ALBERTA SECURITIES COMMISSION

DECISION

Citation: Re Chmelyk, 2017 ABASC 109 **Date: 20170614**

Ferlyn Robert John Chmelyk, Blackbridge Financial Inc., 1735560 Alberta Ltd., 1735563 Alberta Ltd., 1751886 Alberta Ltd. and Studio 33 Inc. (formerly 1751889 Alberta Ltd.)

Panel:	Tom Cotter Webster Macdonald, QC Richard Shaw, QC
Representation:	Peter Verschoote for Commission Staff Craig Leggatt for Studio 33 Inc.
Submissions Completed:	May 3, 2017
Decision:	June 14, 2017

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I. INTRODUCTION

[1] After an eight-day hearing into the merits of allegations made by staff (**Staff**) of the Alberta Securities Commission (**ASC**), we found that Ferlyn Robert John Chmelyk (**Chmelyk**), Blackbridge Financial Inc. (**BFI**), 1735560 Alberta Ltd. (**560**), 1735563 Alberta Ltd. (**563**), 1751886 Alberta Ltd. (**886**) and Studio 33 Inc. (formerly 1751889 Alberta Ltd.) (**889**) each contravened Alberta securities laws. The findings, and the underlying facts, are more fully discussed in *Re Chmelyk*, 2017 ABASC 13 (**Merits Decision**).

[2] Once we issued the Merits Decision, the proceeding moved into a second phase to determine what, if any, sanctions and cost-recovery orders ought to be made against each of the respondents. We established a timeline for the parties to make written submissions on this issue. Staff provided written submissions along with their estimated investigation and hearing costs. The respondents were given an opportunity to be heard (including an extension of their filing deadline), but they provided no submissions.

[3] For reasons set out below, we are ordering an array of sanctions against Chmelyk, BFI, 560, 563 and 886. We are also ordering Chmelyk to pay investigation and hearing costs in the amount of $90,000.

II. BACKGROUND

[4] We summarize here the facts pertinent to our analysis.

A. Blackbridge

[5] In February 2012, BFI raised $425,000 from four Alberta investors in exchange for BFI securities. While marketing BFI securities, Chmelyk and BFI (the **Blackbridge Respondents**) told investors that a BFI subsidiary (Blackbridge Wealth Advisory Corporation (**BWAC**)) was "an exempt market dealer" and "a securities registrant". These statements were material and untrue, as Chmelyk had consented to the suspension of BWAC's registration months earlier and its status did not change throughout the relevant period. Other statements made by the Blackbridge Respondents to investors – that a TSX-traded company had agreed to provide capital financing to BFI and to provide liquidity to BFI shareholders if they exercised certain share conversion rights – were also found to be material and untrue. In addition to this misconduct, the Blackbridge Respondents also acted as a dealer without registration and illegally distributed BFI securities.

[6] Chmelyk, as BFI's sole director and chief executive officer, was BFI's guiding mind at all relevant times, and he authorized, permitted or acquiesced to BFI's contraventions of Alberta securities laws.

[7] The BFI investors lost all of their capital contributions, and one investor also incurred approximately $25,000 to $30,000 in legal fees seeking to recover his funds.

B. Cerezo Developments Inc.

[8] In 2013, Chmelyk entered into a business venture with Clifford George Alexander (**Alexander**) to develop real estate. They created Cerezo Developments Inc. (**Cerezo**), with Chmelyk owning (indirectly) 60% of the company. An agreement between Chmelyk and Alexander provided that Chmelyk would contribute "business and real estate development and operational expertise" while Alexander would provide "development operating capital".

[9] Four real estate projects were pursued separately through 560, 563, 886 and 889 (collectively, the **Cerezo Subsidiaries**). At all relevant times, Chmelyk was the sole director and president of each Cerezo Subsidiary, and we found him to be a guiding mind of each Cerezo Subsidiary.

