ALBERTA SECURITIES COMMISSION

DECISION

Citation: Re Kostelecky, 2017 ABASC 42 **Date: 20170314**

Joseph Anton Kostelecky

Panel:	Stephen Murison Ian Beddis Fred Snell, FCA
Representation:	Don Young for Commission Staff
Hearing:	6 December 2016
Decision:	14 March 2017

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I. INTRODUCTION

[1] Joseph Anton Kostelecky (**Kostelecky**) was alleged by Alberta Securities Commission (**ASC**) staff (**Staff**) to have engaged in misconduct in connection with Poseidon Concepts Corp. (**Poseidon**). More specifically, he was alleged to have contravened the *Securities Act* (Alberta) (the **Act**), and to have acted contrary to the public interest, by (i) causing, authorizing, permitting or acquiescing in a breach, by Poseidon, of certain of its 2012 continuous disclosure obligations; (ii) failing to maintain necessary books and records; and (iii) engaging or participating in a fraud.

[2] This proceeding, and these allegations, originated in a February 2015 notice of hearing that also named three other individuals and Poseidon itself as respondents. In mid-2016 the allegations against all of Kostelecky's individual co-respondents were resolved through settlement agreements with Staff (we therefore sometimes refer to those individuals as **Settling Respondents**), and Staff withdrew their allegations against Poseidon.

[3] The case against Kostelecky was heard in December 2016. We received documentary evidence, witness testimony and submissions from Staff.

[4] Kostelecky declined to participate in the hearing, despite having been given notice and the opportunity to be heard. We understood it to have been Kostelecky's position that he had not "attorned to the jurisdiction" of the ASC, and therefore (by apparent implication) that we lacked jurisdiction in the matter. Such a position was without merit.

[5] As discussed below, Staff proved their allegations against Kostelecky. This proceeding therefore now moves into a second phase, for the determination of what (if any) orders ought to be made against him.

II. BACKGROUND

A. The Original Respondents

[6] In 2012 Poseidon was a public company – a reporting issuer under the Act, with common shares listed on the Toronto Stock Exchange. According to Poseidon's annual information form for 2011 (the **AIF**), Poseidon's head office was in Calgary and it had a "regional management centre in Denver, Colorado" and a "field office in North Dakota".

[7] Poseidon's chief executive officer in 2012 was Lyle Dennis Michaluk (**Michaluk**). He was also a Poseidon director. Michaluk was one of the Settling Respondents.

[8] The other two Settling Respondents were Clifford Leroy Wiebe (**Wiebe**), who in 2012 was a director of Poseidon and held the titles of president and chief operating officer, and Poseidon's chief financial officer in 2012, Matthew Cory MacKenzie (**MacKenzie**).

[9] Kostelecky is a United States **(US**) resident. The AIF identified him as Poseidon's "Senior Vice-President, U.S. Division". He was promoted on 9 May 2012 to become "Executive Vice President" of Poseidon, "still overseeing U.S. operations and business development". Kostelecky apparently left Poseidon in December 2012.

B. Poseidon's Business Generally

[10] Poseidon provided temporary storage tanks to the oil and gas industry. Some customers were charged only for the period during which a hired tank was on location. Poseidon sometimes referred to these as "live tank" arrangements; we call them simply **Rentals**. Other customers entered into take-or-pay arrangements giving them assured access to Poseidon tanks over an agreed period, for which they would be charged irrespective of whether they actually took delivery of a tank; we refer to these as **TOP Contracts**.

[11] Rentals predominated in Canada, although there were apparently a small number of Canadian TOP Contracts. Douglas Robinson (**Robinson**, who was Poseidon's "Operations Controller" for part of 2012), testified that between "65 and 75 percent" of the company's recorded revenue from the US pertained to TOP Contracts.

[12] The US business was important to Poseidon. For the nine months ended 30 September 2012 (the **Interim Period**) a note to Poseidon's interim financial statements (the **Interim Statements**) stated that the company's "revenue is 85 percent from U.S. customers and 15 percent from Canadian customers".

[13] Poseidon's US operations were in some documents described as being conducted through its US "Division", possibly an informal reference to Poseidon's indirect wholly-owned US subsidiary, Poseidon Concepts Inc. In any event, Alan Scott Dawson (**Dawson**), chairman of Poseidon's board of directors in 2012, testified: "I don't think we ever really made a distinction between the two entities."

[14] Although there were occasional disputes with customers (for example, over the precise dates for which a customer was charged), there did not appear to have been significant or systemic difficulties with the Rentals business, or with TOP Contracts outside the US. The allegations centred on the US TOP Contracts, and Poseidon's associated 2012 financial disclosure.

C. 2012 Financial Reporting

[15] As a reporting issuer, Poseidon issued and filed audited annual financial statements and unaudited interim financial statements. The financial statements in evidence were consolidated statements, including results of the US operations.

[16] Poseidon's financial statements showed consolidated revenue rising from just under $79 million for the year ended 31 December 2011 to just over $148 million for the nine months ended 30 September 2012. Poseidon's balance sheet (to use an old but well understood term) showed accounts receivable rising from under $54 million (slightly over 50% of total assets) at 31 December 2011 to over $125 million (some 62% of its total assets) at 30 September 2012.

[17] Poseidon said the following in its Interim Period "Management's Discussion and Analysis" (**MD&A**) about what it termed "dramatic revenue growth" and "sharply increased revenues":

> . . . the Corporation's accounts receivable are expectedly higher and the average number of days to collect receivables has increased as the Corporation continues to implement improvements to its

> invoicing and collections processes. Management conducts frequent detailed reviews of the accounts receivable amounts as part of its ongoing credit risk assessment procedures and reviews the amounts quarterly in determining bad debt expense; amounts are written down to their expected realizable value when management determines they are not fully collectible. During the three month period ended September 30, 2012, bad debt expense of $9.5 million was recorded.

D. Poseidon Disavows its Interim Statements

[18] By the summer of 2012, questions were apparently being asked about Poseidon's growing US accounts receivable, with some concern (at least internally) about progress in collecting on those accounts.

[19] Poseidon engaged Robinson in June 2012. Part of his work involved getting a grasp on the state of US customer contracts. Through this work he came to have doubts (which he shared with some members of Poseidon's senior management) about the US TOP Contracts generally – not just about Poseidon's ability to collect amounts ostensibly owed to it under the contracts, but about the terms, and even the very existence, of many of the contracts.

[20] To some extent Robinson's concerns came to be shared by individuals within Poseidon's senior management and board of directors. By the time the Interim Period results were announced in November 2012, there was an acknowledgement that some of the accounts receivable (albeit only a fraction of those troubling Robinson) were not collectable. The Interim Period income statement (to use another old but well understood term) therefore reported the bad debt expense (approximately $9.5 million) mentioned in the above excerpt from the MD&A.

