

ALBERTA SECURITIES COMMISSION

DECISION

Citation: Global Petroleum Strategies, LLC, Re, 2009 ABASC 280

Date: 20090611

Global Petroleum Strategies, LLC

Panel:

Stephen Murison
Roderick McKay, FCA
Karen Prentice, QC

Appearing:

Shannon Hindmarch and Don Young
for Commission Staff

Date of Hearing:

11 May 2009

Date of Decision:

11 June 2009

I. INTRODUCTION

[1] Global Petroleum Strategies, LLC ("Global"), Petroleum Unlimited, LLC ("PUL") and Roger A. Kimmel Jr. ("Kimmel") were alleged by staff ("Staff") of the Alberta Securities Commission (the "Commission") to have traded and distributed securities of PUL in Alberta illegally – in contravention of the registration and prospectus requirements of the *Securities Act*, R.S.A. 2000, c. S-4 (the "Act") – and in so doing to have acted contrary to the public interest. The allegations were set out in a 5 January 2009 amended notice of hearing.

[2] The matter came to a hearing before a Commission panel on 11 May 2009. None of Global, PUL or Kimmel (together, the "Respondents") was present or represented at the hearing. PUL and Kimmel entered into a Settlement Agreement and Undertaking with Staff (the "Settlement") one week before the hearing.

[3] Accordingly, only the allegations against Global were in issue at the hearing. We are satisfied that Global was given adequate notice of the hearing in accordance with an earlier order for substitutional service. Although Staff had been informed that Global had ceased operation and that its principal, Stephen Pagliughi, had died (as seemingly confirmed by a copy of an obituary in evidence), Staff pursued (as they were entitled to do) their allegations against the company.

[4] We received written evidence, including a copy of the Settlement, and heard testimony from a Staff investigative counsel and two Alberta investors, as well as submissions from Staff. Staff contended that Global operated a "boiler room" – an operation in which PUL securities were sold illegally through telephone solicitations to investors in Alberta and elsewhere.

[5] Our decision on the merits of the allegations against Global, and our reasons, follow. As discussed below, the allegations against Global are proved. Global's operation was indeed a classic example of a boiler room – an operation that extracted money from Alberta investors in breach of fundamental requirements of Alberta securities laws and very much contrary to the public interest.

II. BACKGROUND

A. The Respondents

[6] PUL was a Wyoming company formed in 2008. Its "Manager" was another Wyoming company, Reserve Oil & Gas, LLC ("ROG"), and ROG's manager was Kimmel. Kimmel, a lawyer in the United States (the "US"), was the organizer of both companies.

[7] PUL was to undertake what it called the "North-South" oil and gas drilling program in the southern US. Pursuant to a subscription agreement (electronic and paper versions in evidence were variously dated, on the front page, 18 or 21 March or 4 April 2008), 504 "Limited Liability Company Interests" in PUL ("Units") were offered for sale to non-US residents at US\$25 000 per Unit. The signature page in the paper version of the agreement had spaces for the subscriber's name and contact information, the number and value of Units subscribed for, and the signatures of the subscriber and (in acceptance of the subscription) of ROG.

[8] "Global Petroleum Strategies" was registered in a Florida State database as the name of a business enterprise, with an address in Boca Raton, Florida and its owner identified as "Stephen, [sic] Pagliughi". In evidence were page captures from a website for "Global Petroleum Strategies", which included the same address as well as information that Stephen Pagliughi had

begun "Global Petroleum Strategies LLC" and that the website contents were copyrighted by "Global Petroleum Strategies, LLC". There being additional confirmatory evidence and no contrary evidence, we accept that this "Global Petroleum Strategies" and "Global Petroleum Strategies, LLC" were one and the same entity – the Respondent Global.

[9] None of the Respondents has ever been registered under the Act to trade in securities, and neither Global nor PUL has ever filed a preliminary or final prospectus with the Commission.