[10] Most of the capital raised for the Cerezo Subsidiaries' projects came from individual investors, who signed joint venture agreements that provided them with a right to a "pro-rata share of the profits". 560 raised at least $490,000 from 13 investors between May and October 2013; 563 raised at least $450,000 from four investors between June 2013 and January 2014; 886 raised at least $155,000 from three investors between June and August 2013; and 889 raised $765,000 from a single investor in March 2014. While Alexander referred all but one of the investors, Chmelyk met with at least four individual investors and signed the joint venture agreements on behalf of the Cerezo Subsidiaries. Investors ultimately received full payment of their capital contribution plus a return on their investment.

[11] We found in the Merits Decision that the joint venture agreements were investment contracts, and that each was therefore a "security" within the meaning of the *Securities Act (Alberta)* (**Act**). We also found that the securities of 560, 563 and 886 were issued without a prospectus having been filed or an available exemption from the prospectus requirement (with one exception pertaining to one of 563's investors), and that Chmelyk, 560, 563 and 886 had therefore illegally distributed securities. We dismissed Staff's allegations that Chmelyk and Cerezo were engaged in the business of trading in the Cerezo Subsidiaries' securities.

[12] 563 and 889 both failed to file Form 45-106F1 reports with the ASC for their respective prospectus-exempt distributions.

[13] Finally, we determined that Chmelyk authorized, permitted or acquiesced to the Cerezo Subsidiaries' contraventions of Alberta securities laws. We dismissed a similar allegation against Cerezo in respect of the Cerezo Subsidiaries' contraventions.

C. Alexander's Settlement Agreement

[14] Prior to the merits hearing, the Executive Director of the ASC entered into a settlement agreement with Alexander to resolve Staff's allegations against him. In the agreement, Alexander – "a directing, controlling and guiding mind of each" Cerezo Subsidiary – admitted to having contravened ss. 75 and 110 of the Act by acting as a dealer without being registered and participating in distributions of securities without a prospectus or a prospectus exemption, and acting contrary to the public interest. Alexander undertook to pay $30,000 to the ASC, although this payment was not specifically identified in the agreement as being either a monetary sanction or a cost-recovery order. Alexander also agreed to be subject to certain market restrictions (as modified by limited carve-outs) for a period of one-and-a-half years.

III. PARTIES' POSITION ON SANCTIONS AND COST-RECOVERY ORDERS

A. Staff's Position

[15] For Chmelyk's misconduct, Staff seek an administrative penalty of $75,000, an order requiring Chmelyk to pay investigation and hearing costs of $100,000 and "10 year market access restrictions . . . which shall not expire until Chmelyk repays his administrative penalty in full". The requested market-access restrictions include orders that:

- prohibit Chmelyk from trading in or purchasing securities or derivatives;
- exemptions contained in Alberta securities laws do not apply to Chmelyk;
- prohibit Chmelyk from engaging in investor relations activities;
- prohibit Chmelyk from becoming or acting as a director or officer (or both) of any issuer, registrant, or certain other market participants;
- prohibit Chmelyk from advising in securities or derivatives;
- prohibit Chmelyk from becoming or acting as a registrant, investment fund manager or promoter; and
- prohibit Chmelyk from acting in a management or consultative capacity in connection with activities in the securities market.

[16] In respect of the corporate respondents, Staff seek permanent market-access restrictions against BFI, 560, 563 and 886. Staff do not seek any sanctions against 889.

B. Respondents' Positions

[17] As mentioned, we received no submissions from Chmelyk, BFI, 560, 563 or 886.

[18] Counsel for 889 advised that, in light of Staff's position that they were not seeking sanctions against 889, it had no submissions.

IV. SANCTIONS

A. The Law

[19] Sections 198 and 199 of the Act authorize an ASC hearing panel to impose sanctions against a respondent when it is in the public interest to do so. A sanctions order is preventive in nature and prospective in orientation – not punitive or remedial – having as its purpose the protection of the public interest, having due consideration for investor protection and the efficiency of, and public confidence in, the capital market (*Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37 at paras. 39-45). While specific deterrence (discouraging repeated misconduct by a respondent) and general deterrence (discouraging similar misconduct by others) are both legitimate considerations, an appropriate sanction must ultimately be proportionate and reasonable (*Re Cartaway Resources Corp.*, 2004 SCC 26 at paras. 52-62; *Walton v. Alberta (Securities Commission)*, 2014 ABCA 273 at para. 154).

