



Ontario
Securities
Commission

Commission des
valeurs mobilières
de l'Ontario

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**IN THE MATTER OF THE
SECURITIES ACT, RSO 1990, c S-5**

- AND -

**IN THE MATTER OF
DENNIS L. MEHARCHAND, KWOK YAN LEUNG (also
known as TONY LEUNG) and VALT.X HOLDINGS INC.**

REASONS AND DECISION

Hearing:	October 14, 2015	
Decision:	December 16, 2015	
Panel:	Timothy Moseley	Commissioner and Chair of the Panel
Appearances:	Christie Johnson	For Staff of the Commission
	James Camp	For Dennis L. Meharchand and Valt.X Holdings Inc.
	Kwok Yan Leung	For himself

REASONS AND DECISION

I. OVERVIEW

- [1] Valt.X Holdings Inc. ("**Valt.X**") is an Ontario corporation that sells software and hardware products designed to mitigate the threats associated with malware and other cyber-security issues. Dennis L. Meharchand ("**Meharchand**") is the Chief Executive Officer, Secretary, and a director of Valt.X. Kwok Yan Leung, also known as Tony Leung ("**Leung**"), is the President and a director of Valt.X.
- [2] On September 11, 2015, the Ontario Securities Commission (the "**Commission**") issued a temporary order (the "**Temporary Order**") that cited apparent contraventions of various provisions of the *Securities Act*¹ (the "**Act**"). Specifically, the Temporary Order noted that Meharchand, Leung and Valt.X (collectively, "the **Respondents**") may have:
- a. engaged in the business of trading in securities without being registered; and
 - b. traded in securities in a manner that constituted an illegal distribution.
- [3] The Commission ordered that:
- a. trading in securities of Valt.X cease;
 - b. trading in any securities cease by Valt.X, Meharchand and Leung; and
 - c. any exemptions contained in Ontario securities law not apply to the Respondents.
- [4] The Temporary Order provided that it would expire on September 26, unless extended by the Commission. I extended the Temporary Order twice, on September 23 and October 1. From the record before me, it appeared that Valt.X had been raising capital in reliance upon the "accredited investor exemption" provided for in section 2.3 of National Instrument 45-106 *Prospectus and Registration Exemptions* ("**NI 45-106**"), but had not filed the required reports of exempt distribution on time and may have improperly relied upon the exemption in at least one instance.
- [5] At a hearing on October 14, Staff of the Commission ("**Staff**") requested a third extension of the Temporary Order. At the conclusion of the hearing I advised that I would not further extend the order, that it would therefore expire on its own terms on October 15, and that I would issue written reasons for my decision. These are my reasons.

II. BACKGROUND

A. Incorporation and initial fundraising

- [6] Valt.X was incorporated in 2006 by Meharchand and Leung. According to Meharchand, Valt.X has raised capital over the years in order to:
- a. design and develop computer security products;
 - b. obtain patents in Canada and various other countries;

¹ RSO 1990, c S-5.

- c. retain independent third parties to assess and report on Valt.X's products; and
- d. retain business development consultants.

- [7] As noted above, Valt.X intended to rely upon the accredited investor exemption. Valt.X retained legal counsel to draft appropriate documents, including a subscription form, a shareholder agreement and an accredited investor certification.
- [8] According to Meharchand, Valt.X followed the subscription process designed by its counsel. Valt.X would not issue shares to an investor unless that investor completed the necessary documentation, including the accredited investor certification.

B. Warning letter and subsequent fundraising

- [9] In 2007, Staff reviewed Valt.X's activities and was concerned about whether Valt.X was properly relying upon the accredited investor exemption and whether Valt.X was filing the reports of exempt distribution as required by section 6.1 of NI 45-106. On October 30, 2007, the Commission's Director of Enforcement wrote a letter to counsel for Valt.X that stated, in part:

Based upon our review, it appears that [Valt.X] has improperly relied upon the accredited investor exemption to effect sales of its securities to members of the public. In addition, [Valt.X] has not filed any Reports of Exempt Distribution with us since September 2006...

To ensure that your clients' business activities satisfy Ontario securities laws, we require your clients to conduct proper due diligence on each potential investor to ensure that all future sales are in compliance with Ontario securities law. In addition, we require your clients to file all required Reports of Exempt Distribution with us for all future sales in compliance with National Instrument 45-106.

