ALBERTA SECURITIES COMMISSION

DECISION

Citation: Re Kostelecky, 2017 ABASC 105 **Date: 20170606**

Joseph Anton Kostelecky

Panel:	Fred Snell, FCA Ian Beddis
Representation:	Don Young for Commission Staff
Hearing:	April 19, 2017
Decision:	June 6, 2017

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I. INTRODUCTION

[1] Following a hearing in December 2016 (the **Merits Hearing**), Joseph Anton Kostelecky (**Kostelecky**) was found to have contravened the *Securities Act* (Alberta) (the **Act**) and acted contrary to the public interest in connection with Poseidon Concepts Corp. (**Poseidon**) in 2012. Specifically, he: (i) failed to maintain necessary books and records of Poseidon, contrary to section 60.1(2)(a) of the Act; (ii) caused, authorized, permitted or acquiesced in a breach by Poseidon of certain of its continuous disclosure obligations, contrary to section 146 of the Act; and (iii) engaged or participated in a fraud, contrary to section 93(b) of the Act. The underlying facts and a detailed discussion of the reasoning behind these findings were set out in the March 14, 2017 decision of this Alberta Securities Commission (**ASC**) panel, which is cited as *Re Kostelecky*, 2017 ABASC 42 (the **Merits Decision**).

[2] Following issuance of the Merits Decision, the proceeding moved into this, its second phase, for the determination of what (if any) orders ought to be made against Kostelecky as a result of the aforementioned findings.

[3] An oral hearing was conducted on April 19, 2017 (the **Sanctions Hearing**), at which staff of the ASC (**Staff**) made submissions. Staff also tendered into evidence a document titled "Investigation & Hearing Costs", which we discuss later in this decision.

[4] Kostelecky was not present at the Sanctions Hearing, nor did anyone appear to represent him. However, we were informed by the ASC registrar (the **Registrar**) that Kostelecky and his Alberta legal counsel were served with a copy of the Merits Decision on March 14, 2017 by email. The Merits Decision included directions with respect to the sanctioning phase of these proceedings, and required a response by noon on March 27, 2017. The Registrar informed us that no response was received from Kostelecky or anyone else on his behalf. The Registrar further informed us that on the afternoon of March 27, 2017, she sent another email to all of the parties, including Kostelecky and his Alberta legal counsel, advising that the Sanctions Hearing would proceed on April 19, 2017, at 1:00 p.m.

[5] Accordingly, we are satisfied that Kostelecky had notice of the Sanctions Hearing but declined to participate, despite having been given notice and the opportunity to be heard. As noted in the Merits Decision, Kostelecky did not participate in the Merits Hearing either, as it was his position that he had not "attorned to the jurisdiction" of the ASC. We observed in the Merits Decision that such a position was without merit.

[6] Former ASC Vice-Chair Stephen Murison, who was a member of the panel which conducted the Merits Hearing and issued the Merits Decision, retired at the end of March 2017. The two remaining panel members, Fred Snell, FCA, and Ian Beddis, therefore conducted the Sanctions Hearing and rendered this decision.

[7] For the reasons discussed below, we are ordering certain permanent bans against Kostelecky, plus a substantial administrative penalty and a cost-recovery order.

II. BACKGROUND

[8] The background to this matter and our findings were described in detail in the Merits Decision, which should be read together with this decision. For convenience, we summarize here some of the most significant points. Unless otherwise indicated, quotations are from the Merits Decision or evidence cited therein.

[9] Poseidon, a reporting issuer under the Act, had its common shares listed on the Toronto Stock Exchange. It was in the business of providing temporary storage tanks to the oil and gas industry, including to customers located in Canada and the United States (**US**). Its head office was in Calgary. It also wholly-owned a US subsidiary called Poseidon Concepts Inc. (**Poseidon US**) and had offices in Denver, Colorado and North Dakota. The evidence was that the two Poseidon entities were essentially treated as one.

[10] Kostelecky, a US resident, was identified in a Poseidon disclosure document as the company's "Senior Vice-President, U.S. Division". On May 9, 2012, he became its "Executive Vice President", and was the sole executive officer located in and responsible for all of Poseidon's US operations. In the Merits Decision, we found that Kostelecky played a "significant role" at Poseidon, with "broad authority" over its business in the US. This included occupying a senior sales role either directly negotiating or approving all US sales activity, including that relating to what were described in the Merits Decision as the **US TOP Contracts**. It also extended to such matters as giving instructions to US-based accounting personnel as to how they should perform their duties.