[20] We adopt here the recent restatement of the applicable sanctioning factors from *Re Homerun International Inc.*, 2016 ABASC 95 at para. 20:

> In making the requisite sanctioning assessment and determination, several factors are considered. Numerous potential factors have been discussed in past ASC decisions including *Re Lamoureux*, [2002] A.S.C.D. No. 125 at para. 11 (affirmed on other grounds 2002 ABCA 253); *Re Workum and Hennig*, 2008 ABASC 719 at para. 43 (affirmed 2010 ABCA 405); and *Re Hagerty*,

2014 ABASC 348 at para. 11. With a view to clarifying the interaction of principles and factors, it is helpful here to recast the analytical framework by coupling the principles discussed above with a refined enumeration of sanctioning factors:

- the seriousness of the respondent's misconduct;
- the respondent's pertinent characteristics and history;
- any benefit sought or obtained by the respondent; and
- any mitigating or aggravating considerations.

B. Staff's Submissions on Sanctions

[21] Staff submitted that the untrue statements were "very serious" and caused BFI investors to make investment decisions based on misinformation. The misinformation regarding BWAC's business was critically material to the value of BFI's shares, whereas the false information as to the involvement of a TSX-traded company "made the BFI investment seem more credible and safe to investors". The Blackbridge Respondents' illegal trades were said to be "also very serious", as this misconduct deprived BFI investors of "the opportunity to invest through a registered EMD" who could provide suitability advice on the investment. Similarly, the illegal distributions were serious, as they resulted in four investors losing a total of $425,000.

[22] While none of the respondents have been previously sanctioned by the ASC or "by any other relevant regulatory body", Staff asserted that Chmelyk's capital-market misconduct occurred "within months" of the suspension of his registration with the ASC and "should be viewed as a significant aggravating factor".

[23] Staff contended that the $425,000 raised from BFI investors constituted a financial benefit to BFI, and that Chmelyk benefitted financially from the reimbursement of his expenses. Staff also submitted that 560, 563 and 886 received a collective financial benefit of at least $1,095,000 (the amounts found to have been raised for these entities) and that Chmelyk financially benefitted by receipt of at least $30,000 for referring investors to the Cerezo Subsidiaries.

[24] The Blackbridge Respondents' misconduct harmed investors, who did not receive "any returns of or on capital", and one investor incurred an additional $25,000 to $30,000 in legal fees "attempting to recoup his losses". Staff also pointed to investors' evidence indicating that their losses were significant and made them cautious about investing in the capital market in the future. No mention was made of any harm resulting from the Cerezo Subsidiaries' misconduct.

[25] Chmelyk was described as posing "a significant risk" to future investors and the capital market unless his misconduct is appropriately sanctioned. Staff highlighted the egregiousness of the untrue statements, the "continued pattern of illegal fundraising" and Chmelyk's capital-market experience, which warranted sufficiently severe sanctions to deter him and others who might emulate his misconduct.

[26] BFI, 560, 563 and 886 were also said to "pose a significant risk to future investors and Alberta's capital market if not appropriately sanctioned", given the seriousness of their misconduct. Staff contended that these companies pose a continuing threat and should be

sanctioned accordingly, given that they remain active Alberta corporations and are controlled by Chmelyk.

[27] Staff acknowledged that certain mitigating factors were present, notably that Chmelyk (and Alexander) "repaid" $1,917,207.92 to all of the investors in 560, 563 and 886. Staff also suggested that BFI, 560, 563 and 886 "had genuine, albeit somewhat unsuccessful businesses", which mitigates the seriousness of their misconduct.

[28] Staff suggested a $75,000 administrative penalty and 10-year market-access restrictions for Chmelyk to be sufficient to achieve the necessary specific and general deterrence while taking into account mitigating factors. Staff also sought to tie the expiration of the market-access restrictions to Chmelyk's payment (in full) of the administrative penalty. Staff submitted that permanent market-access restrictions for BFI, 560, 563 and 886 would be appropriate to achieve specific and general deterrence, and that such orders were consistent with prior ASC decisions.

