



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 NEST ACQUISITIONS AND MERGERS,
IMG INTERNATIONAL INC., CAROLINE MYRIAM FRAYSSIGNES,
DAVID PAUL PELCOWITZ, MICHAEL SMITH, and
ROBERT PATRICK ZUK**

REASONS AND DECISION (Section 127 of the *Securities Act*)

Hearing: May 16-18, 23-25, 2012
June 4, 6, 20, 2012
August 29, 2012
October 22, 24-25, 29, 2012
November 12, 2012
January 15, 2013

Decision: April 26, 2013

Panel: James D. Carnwath, Q.C.
Margot C. Howard, CFA

- Commissioner and Chair of the Panel
- Commissioner

Appearances: Cullen Price
Carlo Rossi

- For Staff of the Commission

Graham Pinos

- For David Pelcovitz, on the record, but did not appear

Unrepresented

- For Robert Zuk, Michael Smith,
Caroline Frayssignes, Nest Acquisitions
and Mergers, IMG International Inc.

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PART I - INTRODUCTION

A. Nature of the Hearing

[1] This was a hearing on the merits (the “**Hearing**”) before the Ontario Securities Commission (the “**Commission**”) in connection with the statement of allegations filed by Staff of the Commission (“**Staff**”) dated January 18, 2010 against Nest Acquisitions and Mergers (“**Nest A&M**”) and IMG International Inc. (“**IMG**”), David Paul Pelcowitz (“**Pelcowitz**”), Michael Smith (“**Smith**”), Caroline Myriam Frayssignes (“**Frayssignes**”) and Robert Patrick Zuk (“**Zuk**”).

[2] The Hearing began on May 16, 2012 and continued periodically thereafter until January 15, 2013. On December 5, 2012, the Commission approved a settlement agreement entered into by Staff and Zuk (*Re Nest Acquisitions and Mergers et al.* (2012), 35 O.S.C.B. 11186).

[3] On December 6, 2012, Staff withdrew the allegations against Frayssignes.

[4] These reasons and decision relate to the allegations remaining against Nest A&M, IMG, Smith and Pelcowitz (the “**Respondents**”).

[5] We are satisfied that Pelcowitz and IMG received notice of this proceeding and therefore we were entitled to proceed with the hearing in their absence, in accordance with subsection 7(1) of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, as amended (the “**SPPA**”) and Rule 7.1 of the Commission’s *Rules of Procedure* (2012), 35 O.S.C.B. 10071 (the “**Rules of Procedure**”).

B. Staff’s Allegations

[6] Staff allege that between August 14, 2008 and June 11, 2009 (the “**Material Time**”):

- (a) The Respondents traded in securities without being registered to trade in securities and in circumstances where no exemptions were available to them contrary to subsection 25(1)(a) of the *Securities Act*, R.S.O. 1990 c. S.5, as amended (the “*Act*”);
- (b) The Respondents have, directly or indirectly, engaged or participated in acts, practices or a course of conduct relating to securities that they knew or reasonably ought to have known would perpetrate a fraud contrary to subsection 126.1(b) of the *Act*;
- (c) Smith, being the sole director and officer of IMG, authorized, permitted or acquiesced in the commission of the violations of section 25 and 126.1 of the *Act* by or on behalf of IMG, pursuant to s. 129.2 of the *Act*; and
- (d) The Respondents have engaged in conduct contrary to the public interest.

C. The Alleged Advance Fee Scam

[7] Staff alleges that during the Material Time persons describing themselves as representatives of IMG and Nest A&M contacted residents of the United Kingdom (“U.K.) for the purpose of inducing them to make various payments as part of a fraudulent advance fee scheme. The scheme involved artificial offers by Nest A&M or IMG to purchase shares owned by the U.K. residents at inflated prices. As part of the sales pitch, purported representatives of Nest A&M and IMG told the U.K. residents they would have to pay advance fees in order to complete the transactions and receive the promised purchase price. The advance fee payments were described as necessary to guarantee the transactions and included payments to cover such things as “performance bonds” and “non-resident taxes”. The U.K. residents were instructed to send the requested funds to two Ontario bank accounts, either to IMG (the “**IMG Account**”) or to Nest (the “**Nest Account**”).

[8] Staff alleged that Pelcowitz was actively involved in the solicitations. He purportedly sent the U.K. residents documents by courier and fax in furtherance of the advance fee scheme and controlled one of the bank accounts that received funds from the U.K. residents.

