Ontario
Securities
Commission

Commission des
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IN THE MATTER OF
THE *SECURITIES ACT*, RSO 1990, c S.5

- AND -

IN THE MATTER OF A REQUEST FOR A HEARING AND REVIEW OF A DECISION OF A HEARING PANEL OF THE INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

- AND -

IN THE MATTER OF PAUL CHRISTOPHER DARRIGO

REASONS AND DECISION
(Sections 8 and 21.7 of the *Securities Act*)

Hearing:	May 11, 2016	
Decision:	June 9, 2016	
Panel:	Alan J. Lenczner, Q.C.	Commissioner and Chair of the Panel
Appearances:	Albert Pelletier	For Staff, Ontario Securities Commission
	Paul C. Darrigo	For himself, self-represented
	Robert DelFrate	For the Investment Industry Regulatory Organization of Canada

REASONS AND DECISION

I. OVERVIEW

[1] Paul Darrigo was a registered investment representative and regulated by the Investment Industry Regulatory Organization of Canada ("**IIROC**"). He applies for a hearing and review by the Ontario Securities Commission of a liability decision and a penalty decision of IIROC's Ontario District Hearing Panel.[1] After denying an adjournment requested by Darrigo at the liability hearing, IIROC found that: 1) transactions recommended by Darrigo caused unnecessary fees to clients and undue commissions to Darrigo; and 2) Darrigo's borrowing of funds from clients constituted conduct unbecoming. IIROC penalized Darrigo with a 12 month period of strict supervision upon any reregistration and a global total of $115,000, broken down by count as follows: 1) disgorgement of commissions of $50,000 and a fine of $10,000; and 2) disgorgement of the loan proceeds of $45,000 and a fine of $10,000.

II. ISSUES

[2] In this Application, the Commission must consider the appropriate standard of review and address the following issues:

a. Was the denial of Darrigo's requested adjournment a denial of procedural fairness justifying Commission intervention in IIROC's decisions?

b. Does the Application satisfy any of the grounds upon which the Commission may intervene in IIROC's (i) decision on liability; or (ii) penalty decision? Specifically:

   1. Did Darrigo's recommended transactions cause unnecessary fees to clients and undue commissions to Darrigo, outside the bounds of good business practice?
   2. Did Darrigo's borrowing from clients constitute conduct unbecoming?
   3. If Darrigo engaged in misconduct, were the penalties proportionate to his misconduct?

[3] Darrigo raised another issue in his submissions making allegations against his former dealer member employer, including failures in its supervision of him, compliance obligations during the transactions at issue and questionable motivations in the employer's conduct after his dismissal. Those allegations are irrelevant for the purposes of this Application and do not raise any issues for consideration by the Commission.

III. STANDARD OF REVIEW

[4] In an application for hearing and review of an IIROC decision, the Commission exercises original jurisdiction akin to a trial *de novo* (*i.e.*, a new trial or retrial). A hearing and review is broader in scope than an appeal; the Commission may also substitute its own decision for that of

[1] *Re Darrigo*, 2014 IIROC 48 and 2015 IIROC 03.

IIROC.[2] There are, however, only limited circumstances where the Commission will intervene to reverse an IIROC decision. Those are:[3]

a. the IIROC Panel proceeded on an incorrect principle;
b. the IIROC Panel erred in law;
c. the IIROC Panel overlooked material evidence;
d. new and compelling evidence is presented to the Commission that was not before the IIROC Panel; or
e. the IIROC Panel's perception of the public interest conflicts with that of the Commission.

[5] The Commission recognizes IIROC's specialized knowledge and gives deference to IIROC decisions within its area of expertise, including factual determinations and the interpretation and application of IIROC Dealer Member Rules.[4]

IV. ANALYSIS

A. Was the denial of the requested adjournment a denial of procedural fairness justifying Commission intervention?

[6] Darrigo contends that the Panel's wrongful denial of his last requested adjournment caused procedural unfairness. At the commencement of the IIROC liability hearing in September 2014, after several previous adjournments, Darrigo appeared and a brief adjournment was allowed for settlement discussions. The next day, after settlement discussions were unsuccessful, the liability hearing reconvened and Darrigo requested a further adjournment due to his medical condition, including depression and anxiety, though he provided no new medical evidence in support of his request. After hearing submissions from both parties on the issue, the Panel ruled that no further adjournment would be granted and that the hearing would proceed on the merits. The Panel advised Darrigo that he was entitled to participate, but Darrigo left the hearing, which proceeded in his absence.

