

ALBERTA SECURITIES COMMISSION

DECISION

Citation: Wilby, Re, 2010 ABASC 121

Date: 20100318

Simon Wilby and Michael Sirman

Panel:	Stephen Murison Beverley Brennan, FCA Roderick McKay, FCA
Appearing:	Richard Finn for Commission Staff James Charnock for Simon Wilby Michael Sirman for himself
Date of Hearing:	1 March 2010
Date of Decision:	18 March 2010

I. INTRODUCTION

[1] This proceeding centred on allegations of misconduct related to the distribution of securities of The Hear Now Incorporated ("THN") from 2006 to 2008. The allegations were set out in a notice of hearing issued by staff ("Staff") of the Alberta Securities Commission (the "Commission") on 27 October 2009. Staff had alleged that four respondents – THN, Simon Wilby ("Wilby"), Gerard Besaw ("Besaw") and Michael Sirman ("Sirman") breached section 75 of the *Securities Act*, R.S.A. 2000, c. S-4 (the "Act") by conducting trades in THN securities without the requisite registration or registration exemption; breached sections 92(3)(a) and 92(4.1) of the Act by making prohibited representations to Alberta investors; and breached section 110 of the Act by engaging in a distribution of THN securities without the requisite prospectus or prospectus exemption.

[2] A hearing into the merits of Staff's allegations was held on 1 March 2010. At the commencement of the hearing, Staff announced that the allegations against THN and Besaw had been resolved and would not be pursued in this hearing, and that Staff were also not pursuing the allegations against Wilby concerning prohibited representations. In respect of the remaining allegations against Wilby, his counsel read into the record a statement of admissions – with which Staff agreed – and a joint (with Staff) submission on sanction.

[3] Staff entered into evidence a Statement of Admissions of Michael Sirman and Partial Joint Submission on Sanction, signed by both Sirman and Staff. In that document, Sirman acknowledged having had the opportunity to seek independent legal advice, and that his admissions were made voluntarily. It became apparent that Staff were not pursuing allegations against Sirman under section 92(3)(a) of the Act.

[4] Notwithstanding the considerable measure of agreement that Staff reached with each of Wilby and Sirman, it remained incumbent on the panel to consider the outstanding allegations and reach its own decision on their merits. The hearing therefore continued, with additional documentary evidence, sworn testimony by Sirman and a Staff investigator, and additional submissions and argument by Staff counsel, counsel for Wilby, and Sirman. Although Staff and Wilby agreed on both facts and sanction, and Staff and Sirman agreed on facts and, to some extent, appropriate sanction, the panel made clear that our decision below would go only to the merits of the allegations.

[5] Our findings – which are not inconsistent with the respective admissions of Wilby and Sirman, and the reasons for which are set out below – are that Wilby and Sirman each contravened sections 75 and 110 of the Act and acted contrary to the public interest in respect of trades and distributions of THN securities without the requisite registration and prospectus, or available exemptions, and that Sirman also contravened section 92(4.1) of the Act and acted contrary to the public interest by making statements that he ought to have known were misleading or omitted information necessary to make them not misleading.

II. BACKGROUND AND ANALYSIS

A. THN, Wilby and Sirman

[6] THN is a Canadian federally-incorporated company based in Calgary. In the 2006-to-2008 period relevant to this proceeding, THN was engaged in the pet product business.

[7] Wilby was, according to the evidence, a Calgary resident, the founder of THN and, until February or March 2008, a director. He admitted to also having been an officer during the relevant period. Wilby was an inventor; he transferred to THN some intellectual property used in one or more of the pet products sold by the company.

[8] Sirman, also a Calgary resident, was throughout the relevant time an officer and director of THN. Although THN corporate records and public filings were not always clear or consistent, there was no dispute that, whatever the specifics and timing of his formal appointments, Sirman acted in the capacities of a director and a senior officer of THN, including holding the titles of president and chief executive officer.

[9] At some point during the relevant period, Sirman's de facto role at THN apparently narrowed to a focus on product sales, although he retained his executive status and continued, among other things, to sign documents as THN's president. The change seems to have been prompted by the arrival at THN of Besaw. In Sirman's submissions and testimony, Besaw claimed knowledge and experience in capital-raising and took charge of that significant aspect of THN's activities. "[T]owards the end", Sirman claimed, he himself "was just a puppet", doing and signing as he was told in relation to capital-raising activities.