[9] None of Nest A&M, IMG, Pelcowitz or Smith were registered to trade in securities. The promised transactions never took place and the U.K. funds sent by investors were misappropriated.

D. The Major Players

(i) *Pelcowitz*

[10] Pelcowitz is a resident of Ontario and a former registrant of the Commission. He also impersonated Smith to open the IMG Account at Parama Lithuanian Credit Union (“**Parama**”). Evidence established that he impersonated Smith in a voicemail left for Staff during the investigation.

(ii) *Smith*

[11] Smith appears in the incorporation documents for IMG as president and sole director. The panel finds that Staff has failed to prove on the balance of probabilities that Michael Smith was a real person. The rationale for this conclusion is developed later in these reasons.

(iii) *IMG*

[12] IMG is an Ontario company incorporated in June 2008. IMG purported to be engaged in trading securities, including facilitating sales of securities.

(iv) *Nest A&M*

[13] Nest A&M has been described in Staff’s submissions as a fictitious entity which purported to be engaged in trading securities. The panel finds that Staff has failed to prove on a balance of probabilities that Nest A&M was an existing entity. The rationale for this conclusion is developed later in these reasons.

(v) Zuk and Frayssignes

[14] Zuk was previously a registrant of the Commission. He and Frayssignes lived together. Frayssignes registered the business name “Nest” as a sole proprietorship and opened a bank account for Nest at the Royal Bank of Canada (“RBC”). U.K. residents were directed to forward funds to the Nest Account. Zuk exercised his signing authority over the Nest Account to transfer funds to Pelcowitz after deducting a certain percentage for his services.

PART II - THE EVIDENCE

[15] To assist the reader to follow and understand the evidence, specific documents in a Hearing Brief will be referred to as “Ex. -, H.B. -, Tab -, p. –”. Documents not included in the Hearing Briefs will be referred to as “Ex. –”. Excerpts from transcripts of the evidence will be referenced as “Tr. Vol. -, p. -, l. –”.

[16] To protect the privacy of investor witnesses, we have referred to them anonymously by initials, rather than using their respective names.

A. The Solicitations

(i) A.D.

[17] A.D. is a U.K. resident who was solicited by someone purporting to represent IMG. His evidence may be found in Tr. Vol. 2, pp. 6-59. A.D. testified by video conference from Scotland.

[18] A.D. had purchased 11,850 shares in a company called Evolution Global Capital Partners Inc. He received a telephone call from someone who purported to be “Paul Morgan” who said he represented IMG. In a second call, A.D. was told that IMG was prepared to pay £6.00 per share for A.D.’s holding. He then learned that he would be required to forward £6,135 to IMG as a “performance bond”.

[19] A.D. received instructions from a “Mr. James” to forward the performance bond to the IMG Account in Toronto, which he did. Shortly thereafter, “Mr. James” called again to say that another £2,500 was needed. A.D. reluctantly forwarded a further £2,500 to the IMG Account. A.D. received a further call asking for £10,000 and, unfortunately, A.D. borrowed a further £9,338 from his family and forwarded that sum to the IMG Account.

[20] Needless to say, A.D. never heard back from “Gordon James”, “Paul Morgan” or IMG.

(ii) L.E.

[21] L.E. testified before the panel by way of video conference from South Hampton, England. Her evidence may be found in Tr. Vol. 2, pp. 38-59.

[22] L.E. received a phone call from a “Mr. Gordon James” on behalf of Nest A&M in March 2009. “Mr. James” said he was acting on behalf of Nest A&M who in turn was working for Exxon Mobile to purchase shares in a company in which L.E. had invested, called Royal

Petroleum Company. She paid approximately £4,000 or about £0.01 per share for her holdings. “Mr. James” said Exxon Mobile was willing to pay £5.00 a share for her shares, which amounted to £118,000. L.E. was asked to forward £5,900 by way of a “goodwill bond” that Exxon required as indication of good faith that she would sell the shares. L.E. forwarded £5,900 to the Nest Account by wire transfer.

[23] Subsequently, L.E. telephoned “Mr. James” at the number that appeared on Nest A&M’s letterhead. The address on the letterhead was in Kingstown, St. Vincent in the Grenadines.