[21] This did not dispose of the matter. A drop in Poseidon's share trading price apparently followed disclosure of the Interim Period bad debt expense. According to Dawson, this so concerned the directors that on 19 or 20 November 2012 they designated him "executive chairman", tasked with looking into the situation. The board also formed a special committee of directors, which (through its legal counsel) commissioned an accounting firm to assist it. That firm's team was led by chartered accountant Neil Narfason (**Narfason**).

[22] These efforts (which appeared to corroborate Robinson's expressed worries) led Poseidon to issue a dramatic news release on 14 February 2013 (the **Announcement**): its financial statements for the first three quarters of 2012 would be restated and "all previous guidance with respect to the Company's business should no longer be relied upon", because "approximately $95 million to $106 million . . . of the Company's $148.1 million in revenue for the [Interim Period] should not have been recorded as revenue", and "approximately $94 million to $102 million . . . of the Company's $125.5 million accounts receivable as at [the end of the Interim Period] should not have been recorded" as such.

[23] Narfason made clear in his testimony before us that this was not a matter of writing off bad debts (as might be appropriate in a case of delinquent customers, for example). Rather, the Announcement reflected a determination that up to 70% or 80% (or more) of reported revenue and accounts receivable never qualified as such in the first place.

[24] Poseidon did not long survive this debacle. According to Michaluk (in his June 2016 settlement agreement with Staff), a court granted Poseidon protection from its creditors in April 2013 and the company effectively ceased business.

III. THE ALLEGATIONS

[25] Staff alleged that Kostelecky:

- failed to maintain books and records of Poseidon necessary to record properly its business transactions and financial affairs, contrary to section 60.1(2)(a) of the Act;

- caused, authorized, permitted or acquiesced in the contravention by or failure of Poseidon to comply with its disclosure obligations, contrary to section 146 of the Act; and

- engaged in a course of conduct that perpetrated a fraud on a person or company, contrary to section 93(b) of the Act.

[26] Staff further alleged that Kostelecky's conduct – in particular the "failure to maintain and provide accurate information regarding Poseidon's revenue and accounts receivable" – was contrary to the public interest.

IV. THE EVIDENCE

A. Kostelecky's Roles at Poseidon

[27] Documentary evidence (including transcripts of Staff investigative interviews of personnel from Poseidon's Denver office) and witness testimony established Kostelecky to have played a significant role at Poseidon, more indeed than his formal titles perhaps suggested.

[28] The significance of the US operation to Poseidon was apparent from its proportionate contribution to the consolidated revenue, earnings and accounts receivable reported in the financial statements mentioned earlier. We are in no doubt that this significance was well known, throughout 2012, by all company executives.

[29] The evidence was that Kostelecky exercised broad authority over the US operation, including but not limited to sales aspects. Michaluk and Robinson both confirmed that Kostelecky was Poseidon's only executive officer in the US. Michaluk confirmed that Kostelecky was in charge of US sales and operations and "heavily involved in all business operations in the US", with "the pulse on . . . basically any arrangements with customers in the US". MacKenzie similarly confirmed to Staff (in the course of investigative interviews) that Kostelecky was Poseidon's "only executive-level [US] employee" and "the only executive in the US operations". Robinson identified Kostelecky as the person who "ran the US operations". He confirmed that Kostelecky not only supervised US "business development" (sales) staff, but also performed a senior sales role himself involving negotiations with US-based customers. However, Robinson (like Michaluk) testified to Kostelecky performing a broader role: "All activity [we understood him to have been speaking of the US], whether it was sales, operations, or finance-related was funneled through" Kostelecky. **AF**, an "operations accountant" and then

"U.S. operations accounting supervisor" in Poseidon's Denver office, confirmed to Staff in an investigative interview that Kostelecky "oversaw" the US operations, and that this included him giving direct instructions to US accounting personnel as to how they should perform their duties.

[30] Irrespective of formal titles, Kostelecky was a member of a small inner circle of "executive leadership" at Poseidon. On 4 May 2012, shortly before Kostelecky was appointed Executive Vice President of Poseidon and clearly with that change in mind, Michaluk sent Kostelecky an email stating the following:

> It's a small thing but I view you as an Executive VP which is the Cdn version of top executive . . . and quite frankly internally gives you a differentiating title from other Sr VPs. But don't need to go changing business cards if you don't want to. I'm fine either way as well . . . just as long as you know you get a 1/3 vote on all important biz [sic] matters along with Cliff [Wiebe] and I is all I really care about!!

[31] Michaluk conceded in the hearing that this email did not describe a formal voting process, and that in fact he considered there to have been "a four-man executive leadership team at the time" – himself, Wiebe, MacKenzie and Kostelecky – but he affirmed the spirit of the email, namely that Kostelecky was "an equal partner in guiding the business".

[32] Consistent with this, Kostelecky participated in meetings of Poseidon's management and, although not himself a director, he was a regular invitee or participant in directors' meetings. He was recorded as such in meeting minutes, and Michaluk confirmed that it was "very common" for Kostelecky to give the directors a detailed update on US operations. Dawson testified that Kostelecky was often questioned by the directors, and that Kostelecky "unquestionably" understood that he was being relied upon for information relating to US sales.

[33] In a May 2014 investigative interview by Staff and US counterparts (transcript excerpts of which were in evidence), Kostelecky confirmed an ability to understand financial statement information, and he stated in respect of information about Poseidon's US operations: "I was aware that it was rolled up into Calgary." Michaluk confirmed having understood that Kostelecky knew this. Indeed, he testified that Kostelecky provided input into Poseidon news releases and financial statements.

B. US TOP Contracts: Recordkeeping Procedures

[34] The evidence indicated that contracts for Rentals were short – a one-page term sheet with a second page for signatures – and that TOP Contracts similarly set out all their terms before the final, signing page.

[35] Control and tracking of Rental arrangements reflected the nature of those arrangements, with customers charged only in respect of identifiable tanks actually placed in the field for use. Bookkeeping and invoicing would reflect information from trucking and field "tickets" issued at particular points in the delivery, installation, dismantling and removal process. This system seemed to work; Robinson testified that Rentals were not generally problematic.

[36] The ticket system could not be relied on to the same extent for TOP Contracts, simply because those arrangements did not depend on a tank being delivered or installed, or even allocated to any particular customer pending a delivery request.

[37] In theory, copies of all customer contracts (Rentals and TOP Contracts) were supposed to be entered into an electronic file that Poseidon personnel referred to as the "public drive" or "P-drive".

[38] There also seemed to have been a general understanding within Poseidon that a signed TOP Contract should, or must, be in place before an associated account receivable or revenue was booked. This general understanding would have been shared by Kostelecky, according to Michaluk.

