

**ALBERTA SECURITIES COMMISSION**

**DECISION**

**Citation: KCP Innovative Services Inc., Re, 2007 ABASC 584**

**Date: 20070809**

**KCP Innovative Services Inc. and James Woodrow Baker**

**Panel:**

Glenda A. Campbell, QC  
Beverley A. Brennan, FCA  
Karl M. Ewoniak, CA

**Appearing:**

Allison M. Neapole  
for Commission Staff

John K. Phillips and Angela M. Byrne  
for KCP Innovative Services Inc.  
and James Woodrow Baker

**Dates of Hearing:**

March 5, 6, 7, 12, 13 and 15, 2007

**Date of Decision:**

August 9, 2007

## **I. OVERVIEW OF THE PROCEEDING**

[1] This proceeding involved allegations of trades and distributions of securities of KCP Innovative Securities Inc. (KCP) to Alberta investors and of certain activities related to those trades and distributions in contravention of the *Securities Act*, R.S.A. 2000, c. S-4 (the Act), and contrary to the public interest.

[2] At the outset of this proceeding, the allegations concerning Lavallee Financial Corporation, Lavallee Financial Inc. and Lambert "Bert" Lavallee were severed, to be heard and decided separately. In the course of this proceeding, the allegations concerning Brian Patrick Hughes (Hughes) became the subject of an agreed statement of facts – binding on Hughes only – and were also severed, to be considered separately. The severance of these allegations and respondents is reflected in the style of cause of this decision. In addition, in the course of this proceeding, Staff (Staff) of the Alberta Securities Commission (the Commission) abandoned certain of the allegations concerning James Woodrow Baker (Baker).

[3] This proceeding, then, involved the remaining allegations concerning KCP and Baker (the Allegations; individually, the Allegation), as set out in a notice of hearing issued April 25, 2006, and summarized briefly as follows:

- (a) KCP engaged in illegal distributions of KCP securities in Alberta contrary to section 110 of the Act;
- (b) Baker engaged in illegal trades and distributions of KCP securities in Alberta contrary to sections 75(1)(a) and 110 of the Act;
- (c) Baker made misrepresentations to the Commission in documents required to be filed under Alberta securities laws; and
- (d) as a result of the foregoing and otherwise, KCP and Baker (collectively, the Respondents) acted contrary to the public interest.

[4] In consequence of this alleged misconduct by the Respondents, Staff sought orders against them under sections 198 and 199 of the Act. Staff also asked the Commission to order the Respondents to pay the costs of the investigation and hearing under section 202 of the Act.

## **II. THE HEARING**

[5] The hearing into the merits of the Allegations (the Hearing) took place on March 5, 6, 7, 12, 13 and 15, 2007.

[6] The Respondents appeared at the Hearing through counsel.

[7] In the course of the Hearing, we received documentary evidence and heard the testimony of a Staff investigator, five Alberta-resident investors and the former securities counsel for KCP. We found the testimony credible.

[8] Our decision and reasons follow.

### **III. THE FACTS**

#### **A. The Respondents**

[9] KCP is an Alberta corporation incorporated in 1996 with its registered office located in Calgary, Alberta. As at April 25, 2005, its directors were Baker, Don Getty, Robert Hawkes and Ken Pearson (Pearson), all Alberta residents.

[10] According to the promotional or informational material provided to some of its investors, KCP "[s]pecializes in the data collection of Oil and Gas exploration and production wells" and "[d]evelops and implements the most modern measurement devices". The business of KCP was similarly described in a news release dated July 27, 2004, subsequently provided by KCP to investors in September 2004:

KCP provides modern measurement devices for accurate measurements of oil and gas wells to help companies make their wells as productive as possible. KCP also has injection units to help determine if coal bed methane deposits are profitable. KCP has little or no competition in some of its processes using its proprietary devices, and demand for its services has been increasing.

[11] KCP has never been registered under the Act to trade in securities. It has never filed a preliminary or final prospectus with the Commission or received a receipt therefor, nor from February through September 2004 (the Relevant Period) had any of its securities listed on any exchange or quoted on any quotation and trade reporting system. KCP is not a reporting issuer in Alberta.

[12] The Executive Director of the Commission has never provided written permission to KCP or any individuals acting on its behalf to make any representation that KCP securities will be listed on any exchange or quoted on any quotation and trade reporting system or that application has been or will be made to list or quote KCP securities.

[13] Baker became the vice-president of corporate development and a director of KCP in January 2004. He has been the chief executive officer and a director of KCP since June 2004.

[14] Baker was registered as a salesperson/registered representative with an investment dealer from September 1997 to October 2002.

#### **B. Sales of KCP Common Shares**

[15] During the Relevant Period, KCP sold its common shares (the KCP Shares or Shares) to at least 107 Alberta investors, from which it realized proceeds in excess of

\$1.5 million. Initially this money was deposited with the Canadian Western Bank in trust for KCP. Gus Gallucci (Gallucci), a Staff investigator, testified that his review of KCP's bank records did not reveal any misuse of this money by KCP.

[16] Most of this money was raised by agents of KCP, apparently unpaid volunteers, who contacted prospective investors by telephone or in person and encouraged them to purchase KCP Shares being sold by KCP. Occasionally, existing or committed investors encouraged others to purchase KCP Shares. Prospective investors, some of whom were invited to seminars or meetings hosted by KCP agents at the expense at least in part of KCP, were offered KCP Shares at a price of \$0.45 per Share. One of the KCP agents was Hughes.

[17] Baker on behalf of KCP was aware and supportive of these money-raising efforts. In an investigative interview conducted under oath, Baker said that KCP "[needed] the money".

[18] Apparently each Alberta investor was asked to execute the same "Subscription Agreement for Common Shares" (the Subscription Agreement), to which was appended a "Schedule 'A'" and an "Exhibit to Schedule 'A'". The securities counsel for KCP during the Relevant Period provided the Subscription Agreement, which was the form of subscription agreement used for private placements by the law firm with which he was associated. There was a signature line on the first page of the Subscription Agreement and another on Schedule "A".