B. Investor Witnesses

[10] GB is a self-employed Calgarian. He testified that he bought a Unit in May 2008, for US\$25 000, at the urging of an individual in the US with whom he had, through something called Global Bullion Trading Group, previously invested in precious metals. He later received a call from a James Eulo ("Eulo") who provided him with additional information, resulting in GB's buying a second US\$25 000 Unit in June 2008. The documentary evidence included copies of certificates for the two Units, each in the joint names of GB and his wife; a copy of a 30 May 2008 letter from PUL (purportedly signed by Kimmel) welcoming GB and his wife as PUL members; and a copy of a subscription agreement with handwritten notations by GB but an unsigned signature page. Also in evidence were copies of two subscription agreement signature pages, one dated 30 May 2008 and the other 20 June 2008; each bore Kimmel's signature (or purported signature – the two signatures were in very different handwriting) on behalf of ROG (the PUL manager) and the "Electronic Signature" (that is, the typewritten names in italicized font) of the subscribers GB and his wife.

[11] ST is a Calgarian with an engineering background. His sole prior investment experience was in RRSPs. He was contacted by telephone by a Steve Shore ("Shore") from, as ST recalled the name, "Global Petroleum". Their communications culminated in ST and his wife buying half a Unit, for US\$12 500, in July 2008. The documentary evidence included evidence of payment, a copy of a certificate for half a Unit in the joint names of ST and his wife, and a copy of a 14 July 2008 letter from PUL (signed by Kimmel) welcoming ST and his wife as PUL members. There was no full subscription agreement for this investment in evidence, but there was a copy of a 14 July 2008 subscription agreement signature page bearing Kimmel's signature on behalf of ROG and the "Electronic Signature" of ST.

[12] Neither GB nor ST has ever received any return on, or of, their Unit investments.

C. Selling Activity

[13] Units were offered for sale to investors in several Canadian provinces, including Alberta. (The evidence suggested that similar units of a different issuer, bearing a name very similar to PUL's and operating an "East-West" drilling program, were being offered for sale in a similar manner but not to Canadians; that offering was not the subject of this proceeding.) Concerns about the conduct of Unit sales prompted the Commission to issue an interim (pre-hearing) order on 3 July 2008 (the "Interim Order"), which predated at least the consummation of ST's investment mentioned above and remained in effect at the hearing date. The Interim Order prohibited all trading in PUL securities and barred the Respondents (among others) from trading in any securities or relying on any exemptions under Alberta securities laws.

[14] Units were sold through Global. Both investor witnesses testified to direct dealings with Kimmel as well as with Global personnel. In the Settlement, Kimmel admitted to some such direct dealings: signing and distributing Unit certificates; and assisting Global in the sale of

Units to at least one investor after the Interim Order had been issued. According to the Settlement, PUL had engaged Global in good faith to sell Units, PUL and Kimmel relied on Global to carry on its business lawfully, and Kimmel understood and believed that Global was selling Units only to "accredited investors" (a term widely used to refer to a category of investor to whom, under National Instrument 45-106 *Prospectus and Registration Exemptions* ("NI 45-106"), securities may be traded or distributed without registration or a prospectus). The implication was that PUL and Kimmel left Global to get on with the selling activity with little direct intervention by PUL or Kimmel. Staff did not dispute this at the hearing and, as mentioned, no allegations against PUL or Kimmel were before us.

[15] Canadian counsel for PUL furnished Staff with information about Unit sales that PUL "was able to identify" – another implication that Global conducted sales with limited direct intervention by PUL. This information from PUL included three lists: Global "Salespersons" (GB and ST testified to dealings with two of them – Eulo and Shore, respectively); prospective Canadian investors who apparently did not buy Units; and Canadian buyers of Units. The last-mentioned list identified 27 investors or groups of investors, 14 of them (including GB and ST and their respective wives) with Alberta addresses. This list showed sales totalling over \$650 000, about \$325 000 of that (some amounts differed very slightly between versions of the list) to Alberta buyers.

[16] The selling operation in respect of Alberta investors involved telephone solicitations and written material. Generally, a prospective investor was invited to access a website and various information available on or from it concerning, among other things, PUL, the North-South drilling program, and the attractions of an investment in Units. The drilling was to take place (or was already under way) into specified reservoirs that, with anticipated or potential higher oil prices, were projected to generate very substantial returns.