[24] L.E. then learned from “Mr. James” that Canadian tax laws required her to pay a further sum of around £5,000 to release the money. L.E. told “Mr. James” she didn’t have the money and that was the last she heard from him. L.E. never received a return of her £5,900.

(iii) T.C.

[25] T.C. was a resident Norwich, U.K. He testified by way of video conference and his evidence can be found in Tr. Vol. 3, pp. 6-30.

[26] T.C. retired from the water distribution industry and had little experience with investments. He held some shares in a Canadian pharmaceutical company named Pharma Holdings that he purchased several years ago. He received a letter from IMG and a few days later was called by someone purporting to be “Edward Kelly”. The letter from IMG had pointed out the pharmaceutical shares had undergone a three-for-one forward split and that T.C.’s holding was 4,900 shares. “Mr. Kelly” confirmed to T.C. that IMG was prepared to pay £176,400 for his shares in Pharma Holdings but that various taxes required T.C. to forward £4,900 to the IMG Account. T.C. sent the money.

[27] “Mr. Kelly” called T.C. again to say that Parama was no longer dealing with the business and that his £4,900 would be returned to him. T.C. was told the transactions would be carried out by the RBC and a company known as Nest A&M would be handling the business. Indeed, the sum of £4,756 was returned to T.C. from the IMG Account.

[28] “Mr. Kelly” rang several times in the next few days to the effect that a fully refundable sum of £7,419 needed to be sent to the credit of Nest A&M by wiring the amount to the Nest Account.

[29] There followed several conversations initiated by “Mr. Kelly” that resulted in T.C. making a total of five payments to Nest Account totalling approximately £34,820.

[30] T.C. never received the £178,400 that were promised to him by “Mr. Kelly”. However, he did receive from the Nest Account £4,701 approximately after “Mr. Kelly” told him the transaction had fallen through and that he would get all his money back. This amount of £4,701 was all he received. His total loss was £31,000 which T.C. described as “virtually all our life’s savings” (Tr. Vol. 3, p. 26).

B. The Bank Accounts

[31] U.K. investors were instructed to forward the sums demanded by IMG and Nest A&M to one of two bank accounts. The evidence respecting those bank accounts was led through Albert Ciorma, a forensic accountant employed by the Commission. Mr. Ciorma's evidence may be found in Tr. Vol. 4, pp. 72-146, Tr. Vol. 5, pp. 27-82 and Tr. Vol. 6, pp. 33-116.

[32] Mr. Ciorma identified H.B. Vol. 2 as containing the banking records of account number 16367Cdn, held at Parama in the name of IMG. Mr. Ciorma identified H.B. Vol. 3 as containing the banking records for account number 101-895-1Cdn held at RBC in the name of Nest. Mr. Ciorma's analysis of both accounts was filed as Ex. 38.

C. The IMG Account

[33] Staff obtained a corporation profile report showing IMG International Inc. as having been incorporated on June 17, 2008 and showing Micheal Smith of Waterdown, Ontario as treasurer. Staff made inquiries at the noted address and learned that the occupant was one A.S. who knew nothing about IMG or Michael Smith.

[34] Staff submits that Pelcowitz opened the account at Parama in the name of IMG, using a fake drivers licence in the name of Michael Smith on which appears a picture of Pelcowitz. We agree with this submission. Zuk called Pelcowitz as a witness. His testimony may be found in Tr. Vol. 8, pp. 10-152. In cross-examination, Mr. Pelcowitz testified that he set up the Parama account for IMG and that he signed the opening bank documents as M. Smith. He did not tell the bank his real name and presented himself as Michael Smith and provided the bank with a drivers licence with his photo on it in the name of Michael Smith (H.B. Vol. 9, Tab 4, p. 30). Pelcowitz had sole signing authority for the IMG Account which he opened in the name of Michael Smith.

[35] Mr. Ciorma did a bank account analysis of the IMG Account detailing the source and application of funds (Ex. 38, Tab 1, sub-Tabs A, B and C). Of the total \$642,922.14 deposited in the IMG Account, a sum of \$641,333.98 came from U.K. investors (Ex. 38, Tab 1, sub-Tab A).