[10] None of THN, Wilby or Sirman has ever been registered under the Act, and no prospectus for the distribution of securities of THN was ever filed or receipted in Alberta.

[11] It was common ground that there was a real business – THN did place its pet products on retailers' shelves, spend money on its business and derive some revenue from product sales.

B. THN Capital-Raising

[12] During the relevant period, THN apparently raised over \$7 million from the sale of Class A shares. Some (as well as some Class B shares) were issued to company founders, seemingly for quite nominal consideration, but those issuances were not the subject of this proceeding. Other Class A shares were sold directly to individual investors. The great majority of the money raised, however, came from the sale of Class A shares to a variety of other companies. The evidence was that these companies served as mere conduits for the purchase of THN shares on behalf of numerous other public investors.

[13] The evidence is clear that THN sought to, and did, raise capital from a relatively large number of investors, but under the guise of an exemption from the registration and prospectus requirements available for distributions of securities to an aggregate of not more than 50 investors – the "private issuer" exemption, set out in section 2.4 of National Instrument 45-106 *Prospectus and Registration Exemptions*. The plan was to keep the number of direct THN shareholders below 50, regardless of how many investors were actually involved through the intermediate companies. This supposedly would avoid the need for registration and a prospectus.

[14] This was, of course, a thinly disguised sham arrangement: THN was marketing its shares, with the assistance of the various individuals who founded these intermediate companies, to the

ultimate investors. While those ultimate investors were, technically, purchasing shares in an intermediate company, the subscription money (net of amounts sometimes retained as a commission or fee for the intermediate company or its principals) went to THN in payment for THN shares issued to the intermediate companies. A letter from Sirman, as THN president, addressed to "potential investors" (the "Investor Letter"), stated the following:

The [THN] shares that you purchase will be assigned to a numbered company (financial club). This club will have a Shareholder's Agreement and will issue shares. For every one of these shares issued by the club, it will be equal and be supported by one share from The Hear Now Inc.

[15] In concept, and in substance, the ultimate investors were being solicited by and for THN. This investment structure was wholly inconsistent with the purpose and spirit of the private company exemption. It was transparently designed to evade the unambiguous terms of the exemption. In fact, it breached those terms and was clearly contrary to the public interest. It did not appear that THN relied on any other exemption, and Wilby and Sirman both admitted that no other exemption was available.

[16] Sirman admitted to having personally sold some \$400 000 of THN shares early in the relevant period. However, those sales apparently did not involve the impugned investment structure described above. We therefore do not address those early sales by Sirman here.

[17] However, as to the other share sales described above, they occurred when Wilby and Sirman both occupied senior positions of responsibility in THN. There is no doubt that both were aware that THN was raising money from investors through the sale of shares. Their senior positions obliged them to ensure that they, and THN, acted within the law and consistent with the public interest. Although it was suggested that some advice was given by THN's lawyer, and despite Sirman's claim not to have read the Investor Letter that he signed, we consider that – even viewed in the most favourable light – both Wilby and Sirman fell far short of exercising the degree of diligence consonant with their positions and responsibilities. Accordingly, we find Wilby and Sirman responsible for trades and distributions of THN securities in contravention of sections 75 and 110 of the Act.

[18] Wilby and Sirman both admitted these breaches, and also that their conduct was contrary to the public interest. We agree, and we so find.

C. Prohibited Representations

[19] The sale of THN shares during the relevant period was accompanied by marketing communications. In evidence were PowerPoint slides. The PowerPoint slides described, among other things, certain THN pet products; presented data on the commercial market for pet products; described other potential markets or applications for THN technology; and set out some sales and financial projections. One such slide, for example, included the following statements about one particular product:

- √ We have **2000** Stores ready to sell our product . . .
- √ Each Store will sell approximately **14.7** units per store/month . . .