[17] In evidence were several tables of estimated monthly income and annual percentage returns from a Unit investment – we accept that those accompanied by the "pdf" document identifier "NS" were in respect of the North-South drilling program, in distinction to others with identifier "EW", which we take as a reference to the East-West program – calculated on the basis of varying assumptions as to oil prices (ranging as high as \$300 per barrel) and oil production volumes. According to these tables, annual returns on investment ("ROI") in the North-South drilling program for those who invested "before commercial production" could be as high as 77% (assuming a \$50 price per barrel) or 478% (assuming a \$300 price per barrel).

[18] Further evidence as to the selling operation came from DV, a Staff investigative counsel. He testified that Staff had received a copy of an advertisement which, without naming any company, encouraged readers to call a "1-877" telephone number to "[f]ind out how you can share in this **700% profit** return [emphasis in original]" and to "tak[e] advantage of multiple well programs in existing proven oil fields", promising "monthly royalty [cheques] in the thousands off of minimal investments". DV, posing as a prospective investor, called the number on 27 June 2008 and spoke to a Rosemary Salveggi ("Salveggi"), one of the Global salespersons named on the list mentioned above. What followed – in this call, a follow-up conversation with Salveggi three days later, and an e-mail from Salveggi which identified her as a Global "Senior Account Executive" at a Boca Raton, Florida address – was consistent with the testimony of investors GB and ST as to their encounters with Global salespersons Eulo and Shore. Salveggi solicited DV's investment in Units. Salveggi told DV, among other things, that she personally had six Alberta clients and that at least 40% of the clients for the 504 Units available were

Canadians. She directed DV to websites of PUL and Global; copies of material taken from those websites, including promotional material and a subscription agreement, were in evidence.

[19] Salveggi asked DV some questions about his financial status. No particular financial standards or other qualifications were specified and she said that he did "not have to be an accredited investor". In response to the questions, DV told Salveggi that he was earning \$40 000 at a new job and that \$25 000 (the price of a Unit) "would represent half of my net worth". Given that information, Salveggi pronounced DV "qualified" to invest.

[20] The two investor witnesses also recalled being asked some financial-status questions by Global salespersons (in GB's case this was apparently only in connection with his second Unit purchase, when he dealt with Eulo). GB's and ST's testimony suggested that the questioning seemed directed simply at determining whether they could pay for a Unit or Units. Both testified that it was not explained to them that they needed to qualify as accredited investors in order to invest. Neither of them satisfied the accredited investor financial criteria, as set out in NI 45-106, when they invested.

[21] The sales pitches received by DV, GB and ST were consistent with – and corroborated by – some startling documentary evidence. This consisted of a series of scripts, obtained by DV from the PUL website. These scripts amounted to a set of detailed instructions as to how a salesperson should interact – by telephone or in writing – with a prospective or actual buyer. They were replete with soothing or encouraging comments to be made by the salesperson. Scripts for telephone conversations went so far as to specify pauses to be inserted in, and contrived interruptions to, the conversations. That the scripts were used was illustrated by a copy of an e-mail that DV received from Salveggi which tracked, virtually word-for-word, several lines from two of these scripts. In all, these scripts could – and, indeed in the sale of Units, we conclude that they did – serve as an instruction manual for participants in a classic boiler room securities-selling operation.

[22] Of particular relevance to the allegations here, the selling scripts (consistent with the testimony we heard) included some questions seemingly directed at screening out legally unsuitable Unit investors. It was not, however, much of a screening process. None of the accredited investor financial criteria set out in NI 45-106 was mentioned. The scripted questions (like those about which we heard in testimony) appeared incapable of enabling the salesperson to determine reliably (if at all) whether a person was or was not an accredited investor. It seemed, from the scripts, that prospective investors would "qualify" to invest whatever answers they gave.