[36] The application of the funds in the IMG Account, as determined by Mr. Ciorma, may be found in Ex. 38, Tab 1, sub-Tab B. Mr. Ciorma and Pelcowitz were able to expand on the entries in the application of funds which identified persons to whom Pelcowitz transferred funds, including:

- (a) B.G. (\$13,760) – Mr. G worked for a “call center” that Pelcowitz operated involving MD Lands;
- (b) Cash (\$164,913.50) – Mr. Ciorma identified these transactions as Interac withdrawals from a bank machine and received by Pelcowitz for his own use;
- (c) D.M.O. PLC (\$123,917) – Mr. O assisted Pelcowitz in transferring \$47,666 to some U.K. investors by way of partial repayment. The evidence is unclear as to what Mr. O did with the balance of \$76,251;

- (d) David Pelcowitz (\$67,654) – These funds were received by Pelcowitz for his own use;
- (e) K.B. (\$20,250) – Mr. Ciorma identified Mr. B as someone who worked for MD Lands and made phone calls on its behalf;
- (f) Miscellaneous and personal expenses (\$15,409) – Mr. Ciorma identified this entry as recording personal expenses of Pelcowitz;
- (g) R. P. (\$12,700) – Pelcowitz confirmed that R. P. was his brother to whom Pelcowitz owed money;
- (h) Zuk (\$26,779) – Pelcowitz testified that these sums were cashed by Zuk and transferred to Pelcowitz, less a percentage ranging from 10 to 20 %. This arrangement was done to conceal Pelcowitz’s receipt of U.K. investor funds; and
- (i) Thornhill Drycleaners (C.B.) (\$65,900) – According to Pelcowitz, C.B. was performing the same service as did Zuk to facilitate Pelcowitz’s receipt of U.K. investor funds (Tr. Vol. 8, p. 32, ll. 12-15).

D. The Nest Bank Account

[37] Frayssignes registered the business name “Nest” as a sole proprietorship on June 9, 2003. The mailing address for Nest was in Oakville, Ontario, the address where Frayssignes lived with Zuk (H.B. Vol. 10, Tab 1).

[38] U.K. residents who were persuaded to respond to a proposal made by Nest A&M were instructed to send the required payments of good faith and otherwise to the Nest Account earlier identified in these reasons. Mr. Ciorma used the banking records for the Nest Account found in H.B. Vol. 3, Tabs A-F and proceeded to prepare a source and application of funds for the Nest Account (Ex. 38, Tab 2, sub-Tabs A-C). Of the \$419,137.20 deposited in the Nest Account, a sum of \$366,234.42 came from U.K. investors.

[39] Mr. Ciorma noted the following significant transfers from the Nest Account:

- (a) The S. family (\$33,553.70) – Mr. D.S. was a business associate of Zuk.
- (b) Frayssignes (\$163,662.89) – This amount was transferred to Frayssignes for her personal use; and
- (c) Cash (\$34,568.50) – Some transfers were cash withdrawals from automatic bank machines and other withdrawals were cheques made to cash. Some amounts were transferred to credit cards; Mr. Ciorma fairly conceded these might have been in favour of persons other than Frayssignes;

- (d) Personal (\$27,131.30) – These withdrawals reflected store purchases and other personal expenses such as construction and furniture. These withdrawals were for the personal use of Frayssignes as she decided.

E. David Pelcowitz

[40] Pelcowitz is a resident of Toronto, Ontario. Called as a witness by Zuk, before Zuk settled with the Commission, his evidence is found in Tr. Vol. 8, pp. 10-152. At one time he was a registrant under the *Act*, having been registered with the Commission as a salesperson, trading officer, supervisory procedures officer and director. He testified that he was formerly the president of a registrant, Chartwell Securities (Tr. Vol. 8, pp. 72-74).

[41] During the Material Time, Pelcowitz was involved in setting up a call centre to phone individuals in Canada to solicit sales of securities in a company called MD Lands. He bought a list of names of potential investors but insisted he could not remember how or from whom (Tr. Vol. 8, pp. 82-87).

[42] Pelcowitz sent correspondence on behalf of IMG and Nest A&M to the U.K. residents via UPS and fax. On various UPS shipping orders, Pelcowitz wrote that the shipper was “Gordon James” and on others he wrote “PM” (Tr. Vol. 8, pp. 58-59 and 98-99).

[43] Pelcowitz testified that the addresses he wrote on the various UPS shipping orders – “Murray’s Road” and “8 Silver Ave” – were fake and that he put the name of “Gordon James” as the shipper because he wanted to conceal his identity (Tr. Vol. 8, pp. 23, 90 and 91).