- [10] Over the next several years, Meharchand met with Staff twice to review Valt.X's fundraising activities. As Meharchand now asserts, Staff appears to have been satisfied that Valt.X was complying with Ontario securities law.

C. Events leading to the Temporary Order

- [11] Valt.X came to Staff's attention again on December 31, 2014, when a Texas resident contacted the Commission regarding concerns he had about a share certificate received from Valt.X. The individual had learned of Valt.X through a friend, had reviewed the company's website, had contacted Meharchand, and had ultimately invested approximately US\$10,000 in Valt.X.
- [12] Staff interviewed the investor by telephone in April 2015. The investor confirmed that he qualified as an accredited investor for the purposes of Ontario securities law. The investor sent a number of documents to Staff, including an unsigned subscription agreement for shares of Valt.X. That agreement included a representation that the signing investor is an accredited investor. Schedules attached to the agreement allowed the investor to specify the applicable category to support the availability of the accredited investor exemption (e.g., a person whose net worth was greater than \$1 million).
- [13] Staff continued its investigation and found publicly accessible Valt.X-related materials and videos online. These materials promoted Valt.X, referred to previous

successful funding efforts, outlined plans for future funding, and identified intended uses for the capital that was to be raised.

D. Temporary Order

- [14] As a result of Staff's concerns about Valt.X's past conduct and stated intention to raise further funds, the Commission issued the Temporary Order on September 11, 2015, without a hearing, pursuant to subsection 127(5) of the Act. The Temporary Order provided that it would expire on September 26 unless extended.
- [15] The Secretary to the Commission issued a notice of hearing that set September 23 as the date for a hearing at which the Commission would determine whether to extend the Temporary Order.

E. September 23 hearing

- [16] At a hearing before me on September 23, Staff sought an extension of the Temporary Order. Meharchand appeared on behalf of Valt.X and on his own behalf. Leung did not appear although he had been properly served with the notice of hearing.
- [17] At the hearing, Staff relied upon a September 17 affidavit of Daniella Kozovski, investigative counsel in the Commission's Enforcement Branch. Staff also advised that Valt.X had filed reports of exempt distribution as recently as the day before the hearing, but said that Staff had not yet had an opportunity to review them fully.
- [18] Meharchand accepted responsibility for Valt.X's failure to file the required reports in a timely way and explained that Leung had nothing to do with Valt.X's fundraising activities. He also referred to a number of documents that he intended to submit.
- [19] In order to allow both Staff and the Respondents an opportunity to review the documents and to prepare proper materials to be filed, I adjourned the hearing to October 1 and I extended the Temporary Order until October 2.

F. October 1 hearing

- [20] At the hearing on October 1, Staff sought a second extension of the Temporary Order. Counsel appeared on behalf of Meharchand and Valt.X. Leung did not appear. Staff submitted a second affidavit of Daniella Kozovski, sworn September 25.
- [21] On consent of Staff, Meharchand and Valt.X, I adjourned the hearing to October 14 and extended the Temporary Order to October 15, with a minor modification to permit Leung to trade for his personal account.

G. October 14 hearing

- [22] At the October 14 hearing, Staff sought a third extension of the Temporary Order. Counsel again appeared on behalf of Meharchand and Valt.X. Meharchand and Leung attended in person. Counsel for Meharchand and Valt.X opposed Staff's application, in reliance upon an affidavit sworn by Meharchand on October 13. Leung made no submissions.
- [23] At the conclusion of the hearing I dismissed Staff's application.

III. LEGAL FRAMEWORK

A. Nature of temporary cease trade orders

- [24] Temporary orders such as the one in this case are made pursuant to:

- a. subsection 127(1) of the Act, which authorizes the Commission to make certain orders "if in its opinion it is in the public interest" to do so; and
 - b. subsection 127(5) of the Act, which provides that an order such as the Temporary Order may be made without a hearing.
- [25] Each of Staff's three consecutive applications for extensions of the Temporary Order was made pursuant to subsection 127(8) of the Act, which provides that a temporary order made under subsection 127(1) may be extended for such period as the Commission considers necessary "if satisfactory information is not provided to the Commission".
- [26] Any decision as to whether or not to issue or extend a temporary cease trade order must be done with reference to the purposes of the Act and to the principles that the Commission is obligated to consider. Section 1.1 of the Act sets out the two purposes of the Act:
- 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.
- [27] Section 2.1 of the Act requires the Commission to have regard to a number of "fundamental principles" in pursuing those purposes. One of the principles explicitly contemplates that in specific cases, balancing the importance given to each of the two purposes may be required.
- [28] This is such a case. Staff seeks to protect investors from improper practices. Valt.X seeks fair access to the capital markets in order to raise funds. I must balance these two goals in determining whether to extend the Temporary Order.