Darrigo's previous pattern of adjournment requests

[7] Darrigo's September 2014 adjournment request was one of many adjournments he requested during the IIROC proceedings, the procedural history of which is fully detailed in the IIROC liability decision. IIROC commenced the disciplinary proceeding against Darrigo in September 2012 and Darrigo, through his then counsel, delivered a written response in February 2013. However, the merits of the IIROC proceeding were not heard until over two years after commencement. In large part, this was due to a pattern of Darrigo making last-minute requests for adjournments:

a. In October 2013, the Panel adjourned the hearing after receiving a letter from Darrigo's family doctor stating that a postponement would be advisable due to

[2] *Re McQuillan* (2014), 37 OSCB 8580 at paras 39-40.
[3] *Ibid*, at paras 41-42 citing *Re Canada Malting Co.* (1986), 9 OSCB 3565; See also *Re Kasman* (2009), 32 OSCB 5729 at paras 43-48.
[4] *Re Northern Securities Inc* (2014), 37 OSCB 161 at paras 54-61.

Darrigo's anxiety. The letter, which was provided immediately prior to the hearing, indicated that Darrigo would be reassessed in November 2013;

b. In November 2013, the Panel adjourned the hearing again to accommodate Darrigo, after receiving another letter from Darrigo's same family doctor, which stated that significant improvement of his condition was anticipated by January 2014. The family doctor also indicated that Darrigo had been advised to get psychotherapy and would be reassessed in January 2014;

c. In January 2014, Darrigo's counsel advised IIROC that Darrigo had been seeing a specialist and that a specialist's medical note was expected later that month. No such note was ever delivered;

d. After confirmation of a February 2014 hearing date, Darrigo's counsel provided a letter from Darrigo's same family doctor (*i.e.* not a specialist), stating that Darrigo had not shown enough improvement to participate in the hearing, and that he had again been referred to a psychologist and a psychiatrist. At the February 2014 hearing, where Darrigo was represented by counsel, the Panel ordered that a hearing would be scheduled for April 2014 to determine whether Darrigo was ready to proceed. If not, Darrigo was ordered to produce a report of a psychologist or psychiatrist stating that he was not fit to participate in the hearing. The Panel also ordered that, if the hearing was to proceed, it would take place in June 2014;

e. The April 2014 hearing was adjourned to June 2014. In June 2014, Darrigo attended before IIROC in person, but failed to provide the required medical report. Instead, Darrigo indicated he had met with a nursing specialist and was scheduled to see his family doctor in July 2014. The Panel reasserted the requirement for additional medical evidence and adjourned the hearing until September 2014 on a peremptory basis (*i.e.* the adjournment was granted on the basis that it would be the final adjournment);

f. In August 2014, Darrigo emailed a further adjournment request to IIROC Staff, stating that he was physically unable to attend a hearing in his condition and could not commit to any future hearing date. He indicated that he had an appointment with a psychologist scheduled for October 2014. The Panel determined that Darrigo's adjournment request would be addressed at the scheduled hearing in September 2014. IIROC also told Darrigo that the Panel would require medical evidence of Darrigo's condition.

Was the adjournment denial a failure of natural justice?

[8] Darrigo bore the onus to establish a proper evidentiary record for his adjournment request and he failed to do so, though his health had been at issue for many months and despite previous warnings from the Panel. From at least February 2014 until the liability hearing in September 2014, Darrigo knew that IIROC required substantiation of his medical claims in the form of a formal report from a medical specialist. Before the Commission, Darrigo argued that he was experiencing delays in the public health care system, which were out of his control, and that his impecuniosity prevented him from obtaining additional medical evidence through the private health care system. Throughout all previous adjournment requests prior to the liability hearing, the only medical evidence before the Panel was three letters from Darrigo's family doctor

indicating in general terms that he was suffering from anxiety and stress that prevented participation in the hearings. There were no letters or reports from specialists, despite indications that such specialists were being engaged and despite Panel requests for such evidence. Nor was there any proof of a course of treatment from a specialist. There was also no new medical evidence presented at the hearing of the Application before the Commission.