[44] Pelcowitz testified Smith instructed him in relation to the solicitations of the U.K. residents for IMG and Nest A&M. He said he met Smith in coffee shops or parking lots as often as twice a week. He said further he did not know Smith’s address or how to get in touch with him (Tr. Vol. 8, pp. 67-68 and 108).

[45] Pelcowitz acknowledged that he and Zuk exchanged text messages upon Zuk’s receipt of wire transfers from U.K. residents to the Nest Account. Zuk would arrange to meet Pelcowitz at various locations, and pay Pelcowitz the proceeds of those transfers, less Zuk’s retention of his percentage share (Tr. Vol. 8, pp. 132-139).

[46] It is virtually certain that Pelcowitz had access to the IMG email account that was used to solicit U.K. residents. Pelcowitz admitted it was his voice in a voice email message transmitted to Staff and that he was impersonating Smith in that message. Following receipt of the voicemail from Pelcowitz (Ex. 41, H.B. Vol. 9, Tab 5, CD), Staff received an email from the IMG “gmail” account, which purported to correct an error in the voicemail left by Pelcowitz with Staff. The email is signed by Smith and states “I have recited an incorrect email address ...” (Ex. 41, H.B. Vol. 9, Tab 4, p. 33) Pelcowitz did not deny he had access to the IMG email account but rather testified that he could not “recall if I ever had access to the email account” and that he “did not remember doing any emails” (Tr. Vol. 8, pp. 114-118).

[47] Pelcowitz arranged with Zuk to have funds from the U.K. residents wired into the Nest Account (Tr. Vol. 8, pp. 18-20).

PART III - THE APPLICABLE LAW

A. The Appropriate Standard of Proof

[48] The standard of proof in this hearing is the civil standard of proof on a balance of probabilities. The evidence presented must be sufficiently clear, convincing and cogent (*F.H. v. McDougall*, [2008] 3 S.C.R. 41 at paras. 46 and 49).

B. Use of Hearsay Evidence

[49] The Commission may admit hearsay evidence pursuant to subsection 15(1) of the *SPPA*.

[50] Staff tendered the direct evidence of three of the U.K. residents. For the balance of the U.K. residents, Staff tendered hearsay evidence related to approximately 30 others, who were contacted by Staff or whose information was otherwise provided to Staff.

[51] The Commission may rely on hearsay evidence where it is corroborative and consistent. As was the case in *Sunwide*, the hearsay evidence related to the balance of the U.K. residents not called as witnesses by Staff is substantially consistent (accepting for minor variations) and corroborative of the direct evidence (*Re Sunwide Finance Inc.* (2009), 32 O.S.C.B. 4671 (“*Sunwide*”) at paras. 19-25).

C. Securities Act Fraud

[52] Subsection 126.1(b) of the *Act* prohibits anyone “directly or indirectly” from engaging in “any act, practice or course of conduct relating to securities, derivatives or the underlying interest of a derivative” which the person or company “knows or reasonably ought to know... perpetrates a fraud on any person or company”.

[53] In previous decisions, the Commission has referred to the legal test for fraud set out in the leading case of *Thérioux*, where McLachlin J. (as she then was) summarized the elements of fraud:

... the actus reus of the offence of fraud will be established by proof of:

1. the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and
2. deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim's pecuniary interests at risk.

Correspondingly, the mens rea of fraud is established by proof of:

1. subjective knowledge of the prohibited act; and
2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may

consist in knowledge that the victim's pecuniary interests are put at risk).

(*R. v. Thérioux*, [1993] 2 S.C.R. 5 (“*Thérioux*”), at para. 27; appl. in *Re Al-Tar Energy Corp.* (2010), 33 O.S.C.B. 5535 (“*Al-Tar*”), at paras. 216-221)

[54] For a corporation, it is sufficient to show that its directing minds knew or reasonably ought to have known that the corporation perpetrated a fraud to prove a breach of subsection 126.1(b) of the *Act* (*Al-Tar*, above at para. 221).

(i) **The *actus reus* of Fraud**

[55] As noted above, the *actus reus* of the offence of fraud is established upon proof of two essential elements: a prohibited act and deprivation (*Thérioux*, above at para. 16).

[56] The first element, the prohibited act, is established by proof of deceit, falsehood, or “other fraudulent means.” The second element, deprivation, is established by proof of detriment, prejudice, or risk of prejudice to the economic interests of the victim, caused by the dishonest act (*Thérioux*, above at para. 16 and 27).