[19] The Subscription Agreements entered into evidence included the following terms and conditions:

2. **Representations, Warranties and Covenants of the Subscriber.** By executing this Subscription Agreement, the Subscriber . . . represents, warrants and covenants to the Corporation (and acknowledges that the Corporation and its counsel are relying thereon) that: . . .
  - (j) the Subscriber confirms that neither the Corporation nor any of its representative directors, employees, officers or affiliates, have made any representations (written or oral) to the Subscriber:
    - (i) regarding the future value of the Common Shares; . . .
    - (iv) that the Common Shares will be listed and posted for trading on a stock exchange or that application has been made to list and post the Common Shares for trading on a stock exchange; . . .
  - (n) the Subscriber satisfies one of subsections (i), (ii), (iii) or (iv) below:
    - (i) if the Subscriber is resident in **Alberta**, it is purchasing the Common Shares as principal for its own account and not for the benefit of any other person, and the Subscriber is an "accredited investor" as defined in Multilateral Instrument 45-103 (which definition is reproduced in the

Exhibit to Schedule "A" attached hereto) **and has executed and delivered to the Corporation a Representation Letter in the form attached hereto as Schedule "A"** indicating that the Subscriber fits within one of the categories of "accredited investor" set forth in such definition, **OR . . .**

(ii) if the Subscriber is resident in **Alberta** and is not an "accredited investor" as defined in Multilateral Instrument 45-103, it is purchasing as principal and is: . . .

(D) a close personal friend of a director, senior officer or control person of the Corporation or of an affiliate of the Corporation and, if requested by the Corporation will provide a signed statement describing the Subscriber's relationship with any such persons;

(E) a close personal business associate of a director, senior officer or control person of the Corporation, or an affiliate of the Corporation and, if requested by the Corporation will provide a signed statement describing the Subscriber's relationship with any such persons; . . .

(iv) if the Subscriber is not purchasing as principal for its own account, then: . . .

(D) one of the following applies:

(I) if the Subscriber is resident in **Alberta**, the Subscriber is acting for a beneficial purchaser that is purchasing as principal for its own account and is an "accredited investor" as defined in Multilateral Instrument 45-103 (which definition is reproduced in the Exhibit to Schedule "A" attached hereto) **and the Subscriber has executed and delivered to the Corporation a Representation Letter in the form attached hereto as Schedule "A"** indicating that the beneficial purchaser fits within the category of "accredited investor", **OR . . .** [Emphasis in original.]

[20] Schedule "A" of the Subscription Agreements entered into evidence, titled **"REPRESENTATION LETTER – TO BE COMPLETED BY ALBERTA SUBSCRIBERS WHO ARE ACCREDITED INVESTORS"**, read above the signature and date lines:

**TO: KCP INNOVATIVE SERVICES INC.**

In connection with the purchase of Common Shares of KCP Innovative Services Inc. (the "Corporation") by the undersigned subscriber or, if applicable, the principal on whose behalf the undersigned is purchasing as agent (the "Subscriber"), . . . the Subscriber hereby represents, warrants, covenants and certifies to the Corporation that the Subscriber is an "accredited investor" within the meaning of Multilateral Instrument 45-103 on the basis that the undersigned fits within the category of an "accredited investor" reproduced in the Exhibit to this Representation Letter beside which the undersigned has marked his initials. [Emphasis in original.]

and below the signature and date lines:

**IMPORTANT**

**PLEASE COMPLETE THE EXHIBIT TO THIS REPRESENTATION LETTER BY MARKING YOUR INITIALS BESIDE THE CATEGORY TO WHICH YOU BELONG**  
[Emphasis in original.]

[21] The Exhibit to Schedule "A" read, in part:

***TO BE COMPLETED BY ALBERTA SUBSCRIBERS WHO ARE ACCREDITED INVESTORS***

**PLEASE MARK YOUR INITIALS BESIDE THE CATEGORY TO WHICH YOU BELONG**

Please complete the Representation Letter to the Corporation by marking your initials beside the category of "accredited investor" to which you belong:

**Meaning of "Accredited Investor"**

"Accredited investor" is defined in Section 1.1 of Multilateral Instrument 45-103 to mean any person who fits within any of the following categories at the time of the sale of securities to that person: . . .

- \_\_\_\_\_ (k) an individual who, either alone or with a spouse, beneficially owns, directly or indirectly, financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds \$1,000,000;
- \_\_\_\_\_ (l) an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year;
- \_\_\_\_\_ (m) a person or company, other than a mutual fund or non-redeemable investment fund, that either alone or with a spouse has net assets of at least \$5,000,000, and unless the person or company is an individual, that amount is shown on its most recently prepared financial statements; . . . [Emphasis in original.]

[22] These Subscription Agreements were supplied by Baker or other KCP personnel to the KCP agents or occasionally existing or committed investors for execution by others. All Subscription Agreements executed by investors were also executed by Baker.

[23] On July 12, 2004, KCP filed with the Commission a Form 45-103F4 *Report of Exempt Distribution* (Form 45-103F4) required to be filed under Alberta securities laws when relying on certain exemptions under Multilateral Instrument 45-103 *Capital Raising Exemptions* (MI 45-103). This Form 45-103F4, dated June 11, 2004 and signed by Baker as a director of KCP (the June 2004 Form 45-103F4), indicated that KCP sold KCP Shares at \$0.45 per Share to 64 investors in Alberta and 2 investors in British Columbia, realizing proceeds of \$1,026,302.85 and \$10,000.80 respectively, that the

distribution date was June 11, 2004 and that the exemption relied on was Part 5 – *Accredited Investor Exemption* – of MI 45-103 (the Accredited Investor Exemption). Among the purchasers listed in the June 2004 Form 45-103F4 were three of the five Alberta-resident investor witnesses, AD, PD and JT.

[24] On October 1, 2004, KCP filed with the Commission another Form 45-103F4. This Form 45-103F4, dated September 27, 2004 and signed by Baker as a director of KCP (the September 2004 Form 45-103F4), indicated that KCP sold KCP Shares at \$0.45 per Share to 43 investors in Alberta and 4 investors in British Columbia, realizing proceeds of \$543,123 and \$40,079.70 respectively, that the distribution date was September 27, 2004 and that the exemption relied on was the Accredited Investor Exemption. Among the purchasers listed in the September 2004 Form 45-103F4 were the two remaining Alberta-resident investor witnesses, RB and ML.

## **C. The Investors**

### **1. AD**

[25] In May 2004, AD, a resident of central Alberta, invested \$5,000 in KCP, purchasing 11,111 Shares at \$0.45 per Share.

[26] AD testified that Hughes, the husband of a high school classmate, telephoned to tell her about the KCP Shares and that "they were probably going to do very well". She had never received such a call from Hughes before. AD was invited by Hughes to attend a meeting at a local motel about KCP, hosted by Hughes and another KCP agent.

[27] AD testified that before she attended the meeting she had decided to invest in KCP because "it seems like anything with oil in Alberta does well". She said that, at the meeting, Hughes informed the attendees, numbering about 12, "what the KCP machine did" – "[i]t had something to do with oil, and how much was left in the wells". Hughes also informed the attendees that the price of the KCP Shares was \$0.45 per Share, that they were not trading at that time and that KCP was "trying to get onto the stock exchange". AD did not recall any particular stock exchange being mentioned.