[39] Corroboration of this – and also of Kostelecky's full awareness of the significance to Poseidon of US-sourced revenue and receivables – is seen in some of his email correspondence from April 2012. On 19 April 2012 he wrote the following (in response to a complaint about apparent first-quarter billing glitches) to a group of addressees including Michaluk, MacKenzie and Wiebe:

> I am compelled to do some looking in the mirror and I suggest we all do the same to make sure we are all doing all we can do every day to enhance and solidify our "Systems", company and financial stability. . . . The issue at hand is clearly not getting data in the system . . .. Every week the data needs to be analyzed and adjusted based on our contracts and signed commitments (please look them up on the P drive if there's a question on one). . .. I will have my people wrap their arms around it tomorrow . . . and input and record the proper data so it reflects the TRUE representation of revenue.

[40] A few days later, on 24 April 2012, **KS** (a member of the accounting staff in Poseidon's Denver office) emailed Kostelecky, explaining that in the course of trying to input certain contract-related data some errors (seemingly totalling over $5 million) had been discovered. Kostelecky responded:

> That makes no sense to me? I gave clear direction of what to enter, I did not want anyone deciding one was a duplicate or an error or omission. Let the system do that after the fact! Now I have to spend my entire evening going through what you ladies 'decided' to enter and not what I directed you to do. Ladies this is not a game we are a publicly held company with a fiduciary responsibility to our shareholders.

[41] Kostelecky forwarded this message to a member of Poseidon's Calgary office staff, complaining: "Sometimes people amaze me they have no idea or can fathom the responsibility I have representing 90 percent of this companies revenue and ongoing future and not do what I ask . . .."

C. Key Testimony and Related Documentary Evidence

1. Robinson and Denver Accounting Staff

[42] As Poseidon's Operations Controller from June to November 2012, Robinson's tasks included improving the company's internal operational and financial reporting and its internal controls relating to inventories and revenue.

[43] Robinson testified that it became apparent soon after he joined Poseidon that the company had "significant issues" with its cash flows and recording of revenue, specifically relating to US TOP Contracts: the time interval between recording revenue "on their financial statements" and "actually . . . collect[ing] that money seemed to be well outside the normal limits for the industry". "They had large, outstanding receivable balances that weren't being collected", even while Poseidon was paying "large monthly dividends". As Robinson expressed it, Poseidon's business plan, and its dividend commitments, were built on the assumption of "full utilization" of its storage tanks in the US. He stated that "[t]he company wasn't going to survive unless we . . . got this under control."

[44] Robinson affirmed that all US sales "went through" Kostelecky. He agreed that Kostelecky either directly negotiated or approved all US TOP Contracts, and he described Kostelecky as "the linchpin in the whole process . . .. He had the relationship with the [US] customers."

[45] To address the collections problem, Robinson initiated weekly meetings with members of what he variously termed "management" or "the executive", specifically including Michaluk, MacKenzie and Kostelecky. He testified that they "normally would not hold [these] meetings without" Kostelecky present either in person or by telephone. At these meetings they would discuss receivables ascribed to particular customers, and an "action plan" for collecting the amounts booked.

[46] Robinson recalled that these meetings generally resulted in Kostelecky agreeing to talk to the customers, and claiming he had appointments lined up. Then at follow-up meetings Kostelecky would present "a variety of stories" – "Yes, they're going to pay", "We'll have a cheque next week". Later, when no cheque arrived, Kostelecky would offer excuses – for example, as to why he had been unable to meet with a customer. Robinson also recalled Kostelecky blaming some of the discrepancies on supposed "invoicing errors".

[47] With the US TOP Contracts collections problem thus unresolved, and despite what he suggested was internal resistance to "the finance group" speaking directly with customers and "creat[ing] tension", Robinson himself went to the US (apparently in the summer of 2012) to delve further into the situation, assisted by accounting personnel at the Denver office.

[48] Robinson testified to sketchy supporting documentation and what he termed "disconnects" in the information he found in the P-drive or elsewhere. The "majority" of the US TOP Contracts "weren't signed by the customers". Poseidon had booked accounts receivable and revenue for numbers of tanks that did not match the numbers on the contracts.

[49] AF told Staff in her investigative interview that her group did not usually – or ever – have signed TOP Contracts; a "lot" of the information about their terms instead "was verbal from [Kostelecky]". KS, who indicated that her main job responsibility was invoicing US customers, told Staff in her investigative interview that Kostelecky:

> . . . would tell us to invoice for items that we didn't have paperwork for or weren't agreed upon by the customer, and if I raised questions, there seemed to be a little bit of issue on that type of thing.

> . . .
>
> He would just say do it or he would say come to him first before asking anyone else anything.

[50] Poseidon's records would show that an invoice had been generated, but not what was then done with invoice. It transpired that some of the recorded invoices "were never ever sent to a customer". Robinson acknowledged that he would not expect a customer to know what had to be paid without having been given an invoice.

[51] This was not a case of mere clerical oversight. Robinson testified that although invoicing for US customers would generally have been the responsibility of the Denver accounting department, "invoicing clerk" KS "was often directed by [Kostelecky] not to deliver invoices to certain customers". AF told Staff that KS prepared invoices for TOP Contracts (as mentioned, she would have relied largely or entirely on Kostelecky's "verbal" descriptions of contract terms) but did not send the invoices to the customers. According to AF, this was because Kostelecky either took the invoices and said he would take care of delivering them, or instructed KS to hold onto them until he provided her with other information or direction. AF told Staff that most, if not all, invoices in 2012 were held back in this way, although associated revenue and accounts receivable were being booked.

[52] Kostelecky's role in the withholding of invoices was corroborated by a 4 May 2012 email in which he told KS, "[p]lease do not send these [TOP Contract invoices] anymore until I get you the contract and mailing lists", offering as explanation that invoices for TOP Contracts were being rejected because they were not handled (at the customer end, presumably) by the people who dealt with Rentals. KS confirmed to Staff that in the second quarter of 2012 she began to hear from customers that they were not going to pay invoices they had been sent for TOP Contracts. She recalled being told by Kostelecky that invoices had been sent "to the wrong address so the wrong people were looking at them and they didn't understand what they were". (Apart from Kostelecky's claim, there was no evidence that misdelivery of invoices for US TOP Contracts was a widespread problem, if it occurred at all.)

[53] KS told Staff that when she queried AF about the propriety of some of what she was being directed to do, AF's response was that "[Kostelecky] said to do it so just do it".

[54] Robinson and his colleagues sent US customers written statements of amounts owing, according to invoices (sent or not) recorded in Poseidon's accounting system. AF told Staff that this occurred in August 2012, and that it prompted immediate rejections by "[m]ore or less" all of the customers (only one stood out in her recollection as having paid without protest). Robinson had also created "a source of conflict" internally: he would order accounting personnel to send out "all the invoices", only to have the order countermanded by Kostelecky. When questioned about this by Robinson in the weekly meetings, Kostelecky would respond:

> I'm discussing the issue with the customer. I'm dealing with it. I don't want them blindsided or
> . . . I don't want you to rock the boat while I'm resolving this issue.