[57] In order to find fraud by deceit or by falsehood, “all that need[s] to be determined is whether the accused, as a matter of fact, represented that a situation was of a certain character, when, in reality, it was not” (*Thérioux*, above at para. 16).

[58] The third category of dishonesty, “other fraudulent means,” encompasses all other means other than by deceit or falsehood, which can be properly stigmatized as dishonest. In considering “other fraudulent means”, the Supreme Court of Canada has held that the issue is “determined objectively, by reference to what a reasonable person would consider to be a dishonest act” (*Thérioux*, above at para. 17). It connotes an underhanded design, which has the effect, or which engenders the risk, of depriving others of what is theirs. The dishonesty lies in the wrongful use of something in which another person has an interest, in such a manner that this other’s interest is extinguished or put at risk. The use of wrongful in this sense if it constitutes conduct which reasonable decent persons would consider dishonest and unscrupulous.

[59] Within the meaning of “other fraudulent means,” courts have included the non-disclosure of important facts, the unauthorized diversion of funds and the unauthorized arrogation of funds or property (*Thérioux*, above at para. 18).

[60] The second essential element of the *actus reus* of fraud, deprivation, is satisfied on proof of:

- (a) actual loss to the victim;
- (b) prejudice to a victim’s economic interest; or
- (c) the risk of prejudice to the economic interests of a victim.

(*Thérioux*, above at para. 16)

(ii) The *Mens Rea* of Fraud

[61] The requisite mental elements of proof for the offence of fraud the *mens rea* is established by proof of:

1. subjective knowledge of the prohibited act; and
2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim's pecuniary interests are put at risk).

(*Thérioux*, above at para. 27)

[62] This subjective awareness can be inferred from the totality of the evidence; direct evidence as to the accused's specific beliefs at the time of the fraudulent acts is not required (*Thérioux*, above at paras. 23 and 29).

[63] This subjective awareness of the accused may also be established by evidence showing that the accused was reckless as to the consequences of his or her conduct and the truth or falsity of their statements (*Thérioux*, above at paras. 26 and 28).

D. Section 25 – Trading in Securities Without Registration

[64] Prior to September 28, 2009, and therefore during the Material Time, subsection 25(1)(a) of the *Act* provided that no person or company shall trade in a security unless that person is registered with the Commission as a dealer, or as a salesperson, partner, or officer of a registered dealer:

25.(1) Registration for trading – 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 a 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.

(*Securities Act*, above, s. 25(1)(a))

[65] The definition of "trade" or "trading" as defined in section 1(1) of the *Act* 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 [...]

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

[66] In *Sunwide*, the Commission held that, although a purchase of a security is expressly excluded from the definition of “trade” in the *Act*, when a respondent solicited the sale of shares and made various misrepresentations to induce the sale, those actions constituted acts in furtherance of a trade. The Commission stated as follows:

The transactions solicited by Sunwide ultimately purported to involve a purchase by Sunwide or its client of outstanding shares, including the warrant shares that were to be issued pursuant to the exercise of the warrants. In our view, the actions of Sunwide and its representatives involved a solicitation of the sale of the relevant shares and the making of various misrepresentations to induce those sales. Those actions constitute acts in furtherance of a trade and not the mere purchase of a security.

(*Sunwide*, above at para. 48)

[67] In *Lehman Brothers*, the Commission dealing with a substantially similar advance-fee scheme, followed the reasoning in *Sunwide* with respect to “acts in furtherance of trades (*Re Lehman Brothers & Associates Corp.* (2011), 34 O.S.C.B. 12717 (“**Lehman Brothers**”) at para. 81).

[68] Further, it is not necessary for there to be a completed trade in order for someone to be trading in a security. An act in furtherance of a trade is itself a trade for the purposes of the *Act* (*Sunwide*, above at para. 45; *Lehman Brothers*, above at para. 82).

E. Director and Officer Liability

[69] Section 129.2 of the *Act* provides:

129.2 Directors and officers - For the purposes of this Act, if a company or a person other than an individual has not complied with the 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.