[28] At the meeting, AD completed and signed a Subscription Agreement, including Schedule "A" thereto. On the Exhibit to Schedule "A", she marked her initials beside category (1) – "an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year" – although she knew that she did not so qualify. AD's explanation for marking her initials beside category (1) was: "[Hughes] asked us to initial, and I said but that's not true. He said it doesn't matter, it's just a formality." She further agreed that she did so because she had decided before attending the meeting that she wanted to invest in KCP. AD could not recall any other discussion about the Subscription Agreement.

[29] Specifically, AD testified that she was not told that, in order to purchase KCP Shares, she had to be a qualified investor or to qualify as an accredited investor, nor was she told that making the statement about her income or financial status in the Subscription Agreement was for securities regulatory purposes. AD further testified that, when she was signing the Subscription Agreement, no one reviewed with her the definitions of "accredited investor" in the Exhibit to Schedule "A".

[30] AD acknowledged that she signed Schedule "A" to the Subscription Agreement, addressed to KCP, probably without reading it.

[31] At the meeting, AD wrote a cheque to KCP for \$5,000, on which she also wrote the words "In trust". She wrote the words "In trust" because Hughes "said the money would not be used for operating expenses. It would be used for shares only."

[32] AD has never met Baker. She understood that Baker was an executive with KCP, but she did not know that Hughes and the other KCP agent were not directors or officers of KCP.

## **2. RB**

[33] In June 2004, RB, a resident of central Alberta, invested \$5,000 in KCP, purchasing 11,111 Shares at \$0.45 per Share.

[34] RB testified that he decided to invest in KCP after Hughes, a neighbour, spoke to him about investing in KCP about three times and provided him with 15 pages of promotional material about KCP. According to RB, Hughes said that KCP was "looking for investors . . . for the stock to get on to the stock market" within three months. RB was not sure if Hughes mentioned the TSX or another stock market. RB testified that Hughes said that the KCP Shares, valued at \$0.45 per Share, would be considerably higher in value, somewhere around \$1.30 or \$1.35 per Share, once they were on the stock market. RB thought that Hughes said this before RB invested. Hughes had never made similar recommendations to RB.

[35] RB also had discussions with an individual from Edward Jones about his investment in KCP. It was unclear whether these discussions were before or after RB invested in KCP.

[36] A Subscription Agreement was either sent to RB or presented to him at a meeting at a local law office arranged by KCP. RB did not have any discussions with Hughes about the Subscription Agreement and could not recall any discussions with the individual from Edward Jones about the Subscription Agreement.

[37] Specifically, RB testified that he was not told that, in order to purchase KCP Shares, he had to be a qualified investor or to qualify as an accredited investor, nor was he told that the income and financial status information in the Subscription Agreement was for securities regulatory purposes. RB further testified that no one reviewed with him any of the definitions in the Subscription Agreement.

[38] RB signed the Subscription Agreement, including Schedule "A" thereto, at the meeting at the local law office arranged by KCP, which was not attended by Hughes or Baker. On the Exhibit to Schedule "A", he marked his initials beside category (I) – "an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year" – but he testified that he did not so qualify. When asked why he had marked his initials beside category (I), RB testified: "I'm not really sure, unless I must have – I may have misunderstood the question that I might have thought it was assets, like home and property and whatever. That's the only thing I can think of was why it would be over that amount, but other than that, I don't know why it – why I initialled that." He subsequently testified: "I obviously misunderstood that one question that I had my initials on".

[39] According to RB, the lawyers did not explain the Subscription Agreement to him; they simply told him where to sign. RB did not ask for time to review the Subscription Agreement. He did not believe that he read the whole Subscription Agreement before signing it.

[40] RB wrote a cheque to KCP for \$5,000, which he gave to Hughes. It was unclear whether RB provided the cheque to Hughes before or after he signed the Subscription Agreement. At Hughes' request, RB also wrote the words "IN TRUST" on the cheque. RB recalled discussing this request with Hughes but not the content of the discussion.

[41] RB still owns his KCP Shares.

[42] RB has never met or spoken with Baker.

### **3. PD**

[43] In April 2004, PD, a resident of Edmonton, invested \$10,000 in KCP, purchasing 22,220 or 22,222 Shares at \$0.45 per Share.

[44] PD testified that Hughes, a friend of several years, told him about the opportunity to invest in KCP. Previously PD and Hughes had invested in other companies. PD was invited by Hughes to attend a meeting at a local office about KCP, hosted by Hughes and another KCP agent.

[45] PD testified that, at the meeting, the KCP agent presented information to the four attendees about Pearson, the person for whom KCP was named, and his invention. The KCP agent also informed the attendees that the price of the KCP Shares was around \$0.40 per Share and that they were going to try to go public with KCP. PD understood that going public meant opening on a stock exchange. PD did not believe that any particular exchange was referenced.

[46] At the meeting, following the KCP agent's presentation, PD decided to invest in KCP and signed a Subscription Agreement, including Schedule "A" thereto, which he knew was going to be sent to KCP. On the Exhibit to Schedule "A", he marked his initials beside category (1) – "an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year" – but he testified that he did not so qualify. PD also testified that he did not know why he had marked his initials beside category (1). He could not recall any discussion at the meeting about signing the Subscription Agreement.

[47] Specifically, PD testified that he did not recall being told that, in order to purchase KCP Shares, he had to be a qualified investor or to qualify as an accredited investor, nor did he recall anyone reviewing category (1) with him. PD understood that the purpose of the Subscription Agreement was "[j]ust to buy shares in a company".

[48] PD acknowledged that he probably did not read the Subscription Agreement when he signed it.

[49] Around that time, PD wrote a cheque to KCP for \$10,000, on which he also wrote the words "IN TRUST". He testified that he did not know why he wrote the words "IN TRUST".

[50] Prior to signing the Subscription Agreement, PD had not met Baker, whom PD understood to be a senior executive with KCP.

#### **4. ML**

[51] In June 2004, ML, a resident of central Alberta, invested \$5,000 in KCP, purchasing 11,111 Shares at \$0.45 per Share.

[52] ML testified that she learned of the opportunity to invest in KCP through AD, a good friend, who had already invested in KCP. When ML indicated that she too was interested in investing – "[b]ecause it was in the oilfield and it sounded like a logical speculation to invest in" – AD mentioned that other friends, RZ and SZ (the Zs), were in the process of investing. The Zs told ML that there was a deadline for investing, that the

price of the KCP Shares was \$0.45 per Share and that the minimum investment was \$5,000.