[29] In respect of 889, Staff did not consider a sanction to be warranted "because the only finding made against it in the Merits Decision was that it failed to file one report of exempt distribution". Staff also indicated that 889's sole investor reinvested with the company, and that Alexander (not Chmelyk) was now 889's "sole director and effective 100% voting shareholder".

C. Analysis

1. Seriousness of Misconduct

[30] We consider the Blackbridge Respondents' misconduct to be very serious. It caused four Alberta investors to make important investment decisions based on materially false information, while deprived of key protections afforded by the Act, resulting in a collective loss of $425,000. This argues for significant sanctions to deter the Blackbridge Respondents and others from engaging in similar misconduct.

[31] The illegal distribution of 560's, 563's and 886's securities was also serious. It too caused investors to advance large sums of money without the benefit of a prospectus or an available exemption. Although investors ultimately received their original capital contributions plus a return on their investment, this misconduct was a serious contravention of Alberta securities laws.

[32] Chmelyk authorized, permitted or acquiesced to 560's, 563's and 886's misconduct. Even though he may have thought the joint ventures fell outside the scope of Alberta securities laws, this does not diminish the seriousness of his misconduct, particularly given his capital-market experience and background (as discussed below). The seriousness of Chmelyk's misconduct is also not diminished by assurances he purportedly received from Alexander (later determined to be incorrect) that the joint venture offerings had been prepared by, or with the assistance of, legal counsel. Chmelyk, as the director, officer and directing mind of 560, 563 and 886, bore ultimate responsibility to ensure their compliance with Alberta securities laws.

[33] The exempt-distribution report filing requirement is important, as it gives the ASC certain information that is useful in monitoring the capital market. However, we view the single instance here of failing to file the report as a technical contravention, which does not warrant sanction.

2. Characteristics and History

[34] Staff acknowledged, and we accept, that none of the respondents have previously been sanctioned, either by the ASC or by any other Canadian securities regulatory authority.

[35] In some circumstances, the lack of sanctioning history might moderate the perceived need for specific deterrence, but that is not the case here. Chmelyk had previously been registered as BWAC's Ultimate Designated Person and had taken an "Officers' Partners' and Directors' Course", which (according to Chmelyk) was "designed for the EMD market". Chmelyk was thus familiar with the requirements of Alberta securities laws – particularly in relation to the prospectus-exempt market – yet he was careless about their observance.

[36] In his Staff interview (in response to a question as to whether his experience provided an understanding as to what "should go into an offering memorandum"), Chmelyk explained that they "couldn't hire law firms to help us" due to the lack of "funding . . . to pay a law firm to vet it". This implies that Chmelyk recognized he needed to obtain legal advice to ensure compliance with securities laws, but proceeded to raise money from BFI investors without it. This demonstrated preference for expediency over prudence raises concerns over Chmelyk's future participation in the capital market and indicates a clear need for specific deterrence.

[37] Moreover, we consider it self-evident that providing misinformation to investors when raising capital is wrong (*Re Global Social Capital Partners, Inc.*, 2016 ABASC 97 at para. 17 (**Global**)).

3. Benefits Sought or Obtained

[38] Both BFI and the Cerezo Subsidiaries raised capital from the public in a manner contrary to Alberta securities laws. While the Cerezo Subsidiaries' investors were fully repaid their capital contributions along with a return on their investments, the same cannot be said of the BFI investors. In both circumstances, Alberta securities laws were contravened with the intent to profit.

[39] We were not provided with any clear evidence that Chmelyk received a direct personal benefit from his misconduct. Chmelyk denied receiving investor funds through the Cerezo Subsidiaries. While Alexander's counsel suggested to Staff investigators that Chmelyk had received a modest referral fee, the evidence was unclear whether Chmelyk received that fee or the project management fees (the latter being a term in the joint venture agreements). Nonetheless, Chmelyk was in business with a view to making a profit and we have no doubt that his misconduct was motivated, at least in part, to benefit financially.