[23] Prospective investors were given (or could obtain from the PUL website) a subscription agreement. This agreement included some cautionary information: for example, characterization of the investment as highly risky; mention that drilling might not prove profitable; a statement that ROG and its affiliates "will receive compensation, which may be significant"; and disclosure under the heading "Use of Proceeds" that 34% of the money raised would be spent on what appeared to be offering expenses ("Legal, Accounting, Printing, Organization and Syndication Costs"). However, the agreement also included information of a more promotional nature, such as one of the mentioned tables of estimated income and returns. Of potentially greater significance (as discussed below) was section 1.4 of the agreement, which we reproduce here:

1.4 Subscriber's eligibility for subscription. The Subscriber acknowledges and warrants (and has made diligent inquiries to so determine or has the sophistication and knowledge to know his/her/its status without concern or error), on which the Managing Member relies, that the Subscriber is purchasing the Units on a private basis and without infraction of or impediment by his/her/its domicile laws due to one or more of the following:

- (a) is an eligible investor under the laws of the Subscriber's domicile by virtue of the Subscriber's wealth, income, and investment knowledge or capacity; or
- (b) is subscribing for a value in Units constituting an exempt investment under the laws of the Subscriber's domicile; or
- (c) is an eligible investor under the Subscriber's domicile laws.

[24] Buyers of Units were instructed to send their payment to an "escrow" company which, it happens, was run by Kimmel's daughter. They were presumably also to complete, sign and return subscription agreements. GB recalled signing and mailing a subscription agreement, but only three subscription agreement signature pages bearing buyers' electronic signatures were in evidence. Buyers received Unit certificates and a welcoming letter from Kimmel. The certificates were made out for signature by Kimmel and his daughter, as "Manager" and "Secretary" of PUL, respectively (although, as with one of GB's subscription agreement signature pages, one of the purported Kimmel signatures on a certificate in evidence seems to have been written by someone else, in handwriting similar to that of his daughter and clearly at variance with Kimmel's signature on the Settlement).

[25] The list of Canadian buyers of Units furnished by Canadian counsel for PUL was subsequently augmented, by PUL via Kimmel's daughter, to indicate which of the buyers were – or were not – accredited investors. The augmented list identified some of the buyers, both inside and outside Alberta, as not being accredited.

III. ISSUES AND ANALYSIS

A. Issues

[26] The issues before us were few:

- Were Units, as "securities", "traded" and "distributed" in Alberta in contravention of the registration and prospectus requirements of the Act?
- If so, did Global bear responsibility for that?
- If so, did Global also act contrary to the public interest?

B. The Law

[27] Section 75(1)(a) of the Act prohibits trading in a security by a person or company not registered to do so. Section 110(1) prohibits the distribution of a security unless a prospectus has been filed and receipted by the Commission's executive director. Alberta securities laws provide certain exemptions from the registration and prospectus requirements, generally on the basis that the nature of a trade or its participants, or other available protection, obviate the need for registrant involvement and prospectus disclosure. Among such exemptions are those provided under NI 45-106 for sales to an accredited investor – defined, in the case of an individual, by reference to various financial attributes indicative of an ability to bear financial risk or to retain or obtain private advice.

C. Securities, Trades and Distributions

[28] Section 1 of the Act defines certain key terms. A "security" includes "any document constituting evidence of title to or interest in the capital, assets, property, profits, earnings or

royalties of any person or company"; a "... share, stock, unit, unit certificate, participation certificate . . ."; "any agreement under which money received will be repaid or treated as a subscription to shares, stock, units or interests at the option of the recipient or of any person or company"; "any profit-sharing agreement or certificate"; and "any investment contract" (section 1(ggg)). The Units and the related subscription agreements each clearly fall within one or more of the quoted phrases. Units were "securities" under the Act.

[29] A "trade" includes "any sale or disposition of a security for valuable consideration" and "any act, advertisement, solicitation, conduct or negotiation made directly or indirectly in furtherance of" such a sale or disposition (section 1(jjj) of the Act). A "distribution" includes a trade in securities not previously issued (section 1(p)).