[55] In email conversations with Denver accounting personnel, Robinson presented some specific questions (and doubts) about the arrangements with particular customers. For example,

one former customer that had used tanks in 2011 was shown on Poseidon books as having contracted to pay $877,000 per month in 2012 for tanks that it never used. Robinson questioned this because it "seem[ed] fishy".

[56] Robinson and his Denver colleagues endeavoured to reconcile the billing and receivables information, assembling whatever supporting documentation could be found and making quantitative and qualitative observations, customer by customer. Poseidon personnel referred to the process as "scrubb[ing]".

[57] Robinson communicated with Kostelecky in the course of this work. In one email exchange, Robinson explained to Kostelecky (on 24 August 2012) that "[t]he crux of the matter . . . is do we have customer signed contracts . . . to validate what we are billing on these contracts?" Kostelecky responded: "There are only 3 vendors [sic] all of which are small that do NOT have a signed contract!!" [emphasis in the original]. When Robinson explained that he was prepared to try to collect on contracts for which there was proof –"even an email" – Kostelecky answered, "Great we have all documentation". Despite that, Robinson testified that he never saw confirming documentation, even in the form of emails. Overall, Robinson did not recall a single contract (we understood him to be referring to the US TOP Contracts) "that was being recorded properly in our books".

[58] Clearly aware that Robinson was encountering challenges in the US, MacKenzie emailed him on 30 August 2012 to ask whether his "ulcer [was] growing, maintaining, or shrinking". Robinson's response: "Definitely growing." He elaborated as follows, to MacKenzie's expressed shock:

> Lots of calls being made, lots of blank [stares], and head scratching from our customers end. There is an extremely wide gap in their expectations of these "contracts" and ours.
>
> In a lot of cases I have been talking to customers who we have millions of dollars in receivable balances who have no idea [of] who Poseidon is, aren't set up in their systems, no MSA's [master service agreements with oilfield service companies] on file, no W2's [a US tax form] on file etc. Good news is that 95% of the customers we have spoke to seem very "eager" to figure out what is going on, and why these obligations haven't been recorded on their books.
>
> Bad new is that I have [absolutely] no confidence that we will be paid any of the contract revenue that we have entered, (likely in the 60 million dollar range). Going to collect everyones comment from calls at end of day, and likely need to call [Kostelecky] at end of day to give a chance to explain what is happening here. Tomorrow[']s meeting will either be very long or very short, because there are no immediate plans on anyone['s] end to pay these.

[59] A week later Kostelecky was to provide back-up documentation. He showed up two days late with a "couple [of] bankers boxes' worth of documents". Robinson reported to MacKenzie that this development raised his confidence level to "about a 5" out of 10. However, he testified that his confidence level fell back to zero out of 10 once he had reviewed the contents of the boxes. Most of the documents were those already viewed from the electronic files. Many were unsigned or otherwise (in Robinson's view) "not enforceable", and their terms often did not match what had been recorded in Poseidon's books.

[60] Despite that setback, what Robinson described as "an ongoing battle" to obtain supporting documentation from Kostelecky continued. At one point KS had asked a US salesperson "to get confirmation that [a customer] wanted . . . tanks long term so we had it in writing and could bill for a year". That prompted the following 5 October 2012 email from Kostelecky, addressed to the salesperson and copied to KS:

> Please do not bother Mr. [B] anymore with an "email confirmation" that is NOT required by me!!!!! And I make that decision, great work on [the customer] and keep making those great relationships my friend. For further reference when you ever receive another communication from accounting requesting that please forward those request[s] to me directly. DO NOT jeopardize your and the companies relationship that you built for a request that's not authorized [or] necessary! [emphasis in the original]

[61] Robinson also testified to instances indicative of more than merely deficient or mishandled documents:

> A . . . At least on two separate occasions, we had -- once I had contacted customers, we had supplied documentation that we had on file. In one situation, they claimed that the signature was not theirs; it was a forgery. And in the second situation, the customer provided a document that they had signed, so there was a signature page that they had signed that was a completely different document than the one we were provided for; so they had signed a different document. But what was on our contracts or P-drive was a signature page attached to an actual rental term sheet.
>
> Q Okay, so –
>
> A To make it appear that this was an executed contract.
>
> Q So in relation to the second item, you're saying a signature line from a different agreement was connected or put together with the first page of a rental agreement?
>
> A That's correct.

[62] As the reconciliation work progressed, Robinson apparently circulated to Poseidon executives evolving versions of a table indicating which customer files had been "scrubbed" to date and which were still to be done. For each customer the table outlined the state of documentation on file, "Billing Variance[s]" and amounts that would have to be reversed ("Credits Required") if a contract could not be verified. The version of this table circulated on 1 October 2012 named 41 customers (or supposed customers), for 34 of which the reconciliation work had been done. In only 10 cases had a signed contract been found, and in no case did the terms of the contract seem to align exactly with what had been booked. In most cases only an unsigned contract (or none at all) had been found. Even what was arguably the only reassuring example – a signed contract was on file and the status notation read "working on collection & payment expected" – had revealed billing discrepancies. At perhaps the other end of the spectrum was a notation suggesting that, although a signed contract had been found, the customer in that case was disputing its signature. In all, at that point Robinson's team had identified over $28 million in "Billing Variance[s] Based on Contract", and more than $51 million that might have to be reversed.

[63] In mid-October 2012 Robinson circulated a table summarizing accounts receivable information for 69 named US customers. Among other things this showed that almost $22 million had been collected since 1 July, but that almost $106 million (including Rentals as well as TOP Contracts) was "Outstanding". Over $16 million of the "Outstanding" amount had never been invoiced. Robinson told us that Poseidon "was likely never going to see a dime" of what the table showed to be almost $75 million in outstanding US TOP Contracts. He further testified to having communicated to management his own view that "Zero" of the outstanding amount was collectable.

[64] KS was asked in her investigative interview about Robinson's efforts to implement improved processes that would require "backup" and "having everything in writing". She told Staff that Robinson "got a [lot of] pushback for that from" Kostelecky, who "said that the clients didn't like it and it was just creating problems".

[65] KS also told Staff that Kostelecky said he had signed contracts that were not in the P-drive, but were kept in Dickinson, North Dakota. KS followed up with that Poseidon office, but the contracts could not be found there either.

[66] As this internal process continued, work would have begun toward preparing Poseidon's financial statements for the Interim Period. These were ultimately finalized, approved, certified and released on 14 November 2012. There were also communications with Poseidon's external auditors concerning their requests for information relating to the accounts receivable.

[67] According to Robinson, Kostelecky made representations to Poseidon's senior management that most of the supposed TOP Contract receivables were collectable. He did concede that there were some bad debts, but not to the extent of the approximately $9.5 million bad debt expense ultimately reflected in the Interim Statements.

[68] On 16 November 2012 Robinson circulated among Poseidon executives a table summarizing amounts unpaid or disputed (or both) for 38 named customers. Notations indicated that apart from disputes over amounts unpaid, some of the customers may have overpaid in the past. The table reflected Robinson's view that just under $74 million relating to TOP Contracts was "questionable or uncollectable".