[11] Poseidon was described as having had a "four-man executive leadership team" at the relevant time, each "an equal partner in guiding the business". In addition to Kostelecky, this was comprised of: chief executive officer (**CEO**) and director Lyle Dennis Michaluk (**Michaluk**); president, chief operating officer and director Clifford Leroy Wiebe (**Wiebe**); and chief financial officer (**CFO**) Matthew Cory MacKenzie (**MacKenzie**). These individuals were originally included as respondents in this proceeding (collectively with Kostelecky and Poseidon, the **Original Respondents**), but each entered into a settlement agreement with Staff prior to the Merits Hearing. Staff withdrew their allegations against Poseidon.

[12] The US business was very significant for Poseidon, and generated as much as 85% of its total revenues. As a reporting issuer under the Act, Poseidon issued and filed audited annual financial statements and unaudited interim financial statements. Those in evidence at the Merits Hearing were consolidated and included the results of the US operations.

[13] Poseidon's financial statements showed consolidated revenue rising from just under $79 million for the year ended December 31, 2011 to just over $148 million for the nine months ended September 30, 2012 (we refer to the latter as the **Interim Period**). Accounts receivable rose from under $54 million at December 31, 2011 to over $125 million at September 30, 2012. Even prior to the end of the Interim Period, lack of progress collecting accounts receivable led Poseidon staff to investigate. As described in the Merits Decision, one witness testified it was ultimately determined that up to 70% or 80% (if not more) of the reported revenue and accounts receivable figures for the Interim Period – all relating to purported US TOP Contracts – should not have been recorded as such.

[14] We found that responsibility for Poseidon's grossly misleading financial reporting was primarily Kostelecky's. Since he ran and had authority over the US operation, he directed the way US TOP Contracts were booked, recorded and invoiced. Poseidon's internal investigation revealed that the vast majority of those supposed contracts had essentially been fabricated: if they existed at all, at Kostelecky's behest, they had been entered into Poseidon's books and records unsigned and with little or no – or at least no accurate – supporting documentation. In addition, there was evidence that at least one had been falsified by attaching a customer signature page from a different agreement. Another customer claimed that the signature on its purported contract with Poseidon had been forged. Others, whom Poseidon's records suggested owed it millions of dollars, were completely baffled by the claim and had "no idea [of] who Poseidon [was]".

[15] Poseidon's US accounting staff reported that in the absence of actual documentation, much of the information had been entered based on Kostelecky's verbal instructions. When customer invoices were generated despite the lack of paperwork, Kostelecky would tell staff not to deliver the invoices. Most, if not all, 2012 invoices for purported US customers were held back at his direction, but the associated revenues and accounts receivable were still booked.

[16] Further, Kostelecky continued to dissemble and mislead when other Poseidon staff began to investigate. He blamed discrepancies on "invoicing errors" and either promised that he would speak to the customers and payment would come imminently, or gave excuses as to why they had not paid. After insisting they existed, he promised to provide missing US TOP Contracts and back-up documentation. He never did so, despite repeated requests. When someone else ordered accounting staff to deliver an invoice, Kostelecky would countermand the order. When someone else tried to implement better accounting processes, Kostelecky would claim the customers did not like it.

[17] Ultimately, Poseidon had to withdraw and restate the Interim Period financial statements. It issued a news release in February 2013 which announced that approximately $95 million to $106 million of the $148 million in reported revenues and approximately $94 million to $102 million of the $125 million in accounts receivable should not have been recorded as such.

[18] The "debacle" ultimately led to Poseidon's demise. It was granted protection from its creditors in April 2013 and thereafter effectively ceased business.

III. POSITIONS OF THE PARTIES ON SANCTIONS AND COSTS

[19] As noted previously, Kostelecky did not participate in the Sanctions Hearing, either in person or by way of written response. Accordingly, we do not have the benefit of his position on sanction or costs.

[20] In oral submissions, Staff emphasized "the deception and fraudulent conduct" perpetrated by Kostelecky, and stressed "the significant consequences of his actions to Poseidon", which resulted in "its failure in continuing as an entity". Staff's position on sanction was that Kostelecky should be subject to permanent director-and-officer bans with respect to issuers under sections 198(1)(d) and (e) of the Act, a permanent ban from acting in a management or

consultative capacity in connection with activities in the securities market under section 198(1)(e.3), and directed to pay an administrative penalty of $350,000 under section 199. Staff also sought recovery of costs in the amount of $100,000 under section 202.

IV. SANCTIONS

A. The Law

1. Rationale and Principles

[21] It is well-established that with a view to protecting investors and fostering a fair and efficient capital market, sanctions are imposed by the ASC for protective and preventive purposes. Such orders do not seek to punish a wrongdoer (*Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37 at paras. 39-45).