[30] The evidence clearly disclosed acts, advertisement, solicitation and conduct in furtherance of the sale of Units to Alberta residents, and actual sales of Units to Alberta buyers for money (valuable consideration). These were cast as new securities (not resales of securities previously issued).

[31] Clearly, securities – Units – were traded and distributed in Alberta.

[32] It was PUL that created and issued the Units, and Kimmel played an important role in that. As both admitted in the Settlement, they engaged in trades and distributions of Units. However, as mentioned, they indicated that they retained Global to do the selling, and relied on it to do so lawfully. The evidence made abundantly clear that prospective investors dealt – largely and perhaps exclusively – with Global at least until they sent their money to the Kimmel-related escrow company. Global salespersons did the soliciting. Canadian counsel for PUL informed Staff (and Staff did not dispute) that it was Global that constructed and exclusively administered the PUL website to which prospective investors were directed. For these reasons, we find that Global traded and distributed Units.

D. No Exemption Available

[33] As mentioned, none of the Respondents has ever been registered under the Act to trade in securities, and neither Global nor PUL has ever filed a preliminary or final prospectus with the Commission. However, also as mentioned, prospectus and registration exemptions are available under Alberta securities laws. The person or company purporting to rely on such an exemption bears the onus of demonstrating its availability, and compliance with any attached conditions (*Re Bartel*, 2008 ABASC 141 at para. 109). It does not suffice that some sales qualify for an exemption: a purportedly exempt trade or distribution must qualify for exemption in its entirety, or it is illegal (*Re Euston Capital Corp.*, 2007 ABASC 75 at para. 112).

[34] Although the term "accredited investor" recurred in the evidence, Global tendered no evidence of anything, whereas the unchallenged testimony of GB and ST – each a Unit buyer who responded to solicitations from Global – was that neither of them was an accredited investor. Moreover, both PUL and Kimmel admitted, in the Settlement, to having breached the registration and prospectus requirements. Given who bears the onus of demonstrating the availability of an exemption, this might end the analysis in favour of Staff's position.

[35] That said, we do not overlook certain evidence that might operate in Global's favour: (i) the "screening" questions put to prospective investors by Global salespersons; and (ii) the subscription agreement (section 1.4, specifically).

[36] As discussed, the apparently scripted questions put to prospective investors did not seem to have been designed – and they certainly were not used – to discern whether a prospective investor was accredited. None of DV, GB or ST was, yet all passed the supposed screening test. DV gave Global (via Salveggi) specific information that could not but alert a serious inquirer that DV (as he presented himself) was not an accredited investor or anything close to it. There was, we find, no screening relevant to this exemption; worse, pertinent information (such as that provided by DV) was apparently ignored. The evidence supports Staff's contention that, if an Alberta buyer of a Unit happened to be an accredited investor, that would be the result of chance or luck, not diligent inquiry by Global as seller. The questioning process it used does not assist Global.

[37] Section 1.4 of the subscription agreement might, on its face, be of greater assistance to Global. This section (quoted above) purports to place Global in the position of recipient of a representation by a Unit subscriber (on which reliance is placed) that a sale to that subscriber will be legal. In the right circumstances, some such representations, and some such reliance, might assist a trader – if not in proving that an exemption was actually available, perhaps at least in showing that the trader had good reason to believe there was.

[38] The circumstances here, however, do not assist Global. We do not know whether all Unit buyers signed subscription agreements, but our conclusion would not change even had all buyers signed agreements. Global's distribution of Units was a high-pressure, heavily promotional operation, utilizing (in some if not all cases) scripted communications, none of which was designed to encourage a targeted buyer to think carefully or ponder legalities. In the context and manner in which it was used, the subscription agreement may have helped give the appearance of legality to the operation; however, we do not believe that it was seen or treated – by Global or by buyers like GB and ST – as the basis for, or a true reflection of, their relationship. In particular, nothing in evidence suggests that either Global (or its salespersons) or targeted buyers knew, or were expected or encouraged to know, what section 1.4 was all about. To the extent buyers cared, the assurance as to their qualification given to them by their salespersons would presumably have sufficed.