[69] Robinson testified to discomfort with Poseidon's Interim Statements, specifically in respect of the continued recognition of US TOP Contract revenue, and he told us that he "did not believe that management was willing to take the steps necessary to correct the problem with the revenue". He tendered his resignation, and left Poseidon in November 2012 after just six months on the job. We observe that Robinson – whose concerns proved correct – stands out as something of a solitary voice of reason in an otherwise unedifying saga.

2. A Director's Perspective: Testimony of Dawson

[70] Dawson testified that Poseidon's directors were scheduled to meet on 13 November 2012, but that at Michaluk 's request they convened on 7 November in a "pre-board meeting". First alerted at this meeting to the prospect of recognizing "[$]6 to $7 million" in bad debts, the board was "shocked . . . given that we had no previous expectation of an accounts receivable bad-debt

issue". Dawson observed that, to the board, this bad debt expense – which rose to the ultimately reported figure of approximately $9.5 million "through negotiations during the week with MacKenzie, Michaluk" and the external auditors – "c[a]me out of left field".

[71] Dawson himself considered the bad debt expense to be large. However, he described Kostelecky as "very reassuring on the balance of the contracts as being collectable". Kostelecky told the directors that some "concessions" had to be made "to some of the larger customers . . . to maintain . . . future business relationships because of [a claimed] mess-up with invoicing and field ticketing and billings". However, Kostelecky was "very confident that there was going to be no issues collecting the balance of these outstanding accounts". Dawson (and presumably other non-management board members) had "never" seen Robinson's table showing approximately $74 million in questionable revenue or accounts receivable.

[72] Designated by the board to look into the problem, Dawson went in "late November" to a meeting in Denver with Kostelecky, Michaluk, MacKenzie and others. They reviewed the status of 30 contracts, Kostelecky commenting on each. Dawson understood Kostelecky to consider that "80 percent of the [US TOP Contracts] were . . . going to be collectable". They brought in a lawyer whom Dawson recalled stating that, were Kostelecky to provide "all of the data he says is there, I would be happy to take these [collection] files on contingency". Kostelecky "was tasked to provide that information" – Dawson said that he asked Kostelecky to do so "[m]any times" – but Kostelecky did not deliver.

[73] Kostelecky was given orders to focus on collecting accounts receivable but he resisted, to the point of threatening resignation. Dawson dissuaded him for a time because "[w]ithout him, we really had nothing. He had the supposed contracts [with] these companies. He made the deals."

[74] Kostelecky did eventually resign, apparently in December 2012.

[75] Dawson told us that "it was becoming more and more apparent that there was a substantial lack of data on these contracts", and that "as time went on, it became more apparent that we were getting into a more difficult situation . . . in terms of the accounts receivable". He said that by approximately mid-December 2012 the Poseidon board was receiving legal advice and had established a special committee (which, through counsel, would retain Narfason's firm). Work on US TOP Contracts continued into January 2013. It included an unpleasant face-to-face meeting with a US customer who, in Dawson's words, accused Poseidon of "double-billing" and its employees of "forging documents". The situation culminated in the determination effectively to withdraw Poseidon's Interim Statements, via the Announcement.

3. Testimony of Narfason

[76] Narfason shed further light on problematic aspects of Poseidon's accounting, and on who was involved.

[77] He explained that information relating to US TOP Contracts was recorded in Poseidon's books by what he termed the "Poseidon US accounting group" – not personnel in the Denver office, but two of Kostelecky's nieces working in Dickinson, North Dakota (neither of them, to

Narfason's knowledge, holders of an accounting designation). They would enter the monthly value of a TOP Contract into a "suspense" receivable account, which does not "age" the receivable to indicate how long (for example, 30, 90 or 120 days) it has been outstanding. Narfason stated that receivables are "not supposed to sit" in a suspense account, because leaving them there "masks the aging aspects" that might otherwise identify whether something is a "valid receivable".

[78] Narfason, who spoke to the nieces, affirmed that it was Kostelecky who provided them direction to make these suspense account entries. Like Robinson, he found that supporting documentation was scarce; there was evidence of supposed TOP Contract customers who did not sign contracts, and who did not receive invoices or even learn that they were recorded as Poseidon customers until after the fact.

[79] Specifically, Narfason said that "for the nieces to enter revenue and [accounts receivable] . . . on a basis of an unsigned two-page contract is a . . . first control breach . . . they shouldn't be able to do that". He further testified that a "system should be trying to look for support" such that, through a monthly reconciliation of suspense accounts to supporting documentation, a supported receivable would be transferred to an aging account, and an unsupported receivable would be "just reversed".

[80] At a yet further control point, according to Narfason, "somebody" should have questioned how "84 percent of . . . year-to-date revenues are sitting in receivables" (as he thought Poseidon's books had showed for the Interim Period), a situation that he said "just doesn't make any sense, it's not plausible".

[81] Narfason said that, in "a proper controlled environment", "at the end of the first month or two" any inflated accounts receivable and revenue "would have been picked up and . . . should have been corrected".

[82] In all, Narfason's evidence was that Poseidon lacked the sort of "robust" accounting controls appropriate to its type of business. (Robinson made a similar point, more specifically: "Normally you want a segregation of duties between the operations group and people delivering the invoices.")

4. Observations by MacKenzie and Denver Accounting Staff

[83] The evidence derived from MacKenzie through his investigative interviews was of limited assistance, largely because he appeared to have been trying to present himself to Staff as unaware of what was happening in Poseidon's US operation and essentially a dupe of Kostelecky. Other evidence – notably from, or involving, Robinson – suggests that MacKenzie was rather better informed, at least through communications from Robinson. That said, some of what MacKenzie told Staff was consistent with other evidence, and we accepted it as corroborated, or as corroborating other evidence; examples are mentioned elsewhere in this decision.

[84] Parts of the MacKenzie investigative interviews may also have shed some light on how Kostelecky behaved with his colleagues at Poseidon. MacKenzie described Kostelecky as "a

very charismatic and very lik[e]able guy at times" but, when things did not go his way, "aggressive" and, in his dealings with Poseidon staff, "a tyrant". AF similarly compared Kostelecky's management style to that of "a dictator". A writing style somewhat corroborative of this was seen in various emails from Kostelecky quoted elsewhere in this decision.

[85] Such observations about Kostelecky were, of course, not determinative of any of the allegations; this is not an inquiry into management styles or personality traits. However, behaviour such as described above – at least when coupled with the appearance of remarkable sales success – might help to account for the deference seemingly accorded Kostelecky by others at the helm of Poseidon in 2012.

5. Kostelecky's Investigative Interview

[86] Given Kostelecky's non-participation in the hearing, the most proximate indication of his position on the allegations here might have been found in his mentioned May 2014 investigative interview. However, apart from portions referred to elsewhere in this decision, the transcript excerpts in evidence contained nothing compelling and germane to the allegations.