[9] IIROC recognized that it had to balance 1) the public interests in a timely hearing with 2) Darrigo's interests in knowing the case against him and having an opportunity to answer it. In balancing these considerations, the Panel noted that almost four years had passed since the alleged misconduct and two of IIROC's proposed witnesses were elderly. Meanwhile, there was no resolution in sight for Darrigo's alleged medical issues. In these circumstances, the Panel proceeded to hear the merits and did not err in denying Darrigo's further requested adjournment. The hearing could not be delayed indefinitely.

[10] Given Darrigo's non-attendance after his further adjournment was denied, the Panel was entitled to accept as proven the facts and allegations in the Notice of Hearing, according to the *IIROC Rules of Practice and Procedure*. Nonetheless, the Panel proceeded to hear the merits in a full and thorough evidentiary hearing conducted over three days. The Panel took considerable efforts to balance the interests affected by its proceedings. The Panel questioned IIROC Staff and the witnesses, including the IIROC Investigator and client investors, in order to ensure that Darrigo's position was protected to the extent possible. To that end, the Panel had the benefit of Darrigo's written pleading (which was prepared by his former counsel) and the transcript of Darrigo's interview during IIROC's investigation. A robust evidentiary record was available to the Panel despite Darrigo's absence during the liability hearing. Darrigo subsequently made both oral and written submissions at the penalty hearing, raising several of the arguments that he raises again before the Commission in this Application.

[11] The Commission finds that IIROC's liability hearing was consistent with the interests of natural justice, with no denial of procedural fairness. IIROC balanced the appropriate factors in determining whether the additional adjournment should be granted. The decision to deny the further adjournment reflected a judicious exercise of the Panel's discretion. It was not an error of law and the Panel did not proceed on an incorrect principle. There is no basis of procedural unfairness to support an intervention by the Commission.

B. Does the Application satisfy any of the grounds upon which the Commission may intervene in IIROC's Decisions?

[12] In its liability decision, IIROC found liability on two counts:

> Count 1: transactions recommended by Darrigo caused unnecessary fees to clients and undue commissions to Darrigo, outside the bounds of good business practice, breaching IIROC Dealer Member Rule 1300.1(o); and
>
> Count 2: Darrigo's borrowing from clients constituted conduct unbecoming, contrary to IIROC Dealer Member Rule 29.1.

[13] In this Application, Darrigo seeks Commission interference with the liability findings on both counts.

Were Darrigo's recommended transactions outside the bounds of good business practice?

[14] On count 1, IIROC found that Darrigo engaged in misconduct contrary to IIROC Rule 1300.1(o), which provides: "Each Dealer Member shall use due diligence to ensure that the acceptance of any order for any account is within the bounds of good business practice." Specifically, IIROC found that Darrigo conducted transactions in a manner that was to the clients' detriment from the standpoint of the deferred sales charge (DSC) fees paid and to Darrigo's own benefit in terms of commissions earned. Darrigo recommended the redemption of mutual funds that resulted in DSC fees, though some of those mutual funds had only been purchased a short time prior to redemption. In a number of instances, Darrigo then used the redemption proceeds to purchase similar mutual funds and, in some cases, funds consisting of the same underlying funds that had just been sold. IIROC found that, as a result of Darrigo's recommended transactions, "unnecessary" DSC fees were incurred by the clients and "undue" commissions were earned by Darrigo.

[15] Darrigo contends before the Commission that each impugned transaction was discussed with clients and authorization was granted. He says the DSC fees incurred were discussed with clients for every recommended transaction. The Panel considered this same argument after hearing *viva voce* testimony from several investors who said they were not aware of significant DSC fees. One investor testified that he did not realize DSC fees were involved and would not have approved transactions had he known. Another investor testified that he specifically instructed Darrigo not to undertake any transactions that would incur DSC fees. While Darrigo argued before the Commission that the IIROC investigation improperly misled and influenced client interviewees, resulting in confused and false client testimony before IIROC, it was within the Panel's discretion to weigh the investors' evidence on this issue and assess their credibility. The Panel reviewed Darrigo's investigation transcript on this very issue, questioned the investor witnesses, and applied its significant industry expertise, ultimately determining that, if Darrigo discussed DSC fees with clients, he did so only in a general way. With respect to each transaction, the Panel found that the clients did not know of or consent to paying DSC fees. There is no basis for the Commission to interfere with this finding.