[39] In the circumstances, therefore, we attach no weight to the inclusion of section 1.4 in the subscription agreement (whether or not all Unit buyers actually signed the document). Global could not have relied, reasonably or in good faith, on this section as evidence that the accredited investor exemption – or, indeed, any other registration or prospectus exemption – was available. This, coupled with clear evidence that the accredited investor exemption was positively unavailable for at least the sales to GB and ST, lead us to find that Global traded and distributed securities without an available registration or prospectus exemption. That is, Global engaged in illegal trades and distributions, contrary to sections 75(1)(a) and 110(1) of the Act. These allegations are proved.

E. Conduct Contrary to the Public Interest

[40] We alluded above to the importance of the registration and prospectus requirements of the Act. The registrant requirement is designed to protect investors by giving them the benefit of the involvement of a registrant, knowledgeable about securities, capital markets and the financial status, investment objectives and risk tolerances of their client investors. The prospectus requirement is designed to assist investors in making informed investment decisions by giving them full, true and plain disclosure of material information about an offered security and its

issuer. As mentioned, registration and prospectus exemptions are available, generally where the need for these protections is somehow obviated.

[41] Breaching the registration and prospectus requirements deprives investors of fundamental protections to which they are entitled in law. This puts particular investors at risk of making poor investment choices and incurring financial harm. It also jeopardizes confidence in the fairness and integrity of the capital market – not only on the part of the directly affected investors but also on the part of the broader investing public who learn of their plight.

[42] All of this applies here. Global may have harmed and certainly put in jeopardy identifiable investors, and market integrity and confidence generally.

[43] In operating its classic boiler room – designed to inveigle the unwary into handing over their money – Global exhibited a cynical disregard both for investors and for the spirit (as well as the letter) of Alberta securities laws.

[44] Global's misconduct was egregious and, we find, clearly contrary to the public interest.

[45] We alluded above to evidence of Global's having traded in breach of the Commission's Interim Order (with the sale to ST). That would, obviously, be conduct contrary to the public interest. However, the amended notice of hearing included no allegation to that effect. In the absence of such an allegation, we make no finding on this point.

IV. SANCTIONS PHASE OF HEARING: TIMELINE

[46] Staff's allegations against Global having been proved on their merits, this hearing will now move into a second phase, for the determination of what, if any, sanction or costs orders to make against Global.

[47] We direct that Staff provide to the panel (through the Commission Registrar) and provide or make available to Global any written submissions Staff wish to make concerning sanction or costs orders by the close of business **on 26 June 2009**. If Global in turn wishes to reply in writing to Staff's submissions, those written submissions must be sent to the panel (through the Registrar) and to Staff by the close of business **on 15 July 2009**. Staff will be entitled to reply in writing to any such written submissions by Global, that reply to be sent to the panel (through the Registrar) and sent or made available to Global by the close of business **on 22 July 2009**.

[48] If either party wishes to make oral submissions concerning sanction or costs orders, they must advise the Registrar by the close of business **on 27 July 2009**, with an indication of whether they propose to call witnesses and the amount of hearing time they expect to require. If such a request is made, the panel will set a date for oral submissions and advise the parties accordingly. The panel may also do so of its own accord, if it considers that this would be of assistance to it.

[49] Unless Staff have received new and reliable information as to how material can be served on Global, Staff will be considered to have provided Global with adequate notice of the forthcoming sanctions phase of the hearing if Staff issue as soon as practicable a notice or advertisement advising Global of (i) the issuance of this decision; (ii) the above timeline for the sanctions phase of the hearing; (iii) Global's entitlement to make submissions; and (iv) means

whereby Global can obtain copies of this decision and of Staff's written submissions, such notice or advertisement to be disseminated:

- by e-mail addressed to Robert Rossi at the e-mail address previously used by Staff to serve Global; and
- by publication on two days in a newspaper of general circulation in the region including Boca Raton, Florida.

11 June 2009

For the Commission:

"original signed by"

Stephen Murison

"original signed by"

Roderick McKay, FCA

"original signed by"

Karen Prentice, QC