V. THE LAW

A. Evidentiary Burden and Standard

[87] As the ASC has observed in a number of past decisions (for example, *Re Arbour Energy Inc.*, 2012 ABASC 131 at para. 36), Staff have the burden of proving their allegations to the applicable evidentiary standard: the balance of probabilities. As explained by the Supreme Court of Canada, this requires a determination as to "whether it is more likely than not that an alleged event occurred", based on "sufficiently clear, convincing and cogent" evidence (*F.H. v. McDougall*, 2008 SCC 53 at paras. 46 and 49).

[88] This is an administrative proceeding, to which "the laws of evidence applicable to judicial proceedings do not apply" (section 29(f) of the Act). Section 29(e) of the Act states that a hearing panel is to "receive that evidence that is relevant to the matter being heard". The threshold for admissibility of evidence is, therefore, relevance. Among other things, this means that hearsay evidence is admissible if relevant. An assessment of the weight to be given such evidence will take into account indicators of reliability, which can include corroboration by other evidence (*Arbour* at para. 46).

B. Provisions Allegedly Contravened

1. Books and Records

[89] Section 60.1(1) of the Act states that section 60.1 "applies to every . . . reporting issuer, and every officer [and] director . . . of a reporting issuer".

[90] Section 60.1(2)(a)(i) requires "[e]very person or company to which this section applies [to] maintain . . . the books and records that are necessary to record properly its business transactions and financial affairs. . . ."

2. Financial Statement Obligations

[91] Section 146(a) of the Act requires a reporting issuer to "provide prescribed periodic disclosure about its business and affairs". Relevant rules include National Instrument 51-102 *Continuous Disclosure Obligations* (**NI 51-102**), which among other things prescribes the timing

and content of annual and interim financial statements and associated MD&A. National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards* (**NI 52-107**) requires that financial statements of an entity such as Poseidon "be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises" (section 3.2).

[92] National Instrument 14-101 *Definitions* defines "Canadian GAAP" to mean "generally accepted accounting principles determined with reference to" the *Handbook of the Canadian Institute of Chartered Accountants* (the **Handbook**). By the date of the Interim Statements, the Handbook incorporated the International Financial Reporting Standards *Conceptual Framework* principle that financial information must "faithfully represent" relevant economic phenomena, and International Accounting Standard 1 *Presentation of Financial Statements*, which states in part (at section 15): "Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions . . . ".

[93] The ASC has commented in other cases on the importance of financial statements and other corporate disclosure. We adopt the following remarks from *Re Flag Resources (1985) Limited*, 2010 ABASC 143 (at paras. 112 and 119):

> Disclosure is a cornerstone principle of securities regulation. Alberta securities laws recognize that timely, complete, accurate and accessible disclosure of information protects investors by giving them the information they need to weigh the benefits and risks associated with a particular investment decision. This regulatory focus on disclosure of information also promotes investor confidence and market integrity and efficiency.
>
> . . .
>
> . . . financial statements form the foundation of a reporting issuer's continuous disclosure record. A reporting issuer is obliged to ensure that the financial statements it files pursuant to Alberta securities laws are prepared in accordance with GAAP.

3. Fraud

[94] Section 93 of the Act states:

> No person or company shall, directly or indirectly, engage or participate or attempt to engage or participate in any act, practice or course of conduct relating to a security, a derivative or an underlying interest of a derivative that the person or company knows or reasonably ought to know may
>
> . . .
>
> (b) perpetrate a fraud on any person or company.

[95] The concept and elements of fraud in the context of section 93 of the Act were discussed as follows in *Re Platinum Equities Inc.*, 2014 ABASC 71 (at paras. 40-42):

> The applicable law was set out in [*Re Capital Alternatives Inc.* 2007 ABASC 79 (affirmed *sub nom. Alberta (Securities Commission) v. Brost*, 2008 ABCA 326)] at para. 309 and has been followed in several subsequent ASC decisions:
>
> > The term "fraud" is not defined in the Act. The gist of the meaning is not, however, difficult to discern. Johnston and Rockwell [in *Canadian Securities*

> *Regulation*, 4th ed. (Markham: LexisNexis, 2006) at 421] point to the elements of fraud as enunciated at common law by the Supreme Court of Canada in *R. v. Théroux*, [1993] 2 S.C.R. 5 at 27, which has been adopted in the context of securities regulation (for example, in *Anderson v. British Columbia (Securities Commission*), 2004 BCCA 7 [leave to appeal refused [2004] S.C.C.A. No. 81] at para. 27):
>
> > . . . the actus reus of the offence of fraud will be established by proof of:
> >
> > 1. the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and
> > 2. deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim's pecuniary interests at risk.
> >
> > Correspondingly, the *mens rea* of fraud is established by proof of:
> >
> > 1. subjective knowledge of the prohibited act; and
> > 2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim's pecuniary interests are put at risk).
>
> It is no defence to a fraud allegation that the alleged perpetrator did not profit from the alleged fraud (*Théroux* at 17).
>
> The *mens rea* element may reasonably be inferred from the totality of the evidence (*Brost* at para. 48). A respondent's subjective belief that no one will ultimately be hurt is no defence to a fraud allegation; it is sufficient to have knowingly engaged in a prohibited act and to have known that the prohibited act could place investors' pecuniary interests at risk (*Re DeLaet*, 2013 ABASC 42 at para. 90). As noted in *Théroux* (at 24): "Many frauds are perpetrated by people who think there is nothing wrong in what they are doing or who sincerely believe that their act of placing other people's property at risk will not ultimately result in actual loss to those persons."

VI. ANALYSIS

A. Preliminary Findings

[96] The evidence enables us to make several preliminary findings pertinent to the allegations against Kostelecky.

1. Kostelecky is a Proper Party

[97] First, as mentioned at the outset of this decision, there was no merit to the suggestion (if such it was) that we lack jurisdiction over Kostelecky owing to his not having "attorned".

[98] The ASC is responsible for the administration of the Act and other elements of Alberta securities laws. These laws are not optional, and the scope of our jurisdiction is not dictated by any equivalent of a sign-up sheet. Alberta securities laws apply to all persons and companies who participate in any aspect of the Alberta capital market in any manner regulated by those laws. Poseidon was a Calgary-based public company and a reporting issuer under the Act. Kostelecky was an important contributor to the financial disclosure of that company, of which he was an officer. Those circumstances alone suffice to establish that he was subject to the Act, and therefore that he is today a proper party to this hearing into allegations that he breached the Act. Moreover, he had made a formal application in 2015 for an order setting aside or staying this

proceeding against him on grounds including the ASC's supposed lack of jurisdiction; that application was dismissed (*Re Poseidon Concepts Corp.*, 2015 ABASC 933).