- √ With a **NET** net profit of \$35.21 per unit sold, we realize a net profit of 12,429,052 Dollars per year.
- √ After the return of all investment, the company is still left with 7,400,000 Dollars of profit by the end of 2008.
- √ The estimated **Net** profit for 2009 is 24,620,344 Dollars followed by 39,522,673 Dollars by the end of 2010

[verbatim, with original emphasis]

[20] Another slide, headed "Investment Opportunity" – clearly indicating a capital-raising purpose behind the preparation of the slides – included the following statements:

2008 Projected R.O.I. [in context, presumably "return on investment"] of 119%

Anticipated 50% of investment returned in Q2 of 2008

In Q4 of 2008, you will have received 69% in dividend payouts, totalling 119%

[21] In fact, there was no evidence that THN made any profit at all "by the end of 2008", or generated any positive return for the investors. THN financial data in evidence showed THN sales revenues dwindling in the third quarter of 2008 from approximately \$10 000 for July to a mere \$500 for September. By that time, according to Sirman, the company had shifted its focus from pet products to some new technologies that it hoped to develop in the Chinese market.

[22] The Investor Letter from Sirman to "potential investors" was, according to the evidence, circulated during the period relevant to the allegations. We reproduce the body of the Investor Letter here verbatim, in its entirety:

I, Michael Sirman, President of The Hear Now Inc., wish to confirm the following: that our marketing team is in the process of concluding the sale of our product line with distributors and or retailers in over 14 countries. To date, we have finalized our arrangements with the Canadian distributor and are in the process of finalizing our arrangements with the retail stores in the United States. We expect that by September we shall be concluding our overseas contracts with Italy, France, Germany etc. . . These countries have placed letters of general intention for over 18 million units. We are anticipating three years before it is fully into place at which time our company should be able to pay out at least \$60 U.S. per share with sales of \$1.69 billion U.S. at a cost of over \$598 million. Thus far, the team has done a marvellous job in creating a tremendous demand for our product line. Now we need your help-your investment money- to secure our inventory. If all goes well, dividends should be paid out as early as December 2007.

Example:

Cost to the distributor		
\$94.00 per unit x 18 million units = 1.69 billion in sales -----		1.69 billion U.S.
Expense to The Hear Now Inc.		
\$21.00 per unit x 18 million units = 378 million U.S.		
Cost of operations + commission + royalties = 238 million U.S.		
Total cost = 598 million -----		(598 million U.S.)
Profit =		1.092 billion U.S.

There are a total of 18 million shares. From the 1.092 billion profit , The Hear Now Inc. can pay out 1.092 billion in dividends at \$60.00 U.S. per share assuming that our inventory is fully stocked.

The shares that you purchase will be assigned to a numbered company (financial club). This club will have a Shareholder's Agreement and will issue shares. For every one of these shares issued by the club, it will be equal and be supported by one share from The Hear Now Inc.

For example: For every 1000 shares assigned to you, you SHOULD receive \$60,000.00 U.S. per year @ 60.00 dividend PER SHARE. With 3000, you will earn \$180,000.00 U.S. per year when all agreements are in place.

Furthermore, this financial club will have the flexibility in the Shareholders Agreement to take the revenue that it is receiving from The Hear Now Inc. and invest it into other ventures such as construction projects, oil and gas, etc. . . if it is your wish to do so!!!

Regards,

Michael Sirman

[here, Sirman's signature appeared]

President of The Hear Now Inc.

[23] Although the Investor Letter included a few words indicative of the numerous assumptions underlying the forecasts or projections, the document as a whole nonetheless, in our view, conveyed an exceptionally – and, more important, unjustifiably – optimistic picture. It indicated, seemingly without basis, a high degree of success already attained – " . . . the team has done a marvellous job in creating a tremendous demand for our product line".

[24] This letter is very troubling. Staff did not take the position that, in signing the letter, Sirman had intended to mislead or, indeed, had necessarily made explicit positive misrepresentations. Staff did not dispute Sirman's assertion, before us, that he was not the author of the letter. As noted, Sirman himself – when asked whether he had believed the letter at the time – suggested that he had not read it before signing. More broadly, he stated to the panel that everything he did he believed to have been "on the best behalf of the shareholders". Whatever his intention, we are satisfied that the Investor Letter was misleading. At the very least, it omitted a good deal of factual information – for example, actual sales results to date; actual financial results to date; and risks and uncertainties inherent in the various assumptions about future sales and profitability. Given his role in THN and his direct involvement in product sales, Sirman ought to have known (if he did not actually know) that the letter was misleading. Further, even if he truly never read it before signing, he did sign it, thus making it his statement to the addressee "potential investors".