[53] A Subscription Agreement was faxed to ML, either by KCP personnel or through RZ. ML completed and signed the Subscription Agreement, including Schedule "A" thereto, either at her or AD's residence, and RZ couriered ML's investment with the Zs' investment to KCP.

[54] On the Exhibit to Schedule "A", ML marked her initials beside category (1) – "an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year" – although she knew that she did not so qualify. ML's explanation for marking her initials beside category (1) was that she was told by AD or AD and the Zs that "that's what they were told to initial when they filled this in, and that it was okay to do that, so I followed suit. I did question it, but I followed suit." ML thought but was not certain that AD or the Zs got this information from Hughes.

[55] ML did not recall having any discussions with anyone from KCP prior to investing in KCP. She had spoken with Hughes but believed that occurred after she had invested, and she had had no discussions with Baker. ML testified that no one told her that she could not purchase KCP Shares unless she qualified as an accredited investor.

[56] ML acknowledged that she read Schedule "A" to the Subscription Agreement, addressed to KCP, before signing it and that she read and marked her initials beside category (1) on the Exhibit to Schedule "A" but did not advise anyone at KCP that that marking was incorrect.

[57] ML wrote a cheque to KCP for \$5,000, on which she also wrote the words "IN TRUST". She was instructed to write the words "IN TRUST" but could not remember by whom.

[58] ML received a share certificate or share certificates and she still owns her KCP Shares.

## **5. JT**

[59] In May or June 2004, JT, a resident of central Alberta, invested \$20,000 in KCP, purchasing 44,444 Shares at \$0.45 per Share.

[60] JT testified that Hughes, an acquaintance who had sold him insurance, telephoned him a few times, saying "how great KCP was and some of the people behind the operation and it would be a good investment". Hughes also mentioned that he was

selling KCP Shares to other people in the community. JT did not have contact with anyone from or on behalf of KCP other than Hughes before investing in KCP.

[61] JT signed a Subscription Agreement, including Schedule "A" thereto, provided by Hughes. JT testified that he did not pay much attention to the paragraph that immediately preceded his signature on Schedule "A" because "I trusted the person giving it to me". On the Exhibit to Schedule "A", he marked his initials beside category (1) – "an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year" – but he testified that he did not so qualify. JT did not recall reading category (1) before marking his initials beside it. He explained that "I don't recall taking it very serious when [Hughes] talked to me", "I was asked by [Hughes] to sign it" and it "didn't sound like it was a very important thing that I sign".

[62] At the time JT signed the Subscription Agreement, he also wrote a cheque to KCP for \$20,000, on which he apparently also wrote the words "in trust".

[63] JT testified that he did not recall being told that, in order to purchase KCP Shares, he had to be a qualified investor. At no time after he invested did JT communicate to anyone at KCP that he did not think that he qualified for the initial exemption.

[64] After investing in KCP, JT spoke with Baker and received written communications from him, including a letter on KCP letterhead dated July 12, 2004, which read, in part:

As of June 30<sup>th</sup>, 2004 the issue of the \$.45 shares has come to a close. This capital allows KCP to expand which, in turn, allows the value of our shares to increase. As an example, we purchased Zone Technologies [Ltd.] in July and this purchase is expected to double our present net income. We expect therefore that the next share offering, subject to regulatory approval, will be at a price significantly higher than the initial \$.45.

....

On your cheque you wrote "in trust". The original idea of the trust was to keep investors money separate until we were sure we could raise enough to satisfy the minimum proceeds of the offering. We have reached that stage and assume this is no longer a condition. If, however, you meant to impose other trust conditions on such funds please let the company know by July 23<sup>rd</sup>, 2004 so that we can determine whether we can satisfy your conditions. Otherwise we will assume the trust condition will not apply, after that date.

[65] JT received a share certificate for his KCP Shares dated June 11, 2004.

## 6. Other Investors

[66] Seven additional Subscription Agreements (the Impugned Subscription Agreements) with cheques payable to KCP – compelled from KCP under section 42 of the Act – were entered into evidence by Gallucci. We did not hear testimony from any of the associated investors.

[67] TS, apparently a resident of the Edmonton area, ostensibly invested \$4,500 in KCP in February 2004, purchasing 10,000 Shares at \$0.45 per Share to be registered in the name of VS, apparently his spouse. TS apparently signed the first page of a Subscription Agreement and wrote a cheque payable to KCP, but neither Schedule "A" to the Subscription Agreement nor the Exhibit to Schedule "A" was completed. VS was listed as a purchaser of KCP Shares in a draft of the June 2004 Form 45-103F4 entered into evidence by the Respondents (the Draft June 2004 Form 45-103F4), but neither TS nor VS was listed as a purchaser in either the June 2004 Form 45-103F4 or the September 2004 Form 45-103F4 filed with the Commission. No evidence was adduced as to whether TS or VS completed this purchase of KCP Shares.

[68] RW, apparently a resident of Edmonton, ostensibly invested \$2,250 in KCP in March 2004, purchasing 5,000 Shares at \$0.45 per Share to be registered in the name of SW, apparently his spouse. RW apparently signed the first page of a Subscription Agreement and wrote a cheque payable to KCP, but neither Schedule "A" to the Subscription Agreement nor the Exhibit to Schedule "A" was completed. We note that the initials "SW" were marked beside section 2(n)(ii)(E) of the Subscription Agreement – "a close personal business associate of a director, senior officer or control person of the Corporation, or an affiliate of the Corporation and, if requested by the Corporation will provide a signed statement describing the Subscriber's relationship with any such persons". However, the June 2004 Form 45-103F4, which listed SW as a purchaser of KCP Shares, indicated that the exemption relied on was the Accredited Investor Exemption. No evidence was adduced as to whether RW or SW was either an accredited investor or a close business associate of a director, senior officer or control person of KCP or of an affiliate of KCP, or both.

[69] VL, apparently a resident of Edmonton, ostensibly invested \$10,350 in KCP in April 2004, purchasing 23,000 Shares at \$0.45 per Share. VL apparently signed the first page of a Subscription Agreement and wrote a cheque payable to KCP, but neither Schedule "A" to the Subscription Agreement nor the Exhibit to Schedule "A" was completed. We note that the initials "VL" were marked beside section 2(n)(ii)(D) of the Subscription Agreement – "a close personal friend of a director, senior officer or control person of the Corporation or of an affiliate of the Corporation and, if requested by the Corporation will provide a signed statement describing the Subscriber's relationship with any such persons". VL was listed as a purchaser of KCP Shares in the Draft June 2004 Form 45-103F4 but was not listed as a purchaser in either the June 2004 Form 45-103F4

or the September 2004 Form 45-103F4 filed with the Commission. No evidence was adduced as to whether VL completed this purchase of KCP Shares.