B. Satisfactory information

- [29] The question of what information might be "satisfactory", and the issues that would need to be resolved to answer that question, can be determined only with reference to the grounds upon which Staff submits that the order should be made.
- [30] In an enforcement proceeding, Staff would file a statement of allegations that would describe the conduct that Staff claims violates the Act. Because this is not an enforcement proceeding, no statement of allegations has been filed. However, it is clear from the written materials and from oral submissions that Staff is concerned that the Respondents may have:
- a. traded in securities of Valt.X without being registered, contrary to section 25 of the Act; and
 - b. illegally distributed securities, contrary to section 53 of the Act.
- [31] These two potential violations of the Act form the foundation for Staff's application.

IV. ISSUES

- [32] In written submissions, and initially at the hearing, Staff counsel argued that I should grant the order sought for two reasons: (i) to permit further investigation; and (ii) because it is in the public interest to do so, given the evidence of past conduct harmful to the public interest. Following further discussion regarding the first of these two reasons, Staff counsel conceded that Staff's investigation of the Respondents' past conduct would not be impeded if the Temporary Order were not

extended. Accordingly, submissions from both counsel focused on the past conduct of the Respondents and the risk of future harm to investors and the capital markets.

- [33] At the hearing, Staff counsel agreed that there was nothing in the evidence relating to Valt.X's future plans to raise funds that suggested that Valt.X would do so in a manner that would fail to comply with Ontario securities law. It follows that any concern I might have about the risk of future harm to investors or the capital markets must be based upon past conduct.
- [34] Staff's application to extend the Temporary Order therefore presents the following issues:
- a. Does the evidence adduced by Staff suggest that the Respondents may have:
 - i. engaged in the business of trading in securities of Valt.X without being registered; and/or
 - ii. illegally distributed the securities of Valt.X?
 - b. If so, have the Respondents adduced satisfactory information to justify a dismissal of Staff's application for a further extension of the Temporary Order?
- [35] I have framed the first of these issues differently than Staff did. As I explain in greater detail below, one of Staff's concerns (as noted above) is that the Respondents may have traded in securities without being registered. However, the prohibition in section 25 of the Act extends only to those who engage in the business of trading in securities without being registered. The difference is important, for the reasons set out below.

V. ANALYSIS

A. Does the evidence adduced by Staff suggest that the Respondents may have engaged in the business of trading in securities of Valt.X without being registered?

- [36] Section 25 of the Act prohibits a person or company from "engaging in the business of trading in securities" unless the person or company is appropriately registered or is entitled to rely upon an exemption. None of the Respondents is registered.
- [37] As noted above, the prohibition in section 25 contains two distinct and essential elements. The underlying activity contemplated is trading in securities, but the prohibition extends only to those who engage in the business of doing so.
- [38] In Staff's written submissions, Staff alleges "that the Respondents are trading in securities of Valt.X without being registered". Such a description improperly excludes the essential element of "engaging in the business of".
- [39] Staff's written submissions also contain the bald assertion that "the allegations and evidence... establish that the Respondents are trading without being registered, contrary to section 25 of the Act...". Allegations establish nothing, other than the fact that the allegations are being made. As for evidence, Staff's written submissions are silent as to what evidence in the record supports the contention that the Respondents have engaged in the business of trading.
- [40] At the hearing, Staff counsel argued that the Respondents were engaged in the business of trading because their conduct met the "business purpose" test found in section 1.3 of Companion Policy 31-103CP *Registration Requirements, Exemptions*

and Ongoing Registrant Obligations ("**31-103CP**"). That section enumerates five factors Staff considers "relevant in determining whether an individual or firm is trading or advising in securities for a business purpose".