2. Key Roles and Responsibilities of Kostelecky

[99] Kostelecky was at the relevant time an officer of Poseidon, and in practice a member of the company's inner "executive leadership". The evidence demonstrated that he wielded authority and exercised direction over all aspects of Poseidon's US operation, including sales (notably including the negotiation of US TOP Contracts) and (irrespective of whether it was formally or properly within his remit) recordkeeping, invoicing and accounting for US sales. We find that with that authority came the responsibility to maintain proper books and records relating to Poseidon's US sales, specifically including US TOP Contracts.

3. Kostelecky's State of Knowledge

[100] We conclude from the evidence that Kostelecky was fully aware of the importance to Poseidon of its US sales, and of the implications of the information he caused to be generated, recorded and used. He knew that such information pertaining to US TOP Contracts (real or purported) was significant to Poseidon (we quoted above his only somewhat exaggerated claim to have been responsible for 90% of its business), and that (unless blocked by some exercise of vigilance and authority elsewhere within the company) essential elements of that information were likely to make their way (as indeed they mostly did) into Poseidon's financial statements – specifically including the Interim Statements – and other public disclosure.

[101] We are in no doubt that Kostelecky would also have been aware that Poseidon's financial disclosure (notably, the Interim Statements and the associated MD&A from which we quoted above) presented an image of business success and financial growth, from which investors would reasonably derive a correspondingly favourable impression of Poseidon shares as an investment. It would have been obvious to Kostelecky (as to anyone) that this would reasonably be expected to affect significantly the trading price of Poseidon shares.

4. The Interim Statements Breached the Act

[102] Certain of the allegations against Kostelecky – the allegation relating to section 146 of the Act specifically – were premised on Poseidon itself having breached that provision.

[103] Although Poseidon was not a respondent in this hearing, this does not preclude us from making findings of misconduct by the company, to the extent necessary to enable us to make a determination on the allegations against Kostelecky personally.

[104] We are satisfied from the evidence of Robinson and Narfason that the Interim Statements did not faithfully represent Poseidon's economic state, or present fairly its financial position and financial performance at the relevant time. Those financial statements therefore were not prepared in accordance with Canadian GAAP.

[105] This was amply corroborated by the effective withdrawal of the Interim Statements in February 2013, and by certain admissions made by Michaluk and MacKenzie.

[106] The Announcement indicated that it was prompted by a determination (still "preliminary", at that time) of Poseidon's board of directors, based on a recommendation of the special committee and a report from Narfason's firm. This determination – and the associated Announcement – would not have been made lightly. We are in no doubt that the board, having only months earlier reacted negatively to the roughly $9.5 million bad debt expense included in the Interim Statements, would have been even more troubled at this far more dramatic move in February 2013. An adverse reception from market observers and Poseidon investors would reasonably have been foreseen. The board was unlikely to proceed as it did if not convinced, based in part on the advice of legal and accounting professionals, that there was no alternative. Apart from the implications for Poseidon, there would also have been an impact on individual directors and senior officers, who would surely have appreciated that their business and personal reputations could be affected. In this respect also, we doubt that the February 2013 determination would have been made had there been a viable alternative. The Announcement itself indicated that the outcome was unavoidable: from the assurance that work was then under way "to ensure that revenue is recognized in accordance with . . . International Financial Reporting Standards", the obvious implication was that the disavowed Interim Statements had failed that test.

[107] Michaluk and MacKenzie each made a significant admission (in their respective settlement agreements with Staff) directly relevant to this topic. They each admitted to having personally breached Alberta securities laws by certifying the Interim Statements. Both admissions went on to specify that their certifications were improper (indeed, illegal) because the Interim Statements:

> . . . did not fairly present in all material respects the financial condition, financial performance, and cash flows of Poseidon as of the date of and for the periods presented in those filings[.]

[108] We conclude that in issuing such financial statements, Poseidon breached its obligation to provide periodic disclosure as prescribed by NI 51-102 and NI 52-107. It follows, and we find, that Poseidon contravened section 146 of the Act.

B. Section 60.1: Books and Records

[109] We now analyse the specific allegations against Kostelecky, in the light of the above preliminary findings.

1. Proper Books and Records Not Maintained

[110] The evidence made clear that the books and records maintained at Poseidon in 2012 in respect of its US TOP Contract business were deficient and misleading – grossly so. Supposed terms of US TOP Contracts were entered into the books and records without adequate (or any) satisfactory supporting documentation; terms very often did not align with such documentation as could be found; the very existence of some booked and recorded US TOP Contracts could not even be established; and there were indications that one or more supposedly signed US TOP Contracts had been falsified with a signing page taken from another agreement.

[111] These books and records did not enable (or even assist) Poseidon to record properly its business transactions and financial affairs. To the contrary, Poseidon could not rely on these records to determine the true state of its business and financial position, precisely because these

books and records misrecorded an important aspect of its business transactions and financial affairs. (This in turn led to public misreporting, on a grand scale.) We therefore find, in respect of Poseidon and its US TOP Contracts, that the books and records required by section 60.1(2) of the Act were not maintained.

2. Contravention Established

[112] We found above that Kostelecky, as an officer of a reporting issuer (as explicitly contemplated in section 60.1(1) of the Act), was responsible for maintaining proper books and records relating to Poseidon's US TOP Contracts. The fact that they were not so maintained establishes – and we find – that Kostelecky contravened section 60.1(2)(a) of the Act.

[113] We observe from the evidence that this contravention was not a matter of mere omission or inadvertence, or even negligence.

[114] Nor was this breach a matter of Kostelecky bearing the burden of misconduct by others, even though many others at Poseidon might have averted or curtailed this breach through closer attention to their own responsibilities. His responsibility for books and records was a consequence not only of his official title with Poseidon, but also of the authority he in fact exercised. Moreover, his contravention of the Act was in large measure a consequence – direct and plainly foreseeable – of his own inappropriate, surely deliberate and obviously deceitful conduct. As examples, it suffices to cite his having manoeuvred important aspects of the bookkeeping and recordkeeping through his relatives in North Dakota rather than through the accounting department in Denver; his directions relating to the terms and delivery (or non-delivery) of invoices; his evasion of what he understood to be an internal company requirement for signed (or at least otherwise solid) documentation; and his repeated evasions over a prolonged period when the state of the books and records came under scrutiny within Poseidon.

3. Conduct Contrary to the Public Interest

[115] The capital market functions on the basis of information. As suggested in *Flag*, reliable continuous disclosure (including financial disclosure) concerning the business and affairs of a reporting issuer helps protect investors by facilitating informed investment decision-making. It also fosters fairness and confidence in the capital market. There is, therefore, an obvious public interest in ensuring that reporting issuers are able to make the disclosure required by law. Proper books and records are essential to that task. Any failure to fulfil one's obligations in that regard jeopardizes the prospects of reliable disclosure reaching the investing public and the capital market.

[116] The impropriety of such a failure is aggravated when attributable to evasion and deceit, as exhibited by Kostelecky, particularly when one considers the sheer scale of the resulting misinformation (both in absolute dollar terms and as a proportion of Poseidon's aggregate disclosed revenue and assets).