[70] DCI, an apparent Alberta corporation, ostensibly invested \$20,000 in KCP in May 2004, purchasing 44,444 Shares at \$0.45 per Share to be registered in its name. DS, as secretary-treasurer of DCI, apparently signed a Subscription Agreement, including Schedule "A" thereto, on behalf of DCI, marked his initials – "DS" – beside category (1) on the Exhibit to Schedule "A" – "an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year" – and co-signed a cheque by DCI payable to KCP in trust. DCI was listed as a purchaser of KCP Shares in the June 2004 Form 45-103F4 filed with the Commission, but no evidence was adduced as to whether DCI or DS was the intended beneficial owner of the KCP Shares. Further, no evidence was adduced as to whether DS was an accredited investor as indicated in the Exhibit to Schedule "A".

[71] SC, an apparent Alberta business association, ostensibly invested \$5,040 in KCP in May 2004, purchasing 11,200 Shares at \$0.45 per Share to be registered in its name. JD, as president of SC, apparently signed a Subscription Agreement, including Schedule "A" thereto, on behalf of SC, marked her initials – "JD" – beside category (1) on the Exhibit to Schedule "A" – "an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year" – and wrote a personal cheque payable to KCP. SC was listed as a purchaser of KCP Shares in the June 2004 Form 45-103F4 filed with the Commission, but no evidence was adduced as to whether SC or JD was the intended beneficial owner of the KCP Shares. Further, no evidence was adduced as to whether JD was an accredited investor as indicated in the Exhibit to Schedule "A".

[72] ARL, an apparent Alberta corporation, ostensibly invested \$31,500 in KCP in June 2004, purchasing 70,000 Shares at \$0.45 per Share to be registered in its name. HA, as owner of ARL, apparently signed a Subscription Agreement, including Schedule "A" thereto, on behalf of ARL, marked his initials – "HA" – beside category (1) on the Exhibit to Schedule "A" – "an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year" – and co-signed a cheque by ARL payable to KCP. ARL was listed as a purchaser of KCP Shares in the September 2004 Form 45-103F4 filed with the Commission, but no evidence was adduced as to whether ARL or HA was the intended beneficial owner of

the KCP Shares. Further, no evidence was adduced as to whether HA was an accredited investor as indicated in the Exhibit to Schedule "A".

[73] An apparent Alberta numbered company ostensibly invested \$10,000 in KCP in May 2004, purchasing 22,222 Shares at \$0.45 per Share to be registered in the name of FM, an individual. FM apparently signed a Subscription Agreement, including Schedule "A" thereto, and wrote a cheque by the numbered company payable to KCP in trust. The Exhibit to Schedule "A" in evidence was without the first and fourth pages and without an initialled exemption. FM was listed as a purchaser of KCP Shares in the June 2004 Form 45-103F4 filed with the Commission, but no evidence was adduced as to whether the numbered company or FM was the intended beneficial owner of the KCP Shares. Further, no evidence was adduced as to whether FM was an accredited investor.

[74] Gallucci testified that he did not contact or interview TS, RW or VL and he did not know whether any of them qualified as an accredited investor, nor, we infer, did he know whether SW qualified as an accredited investor or whether RW or SW qualified as a close business associate of a director, senior officer or control person of KCP or of an affiliate of KCP. Gallucci also testified that he did not conduct trade name or corporate searches for DCI, SC, ARL or the aforementioned numbered company, nor did he contact any of them or the individuals associated with them, and he did not know whether any of them qualified as an accredited investor. Gallucci further testified that he did not question Baker about the Impugned Subscription Agreements when he interviewed Baker under oath.

#### **D. Securities Counsel for KCP**

[75] The Respondents called as a witness MK, the securities counsel for KCP during the Relevant Period.

[76] In the latter half of 2003 or the beginning of 2004, KCP approached the law firm (the Law Firm) with which MK was associated for legal advice about raising money through prospectus exemptions. MK received instructions on behalf of KCP from Baker only. MK communicated with Baker "sometimes by telephone, sometimes by e-mail" and rarely face-to-face, with communication by telephone being the preferred means. Some of the e-mailed communications were entered into evidence.

[77] MK provided the Subscription Agreement, which was the form of subscription agreement used for private placements by the Law Firm. MK testified that the function of Schedule "A" to the Subscription Agreement was to "have the investor represent to [KCP] that he is an accredited investor". Further, "you have an investor subscribe to [the Exhibit to Schedule "A"] because . . . it's not enough for somebody to claim that they are an . . . accredited investor. They need to show how they're [an] accredited investor."

[78] MK testified that he gave some advice to Baker about the legal requirements to be met in order to raise money through prospectus exemptions, specifically the close personal friend exemption, the close business associate exemption and the Accredited Investor Exemption. That advice included that the Subscription Agreements "had to be properly and completely filled out". MK also indicated to Baker "in quite certain terms, what the prohibition was against listing of Stock Exchanges and things of that nature".

[79] From time to time, MK also assisted Baker in preparing letters for KCP shareholders, for example, the letter on KCP letterhead dated July 12, 2004 received by JT and other investors. MK believed that it was Baker's practice to review with him the documents that were sent to KCP shareholders.

[80] The June 2004 Form 45-103F4 and the September 2004 Form 45-103F4 (the June and September 2004 Form 45-103F4s) filed with the Commission were initially prepared by MK and other Law Firm personnel, having regard to originals or copies of the Subscription Agreements or portions thereof sent by Baker. MK testified that the Subscription Agreements or portions thereof received from Baker would have been directed first to the Law Firm's corporate services department, where a draft of a Form 45-103F4 would have been prepared. Then, a junior lawyer would have reviewed the draft Form 45-103F4 as against the Subscription Agreements. Finally, MK would have completed a quick review to ensure no glaring issues, and the draft would have been sent to Baker for his review and approval. MK said that he would have notified Baker, in writing or by telephone, of any errors or problems identified throughout the process that required correction or prevented closing on a particular investment. Letters from MK to Baker – dated June 30 and September 27, 2004 – identifying problems with certain Subscription Agreements were entered into evidence. Baker, in turn, would have advised of any changes to be made.

[81] MK testified that he did not believe that the Law Firm had any obligation to review any missing Subscription Agreement or portion thereof; if "[Baker] indicated that he had [and] he was satisfied with its content, that was sufficient for our purposes."

[82] MK further testified as follows as to the process followed in an effort to ensure the timely filing of the June and September 2004 Form 45-103F4s:

It had been a practice to prepare the document preliminarily, send it to have them execute the document, and then page slip, with their consent obviously, a document for [filing].