[25] The evidence linking Sirman to the PowerPoint presentations was less definitive; their preparation and presentation dates, for example, were neither evident nor discussed before us. That said, Sirman in his own statement of admissions expressly referred to both the \$60.00 dividend (mentioned in the Investor Letter) and the projected "R.O.I." of 119% for 2008 (included in the PowerPoint slides) as representations prohibited by section 92(4.1) of the Act for which he bore responsibility.

[26] We agree with that admission. We find that Sirman contravened section 92(4.1) of the Act by making misleading or untrue statements – or omitting necessary information – that would reasonably have been expected to have a significant effect on the value or price of THN shares, and that he (at the very least) ought to have known this to be the case. The Act's prohibition of such conduct is designed to protect investors from being misled into making uninformed and inappropriate investment decisions, and to protect the integrity and fairness of the capital market. We therefore find that this conduct of Sirman was also contrary to the public interest.

III. CONCLUSION

[27] To summarize, in connection with sales of THN securities during 2006 to 2008, we find (consistent with their respective admissions) that: Wilby contravened sections 75 and 110 (the registration and prospectus requirements) of the Act, and in so doing acted contrary to the public interest; and Sirman contravened those provisions of the Act as well as section 92(4.1) (by making prohibited representations), and in so doing he also acted contrary to the public interest.

[28] This proceeding will therefore move to a second phase, for the determination of whether it is in the public interest for us to make any sanction orders against Wilby or Sirman, and whether to order the payment of any costs of the investigation and hearing. As mentioned, counsel for Wilby has already read into the record a joint proposal, with Staff, for sanctions and costs orders against Wilby, and the evidence includes a written statement that set out some partial agreement between Staff and Sirman as to appropriate sanctions against him. The panel, however, has made no determination on these issues. The parties may reiterate these already-expressed positions, supplement them or, indeed, alter them. Moreover, as this remains a proceeding involving two respondents, Wilby and Sirman are entitled to make submissions in respect of one another.

[29] We direct that any such submissions be provided in accordance with the following timelines (all material for the panel to be addressed accordingly and delivered to the Commission's Registrar).

- On the issue of orders, if any, that may be appropriate against Wilby:
 - he and Staff are both directed to inform the panel and one another, by **16:00 on Monday 5 April 2010**, as to whether or not they respectively wish to rely solely on the submissions already on record;
 - if Wilby expresses a wish not to rely solely on the submissions already on record, he is to provide written submissions to Staff, Sirman and the panel by **16:00 on Tuesday 20 April 2010**;
 - if Staff express a wish not to rely solely on the submissions already on record, they are to provide written submissions to Wilby, Sirman and the panel by **16:00 on Tuesday 20 April 2010**;
 - if Wilby provides a written submission, Staff and Sirman may make written replies, to be provided to one another, Wilby and the panel by **16:00 on Tuesday 27 April 2010**; and

- if Staff provide a written submission, Wilby and Sirman may make written replies, to be provided to one another, Staff and the panel by **16:00 on Tuesday 27 April 2010**.
- On the issue of orders, if any, that may be appropriate against Sirman:
 - Staff are to provide written submissions to Sirman, Wilby and the panel by **16:00 on Monday 5 April 2010**;
 - Sirman and Wilby are to provide any written submissions to one another, Staff and the panel by **16:00 on Tuesday 20 April 2010**; and
 - Staff may make a written reply, to be provided to Sirman, Wilby and the panel by **16:00 on Tuesday 27 April 2010**.
- Any party who wishes to supplement their written submissions with oral submissions is to so inform the Registrar by **16:00 on Thursday 29 April 2010**. Such oral submissions would be heard by the panel commencing at **10:00 on Tuesday 11 May 2010**.

18 March 2010

For the Commission:

"original signed by"
Stephen Murison

"original signed by"
Beverley Brennan, FCA

"original signed by"
Roderick McKay, FCA