[41] While it is generally helpful and appropriate for the Commission to refer to a relevant Companion Policy in the course of a proceeding, it is important to bear three things in mind:

1. The purpose of 31-103CP, like all Companion Policies, is to inform market participants and others about how Staff may interpret or apply provisions of Ontario securities law. A Companion Policy is not itself part of Ontario securities law.
2. The enumerated factors in section 1.3 of 31-103CP are merely potential indicators, as opposed to conclusive criteria.
3. The objective of the business purpose test and the five indicators is to distinguish those businesses that require registration under securities law from those businesses that need not register. Even those businesses that are corporations, and are therefore issuers of securities, do not need to register simply because of that fact. In the context of this case, the indicators set out in 31-103CP must be interpreted in a manner consistent with section 25 of the Act, which as noted above extends to a person or company that engages "in the business of" trading in securities.

[42] With these principles in mind, I deal in turn with each of the three of the five indicators Staff counsel cited at the hearing as being relevant to this case.

[43] The first is described in 31-103CP as "engaging in activities similar to a registrant" and is explained as follows:

We usually consider an individual or firm engaging in activities similar to those of a registrant to be trading or advising for a business purpose. Examples include promoting securities or stating in any way that the individual or firm will buy or sell securities. If an individual or firm sets up a business to carry out any of these activities, we may consider them to be trading or advising for a business purpose.

[44] The words "promote" and "sell" in that guidance cannot reasonably be interpreted in such a way as to extend the guidance to every corporation. A corporation that does not promote or sell securities other than its own, but only issues its own securities, should not as a result of doing so be found to be engaging in activities similar to those of a registrant.

[45] In this case, Staff adduced no evidence of the Respondents engaging in any activities with respect to securities other than shares of Valt.X, or any other activities similar to those of a registrant.

[46] The second indicator is described in 31-103CP as "directly or indirectly carrying on the activity with repetition, regularity or continuity", and is explained by the following:

Frequent or regular transactions are a common indicator that an individual or a firm may be engaged in trading or advising for a business purpose. The activity does not have to be their sole or even primary endeavour for them to be in the business.

We consider regularly trading or advising in any way that produces, or is intended to produce, profits to be for a business purpose. We also consider any other sources of income and how much time an individual or firm spends on all activities associated with the trading or advising.

- [47] As counsel for Meharchand and Valt.X correctly submitted, while Valt.X did raise funds regularly, that is true of many issuers, particularly those that are in their early stages as well as those that are engaged in capital-intensive projects. Both of those characteristics apply to Valt.X. Indeed, section 1.3 of 31-103CP goes on to say that “technology companies may raise money with only a business plan for many years before they start producing a product or delivering a service.”
- [48] There was no evidence before me to suggest that Valt.X’s capital-raising activities were any different than would be expected of a technology company in similar circumstances.
- [49] The third indicator referred to by Staff is described in 31-103CP as “directly or indirectly soliciting” and is explained as “contacting anyone to solicit securities transactions or to offer advice”. Once again, these words cannot be interpreted in such a way as to cause them to apply to every issuance of shares by a corporation. There is no evidence to suggest that any of the Respondents solicited securities transactions other than purchases of shares of Valt.X.
- [50] In oral submissions, Staff counsel asserted that “the act of operating a non-securities related business does not qualify the Respondents from being exempt from the registration requirements if they are selling and distributing shares of that company.” The logical extension of that assertion is that any issuer with a legitimate business unrelated to securities must be registered in order to issue its shares. I reject that submission.
- [51] All of the evidence before me suggests that Valt.X is a legitimate technology company that raises capital from time to time. There is no evidence that Valt.X, Meharchand or Leung have at any time engaged in the business of trading in securities.

B. Does the evidence adduced by Staff suggest that the Respondents may have illegally distributed the securities of Valt.X?

- [52] Staff identified two separate concerns about Valt.X’s purported reliance upon the accredited investor exemption. The first is whether the exemption was improperly relied upon in the first place. The second is that where a proper exempt distribution did occur, Valt.X failed to file the appropriate report as required.
- [53] While Staff raised the concern that investors in Valt.X were not being properly screened to ensure that they qualified as accredited investors, Staff adduced no evidence of any Valt.X investor who was not so qualified.
- [54] As for the requirement to file reports, Staff’s September 25 affidavit records that several days earlier, Meharchand advised Staff that he had filed all required reports of exempt distribution on behalf of Valt.X. Staff conducted a review of the reports filed, and of banking documentation. From that review, Staff concluded that Valt.X had raised approximately \$2.6 million from over 100 individual investors between January 2012 and August 2015. Staff identified one investor who appeared to have subscribed for \$1000 worth of Valt.X shares, but in respect of whom no report of exempt distribution had been filed. Meharchand states in his affidavit that at the time of Staff’s affidavit, Valt.X had not yet obtained the completed subscription

agreement and accredited investor certification from the investor. The investor provided those documents to Valt.X days later, and Valt.X filed the required report of exempt distribution.