So . . . we prepared the document, we would send it to them. They would have a quick look at it. We would discuss whatever changes need to be made. They would send me back the signed copy. I would make those changes. Return it to Mr. Baker or walk through the changes with him. He would consent to us then having filed it.

[83] MK speculated that the June 2004 Form 45-103F4 filed by KCP on July 12, 2004 was not filed earlier because the Law Firm had not received the requisite fees and signature page from Baker earlier.

[84] Asked to compare the June 2004 Form 45-103F4 and the Draft June 2004 Form 45-103F4, both dated June 11, 2004, MK noted differences in the Schedules thereto, for which he had no definitive explanations, but testified that "the document that was filed with the Commission would have been accurate". MK said that he would have satisfied himself that he and Baker were happy with the contents of a Form 45-103F4 before filing it. He subsequently clarified that "it was [Baker's] form to be filed. I would file if he was satisfied with the contents."

#### **E. Other Evidence from KCP**

[85] We note that, in an investigative interview conducted under oath, Baker said that the KCP agents, including Hughes, were not provided with any instructions regarding the Subscription Agreements.

[86] However, in an affidavit sworn March 13, 2007 (the Pearson Affidavit), Pearson attested to locating in the files of KCP a memorandum from Baker to Hughes dated March 2, 2004, and apparently signed by both, to which was attached a photocopied page highlighting sections 92(3)(b)(i) and (4) of the Act. The memorandum read:

When referring KCP to prospective investors, please find relevant sections of the securities act.

Also, make sure each accredited investor initials the section on the form that is relevant.

### **IV. POSITIONS OF THE PARTIES**

#### **A. Staff**

[87] Referencing *Re Euston Capital Corp.*, 2007 ABASC 75, Staff urged a finding of illegal trading and distributing of KCP securities. Staff submitted that the referral process accepted by Baker and carried out by the KCP agents with little or no instruction or supervision, by which the KCP Shares were distributed to Alberta investors, failed to ensure that the KCP Shares would be offered only to those that qualified as accredited investors. Staff argued that KCP did not make reasonable or any efforts to ensure that the Accredited Investor Exemption was available to distribute the KCP Shares at the time of the distribution to any of the Alberta-resident investor witnesses. Staff also argued that, on the basis of the Impugned Subscription Agreements, KCP could not reasonably assert that the Accredited Investor Exemption was available to distribute the KCP Shares to the five associated Alberta purchasers reported by KCP in the June and September 2004 Form 45-103F4s. In that regard, Staff noted that the onus of proving an exemption's availability is on the person seeking to rely on the exemption.

[88] Staff further submitted that no weight should be attached to the memorandum introduced by way of the Pearson Affidavit, given, *inter alia*, Baker's inconsistent

statement in an investigative interview conducted under oath and Hughes' inconsistent actions in contravention of section 92(3)(b)(i) of the Act. Staff argued that, even if the memorandum were to be given some weight, it would be insufficient in that it did not inform all KCP agents to ensure the appropriate initialling by investors of the Subscription Agreements. Staff also argued that, given the lack of instruction to the KCP agents and the lack of supervision of their activities, KCP's sales of its Shares undermined the objectives of Alberta securities laws concerning exempt market distributions.

[89] Concerning misrepresentations in the June and September 2004 Form 45-103F4s filed with the Commission, Staff submitted that, in the circumstances, neither KCP nor Baker had a reasonable basis for the stated reliance on the Accredited Investor Exemption concerning certain investors. Staff also submitted that, in each of the June and September 2004 Form 45-103F4s, the date of distribution was misrepresented. In that regard, Staff argued that, at the latest, a trade was completed when KCP accepted a Subscription Agreement and payment from an investor, which, in each instance, pre-dated the applicable reported distribution date. Staff further argued that KCP's determination that it was going to hold money in trust until certain conditions were met did not necessarily mean that KCP had not already completed a trade.

[90] Finally, Staff submitted that the Respondents acted contrary to the public interest in illegally distributing or illegally trading and distributing KCP securities and in making misrepresentations in the filed June and September 2004 Form 45-103F4s. Staff made additional submissions concerning conduct by the Respondents contrary to the public interest, apparently premised on the Respondents' responsibility for any conduct by the KCP agents contrary to the public interest.

## **B. The Respondents**

[91] Counsel for the Respondents argued that KCP was and is a legitimate company, that the money raised was not misused but rather was used for corporate purposes, that there was no active solicitation by commissioned salespersons via cold calls to strangers and that the KCP agents were volunteers who were not "under [Baker's] supervision". Counsel for the Respondents also argued that the trade to each Alberta-resident investor witness did not occur until a representation of accredited investor status was made; that the investor witnesses inexcusably failed to read their Subscription Agreements; that the Subscription Agreement was created by a lawyer so that investors would understand what was meant and would particularize the basis for their accredited investor status; that, when the investor witnesses' Subscription Agreements were received by KCP, there was nothing to alert the Respondents to anything amiss; and that, in the circumstances, the investor witnesses made representations to KCP as to their accredited investor status on which the Respondents reasonably relied. Further, counsel for the Respondents argued that there was a paucity of proof that the Accredited Investor Exemption was unavailable to distribute the KCP Shares to any of the Alberta purchasers associated with the

Impugned Subscription Agreements. Thus, it was submitted that there were no illegal trades or distributions of KCP securities.

[92] Concerning misrepresentations in the June and September 2004 Form 45-103F4s filed with the Commission, counsel for the Respondents submitted that there was no or insufficient evidence to find misrepresentations on the basis of the Impugned Subscription Agreements.

[93] Counsel for the Respondents argued that the Respondents received sound legal advice, on which they relied and acted in good faith, in putting together this money-raising venture in accordance with MI 45-103, particularly the Accredited Investor Exemption, and the Companion Policy to MI 45-103 (45-103CP) and in preparing the filed June and September 2004 Form 45-103F4s. Counsel for the Respondents also argued that, in acting contrary to the memorandum introduced by way of the Pearson Affidavit and, in any event, contrary to the clear wording of the Subscription Agreement, Hughes, a volunteer, acted as a rogue, and the Respondents could not be responsible for his actions. It was submitted that, in consequence, the Allegations could not be sustained.

## **V. ANALYSIS AND FINDINGS**

### **A. Sales of KCP Shares**

#### **1. Illegal Trades and Distributions of Securities**

[94] It is clear that the KCP Shares were "securities" – as defined in section 1(ggg)(v) of the Act – and that their sales or acts in furtherance of their sales by the Respondents to Alberta investors during the Relevant Period constituted "trades" – as defined in section 1(jjj) – in those securities. As those securities had not been previously issued, those trades were also "distributions" – as defined in section 1(p).