[22] The Alberta Court of Appeal has held that while sanctions must be "proportionate and reasonable", achieving both specific and general deterrence are "legitimate considerations" in determining what those orders should be (*Walton v. Alberta (Securities Commission)*, 2014 ABCA 273 at para. 154; see also *Re Cartaway Resources Corp.*, 2004 SCC 26 at paras. 52-62). Specific deterrence seeks to deter future misconduct by a particular respondent; general deterrence seeks to deter others who might be inclined to commit similar misconduct.

[23] Appropriate orders typically depend on the facts and circumstances at issue in the case, as well as the individual characteristics of the party or parties involved. Consideration of those matters allows a panel to assess whether deterrence is required, and, if so, informs the determination of the sanctions necessary to achieve that goal and limit future risks to investors and the capital market.

[24] In assessing the proportionality and reasonableness of a potential sanction, we keep in mind the Court of Appeal's caution in *Walton* that "general deterrence does not warrant imposing a crushing or unfit sanction on any individual [respondent]" (at para. 154). With respect to administrative penalties in particular, we note that they must be "proportionate to the offence, and fit and proper for the individual offender" (*Walton* at para. 156).

[25] Proportionality was canvased in some detail by another ASC panel in *Re Homerun International Inc.*, 2016 ABASC 95. We adopt here paras. 16-18 from that decision:

> Ensuring that sanctions are proportionate involves appropriate consideration of other decisions and settlement outcomes, while recognizing that decisions or outcomes seldom involve identical factual circumstances or wrongdoing.
>
> Panels may be faced with assessing the proportionality of contemplated sanctions against a respondent claiming impecuniosity, or at least a constrained ability to satisfy any monetary order. In this regard, we note the statements in *Walton* that an administrative penalty "beyond the capacity of the individual offender cannot be justified on the basis that it will deter others who are in a better financial condition" (at para. 165) and that the amount of an administrative penalty should not be "determined after overemphasizing the requirement of general deterrence, without having sufficient regard to the individual circumstances" (at para. 166).
>
> We do not understand these statements to preclude consideration of general deterrence in assessing either the need for, or the appropriate extent of, an administrative penalty against an

> individual respondent. Rather, this was an admonition not to focus exclusively, or excessively, on general deterrence. The Court of Appeal explained this, and the danger to be avoided, as follows (*Walton* at para. 156): "An administrative penalty [focused] purely on general deterrence of an unidentified and amorphous sector of the public could easily become disproportionate to the circumstances of the individual involved". We are mindful, however, that a monetary sanction almost inevitably involves (and indeed that a sanction of any type might impose) a burden on a respondent. This does not in itself demonstrate disproportion or unreasonableness in the *Walton* sense; an order with no real effect on the recipient may be no sanction at all.

[26] We are also mindful of the Alberta Court of Appeal's comment in *Maitland Capital Ltd. v. Alberta (Securities Commission)*, 2009 ABCA 186 that "[i]f sanctions under this legislation are so low as to communicate too mild a rebuke to the misconduct, or perhaps a licensing fee for its occurrence, the opposite to deterrence may result. That opposite is demoralization of those who moil in this area of commercial activity in an upright and credit-worthy fashion" (at para. 21).

[27] Finally, the panel in *Homerun* observed that some individual respondents argue that making them subject to market-access bans will unfairly prevent them from earning a living or pursuing a particular career path. We adopt that panel's view on this issue (at para. 19):

> The capital market is a regulated sector, in which participants choose to operate. Once they make that choice, they are subject to the relevant laws. Should they contravene those laws, they are then subject to our jurisdiction to act in the public interest to prevent or constrain their future participation. Such an outcome, even if it compels a respondent to seek a new livelihood outside the capital market, does not in itself indicate disproportion or unreasonableness.

2. Factors to be Considered

[28] In many past decisions, the ASC has set out a set of factors to be considered while assessing appropriate sanctions. The articulation of the relevant factors has evolved somewhat since they were formulated in early decisions such as *Re Lamoureux*, [2002] A.S.C.D. No. 125 at para. 11 (affirmed on other grounds 2002 ABCA 253) and *Re Ironside*, 2007 ABASC 824 at para. 62, which was cited by Staff at the Sanctions Hearing. As it better integrates the principles discussed in the foregoing section of this decision, we rely on the reformulation set out in *Homerun* (at para. 20) and applied recently in *Re Spaetgens*, 2017 ABASC 38 (at para. 19). The factors are therefore:

- 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.