[16] Before the Commission, Darrigo also argued that IIROC overlooked material evidence by not considering the overall performance of the client portfolios. He states that the client portfolios did not sustain losses, despite allegedly misleading figures submitted to the Panel by IIROC Staff. However, IIROC acknowledged this argument in the liability decision, which reflected that it was not the overall result achieved in the client accounts, but the process involved that was inappropriate. IIROC found that alternative means of accomplishing the same, or substantially the same, transactions would have been better for the clients from the standpoint of fees paid and would have achieved the same investment results. There is no basis for the Commission to find that the Panel overlooked material evidence about account performance in its findings on liability.

[17] Darrigo also submitted that the reasons for the impugned transactions were difficulties in the particularly unpredictable markets and that the transactions were ultimately in the best interests of clients, not for his own personal gain in commissions. Again, IIROC's liability decision recognized that using DSC-based mutual funds may be a legitimate investment choice in certain circumstances, but concluded that the repetitive and excessive use of DSC funds and

the inappropriate investment choices recommended by Darrigo amounted to a breach of his obligations to his clients. These findings are within IIROC's expertise, which the Commission finds was applied appropriately. There is no basis for the Commission to interfere with IIROC's liability finding on count 1.

Did Darrigo's borrowing from clients constitute conduct unbecoming?

[18] On count 2, IIROC found that Darrigo engaged in unbecoming conduct contrary to IIROC Rule 29.1 by borrowing from clients between October and December 2010. In two cases, Darrigo borrowed money from investors, allegedly for a short period of time, because he was in financial difficulties with his own dealer member firm and also to bridge the financing for the sale of his personal home.

[19] IIROC Rule 29.1 requires the observance of high standards of conduct and prohibits any business conduct that is unbecoming or detrimental to the public interest. At the time of the loans, it provided:[5]

> Dealer Members and each partner, Director, Officer, Supervisor, Registered Representative, Investment Representative and employee of a Dealer Member (i) shall observe high standards of ethics and conduct in the transaction of their business, (ii) **shall not engage in any business conduct or practice which is unbecoming or detrimental to the public interest**, and (iii) shall be of such character and business repute and have such experience and training as is consistent with the standards described in clauses (i) and (ii) or as may be prescribed by the Board. (emphasis added)

[20] Darrigo admitted borrowing funds from clients in his interview during the IIROC investigation, in his written pleading and again at the penalty hearing. He also admitted that he did not disclose to or seek approval from the dealer member prior to borrowing the funds. However, at the penalty hearing, Darrigo told the Panel that he thought borrowing from clients was allowed because it was not prohibited by a specific IIROC Rule, which rules he claims to have purposely reviewed before borrowing the funds. The Panel rejected the argument, noting that client borrowing is dealt with in the Conduct and Practices Handbook (the "**Handbook**"), as well as in prior cases published on the IIROC website.

[21] The Handbook sets standards of conduct. In 2010, the time of the loans, the Handbook provided the following standard of conduct relating to personal financial dealings with clients:

> Registrants should avoid personal financial dealings with clients, including the lending of money to or the borrowing of money from them…. Any personal financial or business dealings with any clients must be conducted in such a way as to avoid any real or perceived conflict of interest and must be disclosed in order that the situation be monitored.

[5] The language of IIROC Rule 29.1 remained the same throughout the relevant time. However, amendments took effect in December 2013, introducing a new Rule 43, which specifically addresses personal financial dealings with clients.

[22] The Handbook also set out procedures for compliance for personal financial dealings with clients, including: "Any proposed financial relationship with a client should be reviewed with an appropriate official, such as the head of compliance, who must give approval to the relationship and monitor the situation."

[23] The Handbook's stated purpose for this standard of conduct is to prevent the creation of conflicts of interest that may arise when a registrant enters into financial dealings with clients. Borrowing from clients can create fundamental conflicts of interest in that the investment advisor is both a borrower from, and an advisor to, the clients. In such transactions, investment advisers may take advantage of their knowledge of clients' financial circumstances, gained through their professional relationships with the clients, thereby using their professional relationships for their own personal benefit. By borrowing funds, investment advisers also prevent clients from taking advantage of any superior investment opportunities that might arise.