- [55] In the record before me, there was no other evidence of a missing report of exempt distribution.
- [56] Staff submitted that the investigation was in its early stages and Staff needed more time to assess whether or not any of Valt.X's fundraising activities constituted an illegal distribution. That submission is a fair one. However, for the purposes of this application for an extension of the Temporary Order I can consider only the evidence that is available now.
- [57] While that evidence does not, at this point, demonstrate conclusively that the Respondents engaged in an illegal distribution, it is undisputed that Valt.X was not as attentive as it ought to have been with respect to the regulatory requirements that applied to its capital-raising activities. I find that the evidence adduced by Staff raises a concern about the Respondents' compliance with Ontario securities law and that this concern is sufficient to shift the burden to the Respondents to adduce satisfactory information to justify a dismissal of Staff's application for an extension of the Temporary Order.

C. Have the Respondents adduced satisfactory information to justify a dismissal of Staff's application for a further extension of the Temporary Order?

- [58] The Respondents' burden is to adduce "satisfactory information". Determining whether information is satisfactory involves balancing the two interests referred to in paragraph [28] above, namely Staff's interest in protecting investors from improper practices and Valt.X's interest in fair access to the capital markets.
- [59] As the Commission has previously stated, the power to issue and extend temporary cease trade orders is an extraordinary remedy and should not be exercised lightly.² Such an order can have significant consequences for an issuer seeking to raise capital. The fact that an issuer conducted itself in a manner that may have been contrary to Ontario securities law is not necessarily sufficient to warrant this extraordinary remedy that would prevent the issuer from continuing to participate in Ontario's capital markets. The past conduct may, in a given case, provide a basis for the Commission to order sanctions at the conclusion of an enforcement proceeding, but for that past conduct to justify the issuance of a temporary cease trade order, the Commission must be satisfied that any risk of future harm to investors outweighs the issuer's legitimate interest in accessing fair and efficient capital markets.
- [60] In this case, I find that the risk of future harm to investors is low. There is no evidence that any of the Valt.X investors, all of whom Valt.X claims are properly qualified as accredited investors, does not in fact so qualify.
- [61] With respect to the filing of reports of exempt distribution, Meharchand says the following in his affidavit:

As Valt.X is short-staffed it failed to file its Reports of Exempt Distribution in a timely manner. However, as confirmed by Ms. Kozovski in her Supplementary Affidavit Valt.X has brought its

² *Shallow Oil & Gas Inc. et al. (Re)*, (2008) 31 OSCB 2007 at para 33.

filings current. I will ensure that Valt.X files these reports in a timely fashion in future.

- [62] Meharchand has accepted responsibility for the failure and has pledged that he and Valt.X will, in the future, conduct themselves in a fully compliant manner. If they do not, they will of course be subject to an appropriate regulatory response.
- [63] The requirement to file a report of exempt distribution is an important element of the regulatory framework, and is a necessary tool for Staff of the Commission to rely upon in seeking to protect investors. However, in this case, the evidence relating to Valt.X's investors, the evidence explaining past failures to file reports of exempt distribution on time, and the assurances given as to future conduct, constitute "satisfactory information" and are sufficient to discharge the onus placed upon the Respondents by subsection 127(8) of the Act.

VI. CONCLUSION

- [64] It is clear that Valt.X did not fully comply with Ontario securities law, given its failure to file reports of exempt distribution on time. However, for the reasons set out above, I find that Valt.X and Meharchand have adduced "satisfactory information" and therefore it is not in the public interest to extend the Temporary Order against them.
- [65] Staff did not challenge Meharchand's assertion at the September 23 hearing that Leung had nothing to do with Valt.X's capital-raising activities. Further, there was no evidence in the record whatsoever regarding Leung, other than the fact that he is an officer and director of Valt.X. Even if Leung had been involved in Valt.X's capital-raising activities, my conclusions with respect to Valt.X and Meharchand would apply equally to him. It is therefore not in the public interest to extend the Temporary Order against him.
- [66] For the foregoing reasons, Staff's application to extend the Temporary Order is dismissed.

Dated at Toronto this 16th day of December, 2015.

"Timothy Moseley"

Timothy Moseley