4. Mitigating or Aggravating Considerations

[40] We accept that the repayments in full to the Cerezo Subsidiaries' investors by Chmelyk are mitigating circumstances. Staff also suggested that the existence of a genuine business was a mitigating factor. While the respondents' business ventures may have had legitimate purpose, we are not persuaded that this merits any reduction or modification of sanction, taking into account the general and specific deterrence otherwise required.

5. Outcomes in Other Proceedings

[41] As noted in *Re Holtby*, 2015 ABASC 891 (at para. 54): "A consideration of previous decisions and settlement outcomes, particularly those involving the same or similar factual

background and allegations, is essential in determining what sanctions are proportionate to the circumstances of a respondent's misconduct and to the personal circumstances of the respondent".

[42] Staff cited three ASC decisions as relevant to our determination of sanctions: *Global*, *Re Johnston*, 2013 ABASC 456 and *Re McKenzie*, 2014 ABASC 506. We have considered these decisions in our assessment of what sanctions, if any, ought to be imposed. We have also taken into account Alexander's settlement with Staff.

6. Conclusion on Appropriate Sanctions

[43] We conclude that significant sanctions are necessary in the public interest to instill the requisite deterrence demanded by the respondents' misconduct. That is particularly so in respect of the Blackbridge Respondents' contraventions, which were more serious and lacked the mitigating facts present in the Cerezo Subsidiaries' securities distributions.

[44] Consistent with Staff's position, we consider both an administrative penalty and market-access restrictions to be necessary and in the public interest to address Chmelyk's misconduct. We also consider market-access restrictions for BFI and the Cerezo Subsidiaries to be warranted in respect of their misconduct.

[45] In our view, a $75,000 administrative penalty, together with market-access restrictions of 10 years for Chmelyk, will suffice as general and specific deterrence in the circumstances. We also consider it appropriate to tie the duration of the market-access restrictions to payment of the administrative penalty.

[46] We turn now to the sanctions to be assessed for BFI, 560, 563 and 886. We consider permanent market-access restrictions to be appropriate for BFI. Although Staff were of the view that restrictions of similar duration should also be imposed on 560, 563 and 886, proportionality considerations suggest that a shorter duration is appropriate for their misconduct, which we found to be relatively less serious, and to recognize the mitigating facts relating specifically to their misconduct. Accordingly, we order market-access restrictions against 560, 563 and 886 for a period of 10 years.

[47] As mentioned, we have accepted Staff's recommendation not to impose a sanction on 889.

V. COST RECOVERY

A. The Law

[48] Section 202(1) of the Act authorizes an ASC hearing panel, if satisfied after conducting a hearing that a respondent has contravened Alberta securities laws or acted contrary to the public interest, to order the respondent to pay "costs of or related to the hearing or the investigation that led to the hearing, or both". As stated in *Re Marcotte*, 2011 ABASC 287 at para. 20:

> A costs order is not a sanction, but rather a means of recovering, from a respondent found to have engaged in capital-market misconduct, certain investigation and hearing costs that would otherwise be borne indirectly by law-abiding market participants whose fees fund the [ASC's] operations. It is generally appropriate that a respondent pay at least some portion of the relevant costs. Determination of the appropriate portion may involve assessing parties' contributions to the efficient conduct and ultimate resolution of the proceeding.

[49] Cost-recovery orders are typically not made in respect of allegations that have been withdrawn or dismissed, and if such costs "cannot be readily separated" from those incurred in relation to proved allegations, "a panel may estimate the proportion fairly attributable to a particular respondent and particular proved allegations" (*Spaetgens* at para. 108). The reasonableness of the remaining costs claimed by Staff may then be assessed, taking into account the respondents' contributions (if any) to the efficiency of the proceeding.

B. Staff's Submissions on Costs

[50] Staff tendered a statement, along with supporting documentation, identifying investigative and hearing costs of $134,665.02. Staff submitted that Chmelyk, as the guiding mind of BFI, 560, 563 and 886, was primarily responsible for Staff's investigation and hearing costs. Staff acknowledged that Alexander was also responsible for an unspecified portion of the costs related to Staff's investigation and reduced their costs request by approximately 25%. Accordingly, Staff's position was that Chmelyk should pay $100,000 of Staff's investigation and hearing costs.