PART IV – ANALYSIS

(a) Pelcowitz and IMG

[70] We find Pelcowitz committed fraud contrary to subsection 126.1(b) of the *Act*. Evidence of the *actus reus* of fraud includes:

- (a) Pelcowitz and/or IMG made deceitful or false representations to U.K. investors suggesting he or IMG had a purchaser for the shares owned by

- U.K. residents at a substantial premium; promising to refund performance deposits; and providing that funds transferred to IMG and Nest would be used to complete the share purchase;
- (b) Pelcowitz controlled the IMG Account and arranged with Zuk to gain access to the funds transferred to the Nest Account. He diverted approximately \$1 million to purposes other than promised to the U.K. investors; and
 - (c) Pelcowitz was instrumental in diverting U.K. investor funds from their intended use and thereby depriving them of their funds.

[71] Evidence of the *mens rea* of Pelcowitz's fraud include:

- (a) He used false identification to open the IMG Account to which he had sole access;
- (b) Pelcowitz issued IMG cheques to Zuk and others (signed by "Michael Smith"), which those others cashed and then returned the funds to Pelcowitz;
- (c) Pelcowitz sent courier packages to U.K. investors under false names, which he did, he testified, to conceal his identity; and
- (d) As an experienced registrant, he either knew directly of the prohibited acts or was reckless to their existence. He ought to have known of the fraud.

[72] We find Pelcowitz to have been the directing mind of IMG. Indeed, insofar as the actions of IMG are concerned, Pelcowitz was IMG. The actions and mental element described above apply equally to IMG. IMG, as controlled and directed by Pelcowitz, committed fraud contrary to subsection 126.1(b) of the *Act*.

[73] Pelcowitz and IMG acted in furtherance of a trade in connection with the purported sale of the various securities, including:

- (a) Pelcowitz couriered packages to U.K. residents containing details of the purported transactions and discussions;
- (b) Pelcowitz set up the IMG Account and arranged for the use of the Nest Account; and
- (c) Pelcowitz arranged for receiving funds into the IMG Account.

[74] Neither Pelcowitz nor IMG were registered with the Commission as required during the Material Time. Pelcowitz and IMG breached subsection 25(1)(a) of the *Act*.

(b) Michael Smith

[75] Staff submits that Smith has contravened the *Act* in at least two ways and is liable pursuant to section 129.2 of the *Act*. The onus is on Staff to prove on the balance of probabilities that Michael Smith is a real person. We are not satisfied that Michael Smith, as presented in the evidence, was a real person as opposed to an alias for a person unknown to the Commission. We are led to this conclusion by the following:

- (a) Pelcowitz is the only person to testify as having personal contact with Smith. Given our conclusions about Pelcowitz's activities, we do not find him to be a reliable witness;
- (b) The address given for Smith in the opening documents for the IMG Account was false. No one there had ever heard of him at that address;
- (c) Pelcowitz admitted that he impersonated Smith in a telephone message to Staff;
- (d) Pelcowitz signed the cheques on the IMG Account as "M. Smith" or "Michael Smith"; and
- (e) Despite the efforts of Staff, no address was ever found for Smith.

[76] We find that the name Michael Smith was adopted as an alias by a person unknown to the Commission to conceal the identity of that person. This raises the question – is it in the public interest for the Commission to find that a person, unknown to the Commission, has contravened the *Act*?

(c) Nest A&M

[77] Staff submits that Nest A&M has contravened the *Act* in at least two ways. As noted earlier, we agree with Staff's submission that Nest A&M is a fictitious entity. We find that the name "Nest A&M" was created by unknown individuals using aliases such as "Paul Morgan", "Gordon James" and "Edward Kelly". This raises the question – is it in the public interest for the Commission to find that a fictitious entity has contravened the *Act*?

[78] Staff submits that the decisions in *Sunwide*, above and *Lehman Brothers*, above, are authority for the proposition that we should find "Michael Smith" and "Nest A&M" to have contravened the *Act*. Were we to so find, we would expect Staff to seek sanctions including disgorgement and administrative penalties, plus costs.

[79] The facts in *Lehman Brothers*, above, are on all fours with this matter. In *Lehman Brothers*, owners of shares were solicited by one "Marks" to sell those shares. The shareholders, at the direction of "Marks" forwarded sums of money to cover "performance bonds," "taxes", etc. Those sums were lost and not recovered. "Marks" represented "Lehman Brothers". Staff alleged that "Marks" was an alias for an unknown individual. The panel found:

The evidence shows that Lehman Corp. and Marks used false names, telephone numbers and addresses that could not be traced to the true owner, making it impossible for Staff, other regulators or investors to identify or locate Lehman Corp., Marks or other representatives. Accordingly, we find that Staff has taken all steps reasonable in the circumstances to locate and serve Lehman Corp. and Marks.