[95] The evidence was that KCP has never filed or received a receipt for a prospectus for its offering of securities to Alberta investors, that KCP has never been registered under the Act to trade in securities and that Baker was not a registrant under the Act during the Relevant Period. Thus, the trades and distributions by the Respondents to Alberta investors during the Relevant Period would be illegal unless an exemption was available.

[96] The Respondents relied on the Accredited Investor Exemption to sell the KCP Shares to Alberta investors during the Relevant Period. The Accredited Investor Exemption permitted trades and distributions of securities, without registration and without a prospectus, to accredited investors purchasing as principal. Section 1.1 of MI 45-103 set out the criteria to qualify an individual as an accredited investor:

"accredited investor" means . . .

(k) an individual who, either alone or with a spouse, beneficially owns, directly or indirectly, financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds \$1,000,000,

(l) an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year,

(m) a person or company, other than a mutual fund or non-redeemable investment fund, that, either alone or with a spouse, has net assets of at least \$5,000,000, and unless the person or company is an individual, that amount is shown on its most recently prepared financial statements, . . .

[97] An issuer relying on an exemption in trading or distributing securities must have made a reasonable, serious effort, or taken whatever steps were reasonably necessary, to satisfy itself that the exemption was available to make the trade or distribution at the time of the trade or distribution (see *Re InstaDial Technologies Corp.*, 2005 ABASC 965 at para. 61; and *Euston Capital* at paras. 103, 115-117, 119).

[98] Five Alberta-resident investors testified that they did not qualify as accredited investors as particularized in their Subscription Agreements, that is, that they did not meet the net income test of category (l) as initialled on the Exhibit to Schedule "A". One investor witness was asked by Hughes to make an untrue representation in her Subscription Agreement by marking her initials beside the inapplicable category (l) and was assured by him that her doing so did not matter. Another investor witness was told by an existing investor, or existing and committed investors – who had been told to mark their initials beside category (l) – that it was "okay" to mark her initials beside the same category, a category that she knew to be inapplicable. Two investor witnesses had no one review with them any of the categories of "accredited investor" when they were signing their Subscription Agreements, and another investor witness did not recall anyone reviewing category (l) with him. All five investor witnesses were not told or did not recall being told that, in order to purchase KCP Shares, they had to be a qualified investor or to qualify as an accredited investor.

[99] Based on the testimony of the five Alberta investors, we conclude that, despite KCP's utilization of Subscription Agreements drafted with a view to consistency with the Accredited Investor Exemption and 45-103CP, Baker, as the guiding mind of KCP in its raising of money in the exempt market during the Relevant Period, failed to take steps reasonably necessary to ascertain whether the investor witnesses were in fact accredited investors prior to the sales of KCP Shares to them being completed. In that regard, when Baker on behalf of KCP acceded to the KCP agents' raising of money in the exempt market for KCP and supplied Subscription Agreements to them for that purpose, it became incumbent on him to take reasonable care and be diligent in providing sufficient

instruction to and supervision of the KCP agents in relation to their money-raising efforts. However, the evidence disclosed a paucity of instruction from Baker to the KCP agents and, as conceded by counsel for the Respondents, Baker failed to supervise the KCP agents adequately or at all in their money-raising efforts for KCP. There was no evidence that Baker made any attempt to ascertain the KCP agents' knowledge of Alberta securities laws or to ensure their understanding of the importance of complying with Alberta securities laws, specifically the Accredited Investor Exemption. On the evidence, as regards the investor witnesses, these deficiencies in instruction to and supervision of the KCP agents resulted in no reasonable, serious efforts being made on behalf of KCP that were consistent with the apparent intent of the Subscription Agreements; instead, the selling efforts on behalf of KCP were conducted in a manner incompatible with and obstructive of the apparent intent of the Subscription Agreements and the objectives of the exempt distributions regime. This resulted in KCP Shares being sold to persons who did not qualify as accredited investors as particularized in their Subscription Agreements. In sum, in consequence of Baker's failure to take reasonable care and be diligent in providing sufficient instruction to and supervision of the KCP agents, KCP, through Baker, could not reasonably rely on the investor witnesses' representations as to their accredited investor status in their Subscription Agreements.

[100] Staff also pointed to the Impugned Subscription Agreements as evidence that KCP could not have reasonably relied on the Accredited Investor Exemption in respect of the sales of its Shares to five associated Alberta purchasers – SW, DCI, SC, ARL and FM – as reported in the June and September 2004 Form 45-103F4s. In a hearing such as this, when it is prima facie shown that an exemption relied on by a person trading or distributing securities was unavailable, the onus of proving an exemption's availability rests on the person seeking to rely on the exemption (see *Re Hampton Court Resources Inc.*, 2006 ABASC 1345 at para. 81; and *Re Atlas Communications Inc.*, 2007 ABASC 289 at para. 61).

[101] In our view, however, it is not apparent from the Impugned Subscription Agreements concerning SW, DCI, SC, ARL and FM that KCP could not have reasonably relied on the Accredited Investor Exemption or another exemption at the time of the trades and distributions to at least some of them. For example, the Impugned Subscription Agreement concerning SW contained a written representation as to the availability of the close business associate exemption, and the Impugned Subscription Agreements concerning DCI, SC and ARL contained written representations as to the availability of the Accredited Investor Exemption. As to the former, the reporting of SW as an accredited investor in the June 2004 Form 45-103F4 does not render unapparent the availability of either the close business associate exemption or the Accredited Investor Exemption. As to the latter, we note that the Subscription Agreements contemplated beneficial purchasers being identified as accredited investors. Thus, in our view, there is nothing on the face of the Impugned Subscription Agreements concerning SW, DCI, SC and ARL that would cast doubt on the written representations in them or should have

alerted KCP, through Baker, that it could not reasonably rely on those representations or that further inquiry was warranted.

[102] In any event, based on the testimony of MK, KCP's securities counsel during the Relevant Period, and with no evidence to the contrary, we are satisfied that it is more likely than not that any omissions from or errors or uncertainties in the Impugned Subscription Agreements were detected and addressed through the Law Firm's screening process and that the June and September 2004 Form 45-103F4s correctly reflected the Accredited Investor Exemption's availability to KCP in respect of the sales of its Shares to the five associated Alberta purchasers reported. With no evidence to the contrary, we believe it reasonable to conclude that any missing portions from Subscription Agreements, such as the missing first page from the Exhibit to Schedule "A" of the Impugned Subscription Agreement concerning FM, were detected through the Law Firm's screening process and specifically addressed and resolved with Baker. Further, having regard to the omissions from the Impugned Subscription Agreements concerning VS and VL, we perceive the inclusion of VS and VL in the Draft June 2004 Form 45-103F4 and their subsequent absence from the June and September 2004 Form 45-103F4s as evidence of the effectiveness of the Law Firm's screening process.

