(*Limelight* at para 52.)

[28] *Limelight* goes on to state that, once Staff has proven on a balance of probabilities the amount illegally obtained by a respondent, the risk of uncertainty in calculating disgorgement should fall on the wrongdoer whose non-compliance with the Act gave rise to the uncertainty.

C. **Analysis and Findings**

[29] I find that the market bans requested by Staff are reasonable and appropriate in the circumstances. The Respondents breached multiple provisions of the Act designed to protect investors and provide them with confidence when investing in Ontario's capital markets and have failed to appear or make submissions with respect to their actions. As a result, in order to protect investors in Ontario, they must be banned permanently from trading in Ontario.

[30] Staff submits that the test for the imposition of administrative penalties against the Respondents has been met. In *Limelight* and *Rowan*, the Commission enumerated a number of factors that may be considered in determining an appropriate administrative penalty, including, the scope and seriousness of a respondent's misconduct, whether there were multiple and/or repeated breaches of the Act, whether the respondent realized any profit as a result of his or her misconduct, the amounts raised from investors, the harm caused to investors and the level of administrative penalties imposed in other cases.

[31] The evidence relating to the Respondents' conduct in relation to the foregoing factors leads me to conclude that an administrative penalty should form part of the sanctions in this matter.

[32] Staff requests that each of the Respondents pay an administrative penalty of $300,000. I find that such an amount is consistent with previous decisions of the Commission (see *Majestic*; *Re Ciccone* (2014), 37 O.S.C.B. 150; *Re Innovative Gifting Inc.* (2014), 37 O.S.C.B. 1461; and *Re M P Global Financial* (2011), 34 O.S.C.B. 8897) and will issue an order accordingly.

[33] Pursuant to clause 10 of subsection 127(1) of the Act, the Commission has the power to order the disgorgement of any amounts obtained as the result of non-compliance with the Act. Applying the factors described above in paragraph [27] and having regard to the fact that:

(a) All of the investor funds were raised as a result of the Respondents' unregistered trading and illegal distribution of securities;

(b) The Respondents' conduct was egregious and harmed investors;

(c) The Respondents obtained $5,061,979 and US$319,597, which Staff submits should be reduced by the amount the Respondents have already returned to investors in the form of production payments, namely, $1,000,000, and by the $1,300,000 amount that GWI has already been ordered to disgorge, for a total of $2,761,979 and US$319,597, respectively;

(d) Investors are unlikely to obtain redress for amounts invested and not already returned; and

(e) A disgorgement order against the Respondents would have a significant specific and general deterrent effect;

I find that it is appropriate to order that the Respondents disgorge a total of $2,761,979 and US$319,597 on a joint and several basis.

IV. COSTS

[34] Staff requests that the Respondents pay $363,146.87, on a joint and several basis, towards the costs of the hearing and the investigation. Staff filed a Bill of Costs that establishes that the total cost of the hearing and the investigation to be in excess of $700,000. Staff submits that the amount requested represents 50% of the costs incurred prior to the settlements with the Settling Respondents, and 100% of the costs accrued after the Settling Respondents settled.

[35] Section 127.1 of the Act gives the Commission the power to order a respondent to pay the costs of an investigation and hearing if it is satisfied that the person has breached the Act or has acted contrary to the public interest. A costs order is not a sanction but rather a means by which the Commission can recoup some of the costs expended during the hearing and investigation stages of a matter.

[36] Section 18.2 of the Commission's *Rules of Procedure* set out the factors the Commission may consider with respect to costs, including, the complexity of the proceedings, the importance of the issues and whether the Respondents participated in the proceeding.

[37] Staff submits that its approach to costs represents a conservative approach and that the amounts requested are fair and reasonable in the circumstances. I agree with Staff's submissions on costs and order the Respondents to pay the amounts sought by Staff.

V. CONCLUSION

[38] For the foregoing reasons, I will issue an order as follows:

(a) Pursuant to clause 2 of subsection 127(1) of the Act, trading in any securities by the Respondents shall cease permanently;

(b) Pursuant to clause 2.1 of subsection 127(1) of the Act, the acquisition of any securities by the Respondents shall cease permanently;

(c) Pursuant to clause 3 of subsection 127(1) of the Act, any exemptions contained in Ontario securities law do not apply to the Respondents permanently;

(d) Pursuant to clause 9 of subsection 127(1) of the Act, each of the Respondents shall pay an administrative penalty of $300,000, to be allocated to or for the benefit of third parties in accordance with subsection 3.4(2)(b) of the Act;

(e) Pursuant to clause 10 of subsection 127(1) of the Act, the Respondents shall jointly and severally disgorge to the Commission a total of $2,761,979 and US$319,597, to be designated for allocation to or for the benefit of third parties in accordance with subsection 3.4(2)(b) of the Act; and

(f) Pursuant to section 127.1 of the Act, the Respondents shall jointly and severally pay the investigation and hearing costs incurred in this matter in the amount of $363,146.87.

Dated at Toronto this 18th day of November, 2015.

"*Christopher Portner*"

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Christopher Portner