C. Analysis

[51] Not all of Staff's allegations were proved. In particular, Staff failed to establish that Chmelyk acted as a dealer in respect of the Cerezo Subsidiaries. Staff also did not prove any of the allegations against Cerezo (that it acted as a dealer or that it authorized, permitted or acquiesced to the Cerezo Subsidiaries' misconduct), as well as some of the allegations that BFI and some of the Cerezo Subsidiaries failed to file exempt distribution reports. Staff's submissions did not appear to account for these unproven allegations.

[52] As acknowledged by Staff, some of the investigative and prehearing costs are also the responsibility of Alexander. Although the precise amount cannot be readily identified, we agree with Staff's submission that a 25% reduction provides a reasonable estimate of the investigation and settlement time attributable to Alexander.

[53] We are reducing the $100,000 of costs sought by Staff by a further $10,000 to account for the allegations that were not proved.

VI. CONCLUSION

[54] For the reasons given, we make the following orders.

[55] Against Chmelyk, we order that:

- under section 198(1)(d) of the Act, he must resign all positions he holds as a director or officer (or both) of any issuer, registrant, investment fund manager, recognized exchange, recognized self-regulatory organization, recognized clearing agency, recognized trade repository or recognized quotation and trade reporting system;

- until the later of June 14, 2027 and the date on which the administrative penalty ordered against Chmelyk has been paid in full to the ASC

- under section 198(1)(b) and (c), he must cease trading in or purchasing securities or derivatives, and all of the exemptions contained in Alberta securities laws do not apply to him;

- under section 198(1)(c.1), he is prohibited from engaging in investor relations activities;

- under section 198(1)(e), he is prohibited from becoming or acting as a director or officer (or both) of any issuer (or other person or company that is authorized to issue securities), registrant, investment fund manager, recognized exchange, recognized self-regulatory organization, recognized clearing agency, recognized trade repository or recognized quotation and trade reporting system;

- under section 198(1)(e.1), he is prohibited from advising in securities or derivatives;

- under section 198(1)(e.2), he is prohibited from becoming or acting as a registrant, investment fund manager or promoter; and

- under section 198(1)(e.3), he is prohibited from acting in a management or consultative capacity in connection with activities in the securities market;

- under section 199, he must pay an administrative penalty of $75,000; and

- under section 202, he must pay $90,000 of the costs of the investigation and hearing.

[56] Against BFI, we order, with permanent effect, that:

- under section 198(1)(a), (b) and (c) of the Act, all trading in or purchasing of securities or derivatives of BFI must cease, BFI must cease trading in or purchasing securities or derivatives, and all of the exemptions contained in Alberta securities laws do not apply to BFI;

- under section 198(1)(c.1), BFI is prohibited from engaging in investor relations activities;

- under section 198(1)(e.1), BFI is prohibited from advising in securities or derivatives;

- under section 198(1)(e.2), BFI is prohibited from becoming or acting as a registrant, investment fund manager or promoter; and

- under section 198(1)(e.3), BFI is prohibited from acting in a management or consultative capacity in connection with activities in the securities market.

[57] Against 560, 563 and 886, we order that until June 14, 2027:

- under section 198(1)(a), (b) and (c) of the Act, all trading in or purchasing of securities or derivatives of 560, 563 and 886 must cease, 560, 563 and 886 must cease trading in or purchasing securities or derivatives, and all of the exemptions contained in Alberta securities laws do not apply to 560, 563 and 886;

- under section 198(1)(c.1), 560, 563 and 886 are each prohibited from engaging in investor relations activities;

- under section 198(1)(e.1), 560, 563 and 886 are each prohibited from advising in securities or derivatives;

- under section 198(1)(e.2), 560, 563 and 886 are each prohibited from becoming or acting as a registrant, investment fund manager or promoter; and

- under section 198(1)(e.3), 560, 563 and 886 are each prohibited from acting in a management or consultative capacity in connection with activities in the securities market.

June 14, 2017

For the Commission:

"original signed by"
Tom Cotter

"original signed by"
Webster Macdonald, QC

"original signed by"
Richard Shaw, QC