[103] For the foregoing reasons, we find that the Accredited Investor Exemption was not available for the trades and distributions by the Respondents to the five Alberta-resident investor witnesses. It follows and we find that there were trades and distributions of KCP securities to Alberta investors during the Relevant Period in contravention of sections 75(1)(a) and 110 of the Act.

## **2. Responsibility**

[104] Through its director and officer Baker, KCP executed the Subscription Agreements, issued share certificates and filed the June and September 2004 Form 45-103F4s with the Commission. KCP covered some of the expenses of seminars and meetings hosted by the KCP agents and received and expended the money raised – over \$1.5 million – from the trades and distributions of its securities to Alberta investors during the Relevant Period.

[105] Baker, a director and senior officer of KCP, was the guiding mind of KCP in its raising of money in the exempt market during the Relevant Period. Baker was aware and supportive of the money-raising efforts of the KCP agents and he provided Subscription Agreements as well as instruction, albeit negligible, to them. He also executed the Subscription Agreements, executed share certificates and certified the filed June and September 2004 Form 45-103F4s on behalf of KCP.

[106] Thus, KCP would bear responsibility for the illegal distributions of KCP securities during the Relevant Period and Baker would bear responsibility for the illegal trades and distributions of KCP securities during the Relevant Period unless their responsibility was

negated, as their counsel argued, by their reliance on legal advice and on the KCP agents' presumed compliance with Alberta securities laws.

[107] The evidence was that Baker and KCP, through Baker, received sound legal advice about the raising of money in the exempt market and that KCP utilized Subscription Agreements drafted with a view to consistency with the Accredited Investor Exemption and 45-103CP. In our view, these were commendable, albeit insufficient, actions in the circumstances. In short, Baker and KCP, through Baker or otherwise, failed to implement reasonable measures aimed at translating the sound legal advice that they had received into practice by those at the forefront of the money-raising efforts for KCP, the KCP agents.

[108] When an issuer chooses to depend on agents – whether volunteers or otherwise – to trade and distribute its securities in Alberta, as KCP did here, it is obliged to take reasonable care and be diligent in instructing and supervising those agents with a view to ensuring their adherence to Alberta securities laws. In our view, in such circumstances, it is imperative that the issuer impress on its agents the necessity of strict compliance with any exemption or exemptions relied on. In this case, there was no evidence that Baker had stressed to the KCP agents the critical importance of ensuring that KCP securities were sold only to those who qualified as accredited investors or that he had ensured that the KCP agents understood the importance of compliance with the Accredited Investor Exemption. Indeed, having regard to the evidence, there was a paucity of instruction from Baker to the KCP agents and Baker failed to supervise the KCP agents adequately or at all in their money-raising efforts. These deficiencies in instruction to and supervision of the KCP agents led to efforts being expended on behalf of KCP that were incompatible with and obstructive of the apparent intent of the Subscription Agreements. In the result, because Baker failed to take reasonable care and be diligent in his instruction to and supervision of the KCP agents, KCP Shares were sold to persons who did not qualify as accredited investors as particularized in their Subscription Agreements.

[109] As the Commission has said in previous decisions, while Alberta investors must take care to read, understand and truthfully execute legal documents proffered by or on behalf of an issuer, their failure to do so does not necessarily negate the ultimate responsibility of the issuer to comply with Alberta securities laws (see *Hampton Court* at para. 93; and *Euston Capital* at paras. 123-124).

[110] In the circumstances, we find that KCP was responsible for the illegal distributions of KCP securities during the Relevant Period and Baker was responsible for the illegal trades and distributions of KCP securities during the Relevant Period. Thus, we find that KCP illegally distributed KCP securities, thereby contravening section 110 of the Act, and that Baker illegally traded and distributed KCP securities, thereby contravening sections 75(1)(a) and 110 of the Act.

## **B. Misrepresentations in Commission Filings**

[111] Each of the June and September 2004 Form 45-103F4s required that a certificate be signed. Baker signed as a director of KCP. The certificate stated: "On behalf of the issuer (or vendor), I certify that the statements made in this report and in each schedule to this report are true". Given our finding that Baker failed to take steps reasonably necessary to ascertain whether the Alberta-resident investor witnesses were in fact accredited investors prior to the sales of KCP Shares to them being completed, it follows that Baker had no reasonable basis for the stated reliance on the Accredited Investor Exemption concerning certain investors in the filed June and September 2004 Form 45-103F4s or for certifying that such statements were true. In our view, however, this falls short of misrepresentation as alleged by Staff.

[112] Further, we are of the view that the evidence was insufficient to show that the date of distribution was misrepresented in the June and September 2004 Form 45-103F4s.

[113] This Allegation fails.

## **C. Conduct Contrary to the Public Interest**

[114] In consequence of our findings of illegal distributions by KCP and illegal trades and distributions by Baker, we also find that the Respondents acted contrary to the public interest. Illegal trades and distributions are serious matters. They harm investors – both the investors targeted and investors in general who may lose confidence in the Alberta capital market.

[115] Staff made additional submissions concerning conduct by the Respondents contrary to the public interest, apparently premised on the Respondents' responsibility for any conduct by the KCP agents contrary to the public interest. Given the severance of allegations at the outset and in the course of this proceeding, we are disinclined to make a finding in that regard.

## **VI. CONCLUSION**

[116] By illegally distributing KCP securities, KCP contravened section 110 of the Act. By illegally trading and distributing KCP securities, Baker contravened sections 75(1)(a) and 110 of the Act. In so doing, both also acted contrary to the public interest.

[117] This decision concludes the first part of this proceeding. It remains to be decided whether it is in the public interest for us to make any orders against the Respondents. Staff are directed to file their written submissions on sanction by August 31, 2007. The Respondents are directed to file their written submissions on sanction, if any, by September 21, 2007. Staff are directed to file their written reply, if any, by September 28, 2007.

[118] Oral submissions on sanction are not required. However, if any of the parties wish to make oral submissions in addition to their written submissions, they are directed to contact the Executive Assistant to the Chair by September 7, 2007 to set a date for that purpose.

August 9, 2007

**For the Commission:**

"original signed by"  
Glenda A. Campbell, QC

"original signed by"  
Beverley A. Brennan, FCA

"original signed by"  
Karl M. Ewoniak, CA