(*Lehman Brothers*, above at para. 30).

[80] There was no evidence that “Lehman Brothers” existed. Staff submitted that it was a fictitious business.

[81] The *Lehman Brothers* panel found that Staff had made reasonable efforts to serve “Marks” and “Lehman Brothers” and waived service on them pursuant to Rule 1.5.3 of the Commission’s *Rules of Procedure* (*Lehman Brothers*, above at para. 34).

[82] The *Lehman Brothers* panel then analyzed the evidence, referring throughout to “Marks” and “Lehman Brothers” and found them both to have committed acts of fraud, unauthorized trading and acts contrary to the public interest.

[83] There followed a sanctions and costs hearing (*Lehman Brothers et al* (2012), 35 O.S.C.B. 5357 (“**Lehman Brothers Sanctions**”). The panel ordered “Marks” to disgorge \$148,089 jointly with one Lounds, an individual known to the Commission. The panel also ordered “Marks” to pay an administrative penalty of \$250,000. Costs were imposed jointly against “Marks” and “Lounds”.

[84] Although “Lehman Brothers” was found to have committed fraud and other contraventions of the *Act*, Staff chose not to ask that it be ordered to disgorge or to pay an administrative penalty. Perhaps the cognitive dissonance created by ordering a fictitious entity to pay sums to the Commission persuaded Staff to avoid an incongruous result.

[85] As for “Marks”, the panel offered the following explanation of the sanctions imposed:

[50] In our Merits Decision, we determined that Marks was in fact an alias used by an individual for the purpose of perpetrating a serious fraud against TBS Investors. The fact that this individual is known to the Commission only by an alias does not detract from the public interest in imposing sanctions on that individual. Indeed, the Commission should not permit an individual to elude sanctions for serious contraventions of the Act simply by hiding behind a false identity. Therefore, we believe that it is in the public interest to impose sanctions against the individual known to the Commission as Marks.

(*Lehman Brothers Sanctions*, above at para. 50)

[86] We respectfully disagree with the *Lehman Brothers Sanctions* panel’s decision that it is in the public interest to impose sanctions against individuals unknown to the Commission. Suppose that Staff subsequently discovered an individual that Staff believed was the person who assumed the alias “Smith”. If Staff wanted to pursue that person, Staff would be required to

issue a Notice of Hearing and a Statement of Allegations and prove, on the balance of probabilities, that it was that person who used “Smith” as an alias, and infringed the *Act*. Then, and only then, could Staff seek to sanction that person.

[87] A further concern of the panel is the potential mischief caused to real persons whose names coincide with an alias against whom a Commission order is registered. A real Michael Smith could, at the least, be inconvenienced. This potential to cause difficulty outweighs any imagined benefit of issuing orders against persons unknown to the Commission.

[88] We find it would be contrary to the public interest for the Commission to find that a person unknown to the Commission has contravened the *Act*.

[89] The above findings apply with equal, if not greater, force to entities found to be fictitious.

[90] We are unable to find that either “Smith” or “Nest A&M” contravened the *Act*.

[91] Staff has failed to prove the identity of the unknown person who assumed the alias of “Michael Smith”. Staff have failed to prove that Nest A&M is an existing entity. No order shall be issued with respect to either of them.

PART V – CONCLUSION

[92] We conclude that:

- (a) Pelcowitz and IMG committed a fraud contrary to subsection 126.1(b) of the *Act*;
- (b) Pelcowitz and IMG acted in furtherance of a trade of securities contrary to subsection 25(1)(a) of the *Act*; and
- (c) Pelcowitz and IMG acted contrary to the public interest.

[93] A separate order shall be issued scheduling a date for the sanctions hearing. It is ordered that the hearing to determine sanctions and costs will be held at the Commission’s offices commencing on June 27, 2013 at 10:00 a.m.

[94] It is further ordered upon the failure of any party to attend at the time and place aforesaid, the hearing may proceed in the absence of that party, and such party is not entitled to any further notice of the proceeding.

Dated at Toronto this 26th day of April, 2013.

“James D. Carnwath”

James D. Carnwath, Q.C.

“Margot C. Howard”

Margot C. Howard, CFA