[24] The Handbook clarifies that there is not an absolute prohibition against borrowing because there may be some circumstances where such dealings are not objectionable (*i.e.* where there is a close, pre-existing relationship, or family relationship between the registrant and client, such dealings may not be objectionable, depending on the circumstances). But the Handbook is also clear that any such dealing should not be entered into without the knowledge and approval of the dealer member, to ensure that client interests are fully protected. Further, IIROC panels have a history of finding that borrowing from clients without the knowledge or consent of the dealer member constitutes conduct unbecoming, contrary to IIROC Rule 29.1.[6]

[25] Before the Commission, Darrigo argued once again that there should be no liability for borrowing from clients in light of the absence of an express IIROC Rule. The Commission agrees that there was no clear IIROC Rule against borrowing from clients at the time of the loans in question, and even the Handbook's standard was not an absolute prohibition, rather only a caution and a disclosure requirement. But Darrigo was an 18-year veteran of the investment industry who was borrowing money from clients due to his own personal, difficult financial circumstances.[7] Part of the explanation why Darrigo did not clear these borrowings with his employer is that he was, in one instance, borrowing money to pay amounts owed to his employer. Darrigo counselled clients to redeem dealer member investments (held with his employer) in order to obtain the loan funds. He obtained loans from clients without his employer's knowledge or consent and, as set out in the Handbook, the loans were an apparent conflict of interest. Darrigo never repaid the loans. He ought to have known that his conduct was not appropriate, even in the absence of an express IIROC Rule.

[26] The Commission does not find that IIROC proceeded on an incorrect principle or erred in law in its finding that Darrigo engaged in unbecoming business conduct. The Panel was acting within its area of expertise to interpret and apply IIROC Rule 29.1 to establish appropriate standards of conduct for its own industry. There is no basis for the Commission to interfere with the resulting liability finding on count 2.

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[6] At the liability hearing, IIROC was referred to *Re Evans*, [2007] I.D.A.C.D No. 53, *Re Dass*, 2009 IIROC 22 and *Re Hackett*, 2010 IIROC 5.

[7] IIROC found that Darrigo had been experiencing financial difficulties prior to the transactions in question and several cheques he had written to his employer had been returned "non-sufficient funds".

Were the penalties proportionate?

[27] Finally, the Commission must consider Darrigo's request for a reduction of IIROC's imposed penalties. IIROC penalized Darrigo with a 12 month period of strict supervision upon any reregistration and a global total of $115,000, broken down by count:

Count 1: disgorgement of commissions of $50,000 and a fine of $10,000; and

Count 2: disgorgement of the loan proceeds of $45,000 and a fine of $10,000.

[28] In coming to its decision on the appropriate penalty for count 1, the Panel took into account as a mitigating factor that some of the investment recommendations may have been legitimate and appropriate investment decisions, as argued by Darrigo at the penalty hearing. Notably, IIROC Staff's requested commission disgorgement of $69,170 was reduced by the Panel to $50,000. Though Darrigo alleged that the Panel improperly accepted IIROC Staff misrepresentations of the actual commissions earned, the Panel heard Darrigo's argument on this issue at the penalty hearing and there is no basis to find that IIROC overlooked material evidence in calculating this penalty.

[29] In Darrigo's case, IIROC ordered minimal penalties, relative to those set out in the IIROC *Dealer Member Disciplinary Sanction Guidelines* (the "**Guidelines**"), which the Panel considered expressly. While the Guidelines were not binding on the Panel, they offer a touchstone to assess an appropriate penalty.[8]

[30] For breaches of Rule 1300.1(o), as in count 1, the Panel found the Guidelines on penalties for actions commonly known as "churning" to be instructive. In those cases, the Guidelines recommend a minimum fine of $20,000, disgorgement of profits, a rewrite of the Handbook, a minimum of 12 months close or strict supervision and a period of suspension in egregious cases.

[31] The Guidelines also address undisclosed personal business with clients contrary to Rule 29.1, as in count 2, expressly including the breach of borrowing from a client without firm knowledge or consent. For such breaches, the Guidelines recommend sanctions including a minimum fine of $10,000, disgorgement of commissions earned as a result of impugned transactions, and a period of close supervision for 12 to 24 months, along with other penalties.

[32] Penalties imposed on Darrigo by IIROC were proportionate, made in accordance with the Guidelines, and not based on an error of law. The Panel did not proceed on an incorrect principle. There is no basis for the Commission to intervene in IIROC's penalty decision.

[8] *Re Gareau*, [2005] IDACD No 25 at para 52.

V. ORDER

[33] None of the circumstances permitting Commission intervention in an IIROC decision apply to the facts of this case. The Application for hearing and review is hereby dismissed.

DATED at Toronto this 9th day of June, 2016.

"Alan J. Lenczner"

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Alan J. Lenczner, Q.C.