[117] We therefore find that by failing to maintain proper books and records, Kostelecky also acted contrary to the public interest.

C. Section 146: Financial Disclosure

1. Kostelecky's Responsibility for Contravention of Section 146

[118] We found above that Poseidon contravened section 146 of the Act by issuing the Interim Statements. As noted in *Re Aurora*, 2011 ABASC 501 (affirmed *sub nom. Alberta (Securities Commission) v. DePalma*, 2012 ABCA 295) at para. 199:

> Corporations . . . act through individuals. Authority over the acts of a corporation generally rests, ultimately, with its directors and officers – who in consequence will bear responsibility for having approved or condoned (authorized, permitted or acquiesced in) those acts.

[119] More than one individual played a part in that contravention, whether through active instigation, giving permission or authorization, or acquiescence. It was an understatement to acknowledge that Poseidon lacked robust accounting controls (as Narfason observed), or even a common-sense separation of duties (as Robinson pointed out). These failings speak poorly of the conduct of many individuals in senior positions at the company. We saw acknowledgement of their own mistakes, in the settlement admissions made by Michaluk and MacKenzie.

[120] However, the fact that others failed in their responsibilities is of no assistance to Kostelecky in respect of the section 146 allegation against him. The evidence before us indicates that Kostelecky was the source – often directly – of the misinformation that made its way into Poseidon's Interim Statements, and the primary cause of Poseidon's breach of section 146. When challenged, his evasions and deceptions – we consider it to have been an all-too-successful campaign of disinformation – prevailed, and the misinformation went largely uncorrected until months afterward.

[121] He should have been caught much sooner; in a better-run company, he would have been caught sooner, by others besides Robinson. That does not diminish his culpability.

[122] The evidence is clear, and we therefore find that Kostelecky caused, authorized, permitted or acquiesced in Poseidon's contravention of section 146 of the Act.

2. Conduct Contrary to the Public Interest

[123] For the reasons discussed above in respect of the maintenance of books and records, conduct that leads to, or facilitates, a breach by a reporting issuer of its financial statement disclosure obligations is incompatible with the public interest. Kostelecky played an egregious part in Poseidon's contravention of section 146 of the Act in respect of its Interim Statements.

[124] We therefore find that by causing, authorizing, permitting or acquiescing in that contravention, Kostelecky also acted contrary to the public interest.

D. Section 93(b): Fraud

1. *Actus Reus* of Fraud Established

[125] There may have been an element of sloppiness on Kostelecky's part in some of this, but (as noted) his conduct went beyond anything that might be ascribed to mere carelessness or even negligence.

[126] Kostelecky engaged in what we termed above a campaign of disinformation relating to US TOP Contracts and associated bookkeeping, recordkeeping and accounting. We are satisfied that the misinformation was deliberate. It involved evasions and deception over a considerable period. Although directed most immediately within Poseidon (for example, in his interactions with Robinson, as well as with senior executives in the mentioned weekly meetings), Kostelecky was aware that this misinformation would make its way into Poseidon's financial statements and other public disclosure, as in fact occurred.

[127] Poseidon's financial disclosure would foreseeably have influenced investor perceptions, individual investment decisions to buy (or to continue holding) Poseidon shares, and the market's pricing of those securities. The thoroughly misleading portrayal of Poseidon's US TOP Contracts business communicated by the Interim Statements thus exposed investors to the risk (and for some, no doubt, the reality) of financial harm once the misinformation was corrected.

[128] We find, therefore, that both elements of the *actus reus* of fraud are established: the prohibited act, in this case including deceit by Kostelecky in respect of the US TOP Contracts and associated revenue and accounts receivable; and deprivation caused by that prohibited act, namely the consequent risk (and reality) of financial harm to Poseidon shareholders.

2. *Mens Rea* of Fraud Established

[129] The facts establish clearly that Kostelecky had subjective knowledge of his prohibited act. He ran the US operation, and therefore knew what US TOP Contracts existed, and on what terms. He directed the manner in which they were booked, recorded and invoiced, and was thus aware of how and where reality was being distorted. He evaded and deceived when some others tried to investigate and eventually correct the resulting misinformation, up to and even after the Interim Statements were finalized and issued.

[130] We concluded above that it would have been obvious to Kostelecky that the favourable impression given by his misinformation, disseminated through Poseidon's Interim Statements and other public disclosure, would reasonably be expected to affect significantly the trading price of Poseidon shares. We are in no doubt that he appreciated the risk to which this exposed anyone buying, or deciding to continue holding, Poseidon shares on the basis of such misinformation.

[131] Moreover, it is difficult to conceive how Kostelecky could reasonably have anticipated that the misinformation would continue undetected for very long. Poseidon's next round of mandatory financial statement disclosure after the Interim Period would involve an independent audit. One way or another, he must have appreciated that the truth would come out at some point, with predictably dire financial consequences for Poseidon's shareholders (as in fact seems to have occurred).

[132] Kostelecky, in other words, had subjective knowledge that his prohibited act could cause deprivation to others.

[133] We find, therefore, that both elements of the *mens rea* of fraud are also established.

[134] The evidence before us did not indicate the manner or extent (if any) to which Kostelecky profited from his actions, financially, reputationally (owing to the appearance of his dramatic success in the US TOP Contracts business) or otherwise. No such evidence was necessary, profit not being a necessary element of fraud (*Théroux* at para. 17).

3. Fraud is Established

[135] All elements of fraud are established here. We therefore find that Kostelecky engaged or participated in practices and a course of conduct at Poseidon that perpetrated a fraud on investors in Poseidon shares, in contravention of section 93(b) of the Act.

4. Conduct Contrary to the Public Interest

[136] Fraud is self-evidently antithetical to investor protection and a fair and efficient capital market. It follows, and we find, that Kostelecky's fraudulent conduct was contrary to the public interest.

VII. CONCLUSION

[137] The allegations against Kostelecky were proved. He contravened sections 60.1 and 93 of the Act; he caused, authorized, permitted or acquiesced in Poseidon's contravention of section 146 of the Act; and in all of this he acted contrary to the public interest.

[138] This proceeding therefore now moves into a second phase, for the purpose of determining what, if any, orders are warranted against Kostelecky in consequence of the findings against him. To that end, Staff and Kostelecky are each directed to inform one another and the ASC Registrar (using each recipient's most recent known email address), not later than **noon on Monday 27 March 2017**, of the following: (i) whether they propose to call new evidence on the sole issue of appropriate orders; (ii) their preference as to making submissions on the issue orally or in writing (or both); and (iii) their expected timing requirements and suggested dates. After the panel has received and considered the responses to this direction (or after the date specified for such responses has passed), the Registrar will inform the parties of the timing of next steps in this proceeding.

14 March 2017

For the Commission:

"original signed by"
Stephen Murison

"original signed by"
Ian Beddis

"original signed by"
Fred Snell, FCA