[29] These factors were described and discussed at some length in *Homerun* (at paras. 22-46). We adopt the reasoning set out in those paragraphs.

B. Analysis

1. Sanctioning Principles and Factors Applied to the Facts

[30] We turn now to the application of the factors to this case and further consideration of the submissions made by Staff.

(a) Seriousness of the Misconduct

[31] The seriousness of the misconduct at issue can be assessed by considering three elements: (i) the nature of the misconduct; (ii) the intention behind it (i.e., was it deliberate, negligent or inadvertent?); and (iii) the harm it caused or could have caused specific investors or the capital market as a whole.

[32] Kostelecky contravened three sections of the Act, including the prohibition against fraud, the most egregious form of market misconduct. The evidence showed that he was primarily – if not solely – responsible for providing grossly misleading and deliberately falsified information with respect to the results of Poseidon's US operations. He knew that information would be included in the Interim Period financial statements, and that it would therefore be disseminated to the public, leading to "public misreporting, on a grand scale". He knew that revenues generated in the US were a substantial portion of Poseidon's total revenues, and that misinformation with respect to US revenues would greatly skew the overall picture of Poseidon's financial health and desirability as an investment. He knew that investors, misled by an erroneous portrait of a thriving business, might be more inclined to purchase Poseidon shares as a result, and that the security of their investments would be in jeopardy. His conduct thus exposed them to the risk – if not the reality, given Poseidon's ultimate demise – of financial harm.

[33] In this regard, we agree with the ASC panel in *Re Reeves*, 2011 ABASC 107, which made these observations in a case also involving fraud (at para. 28):

> Such breaches not only adversely affect those with failed investments but also can negatively affect the ability of law-abiding issuers to raise money. Moreover, nothing erodes public confidence in our capital market more than fraud. Investors are aware that most investments involve risk, but, when deception is involved and money misappropriated, those deceived and others who learn of their unfortunate experience understandably lose confidence in our capital market and look elsewhere to invest their money.

[34] Further, Kostelecky persisted in his deliberate deception over a protracted period of time. It began with the misinformation he fed to US accounting staff, including with respect to the existence of signed contracts. It continued and worsened as others began to question and investigate the increasing size of Poseidon's accounts receivable. To his fellow executives, whom he knew were relying on him for information about the results of US operations, he not only maintained his lies about the true state of the US TOP Contract business, but also lied about his efforts to collect the accounts allegedly owing, the collectability of those accounts, and the existence of back-up documentation.

[35] Nor was Kostelecky an ordinary employee of Poseidon. He occupied one of the most senior officer roles and was the only executive located in the US, responsible for all US business. He was aware of the significance of his position and the fiduciary nature of the responsibility a

publicly-held entity has to its shareholders. While it may be true that others at Poseidon might have caught his misconduct if they had been more vigilant about their own responsibilities (especially those who were directors and officers), that does not diminish Kostelecky's blameworthiness as the architect of the deception.

[36] In any event, the evidence showed that he was adept at concealing his misconduct by behaving like a "tyrant" or a "dictator" when challenged, especially toward the US accounting staff who worked under him. They reported that if they asked questions, Kostelecky would tell them to just "do it". If they took the initiative to try to obtain back-up documentation or confirmation of a supposed transaction, they were met with Kostelecky's rebuke. There was also evidence that Kostelecky was able to control the bookkeeping by hiring two of his own North Dakota-based nieces to perform accounting tasks and directing them to make entries in such a way as to "mask" aging accounts receivable – which prevented earlier detection of suspect receivables by others in the company. All of this conduct further underscores the persistent and deliberate nature of Kostelecky's campaign of deceit.

[37] As set out in the Merits Decision, we also take note of the "sheer scale" of the misinformation created by Kostelecky, "both in absolute dollar terms and as a proportion of Poseidon's aggregate disclosed revenue and assets": based on the figures set out in Poseidon's February 2013 news release, approximately 65% to 70% of reported revenues and approximately 75% to 80% of reported accounts receivable should not have been recorded as such, figures near or over the $100 million mark. Given the magnitude of these figures, it is not surprising that Poseidon's failure as a going concern ensued.

[38] The Alberta Court of Appeal has commented that the securities market is "intensely dependent upon trust" (*Maitland* at para. 17). The ASC has frequently stated that timely, complete and accurate corporate disclosure is vital to the effective, fair operation of our capital market, and to the ASC's public interest objectives of promoting confidence in that market and protecting investors. Members of the public must be able to rely on the information they are given. We agree with the following comments from *Ironside* (at paras. 117-18):

> A sound and reliable disclosure system is fundamental to the operation, integrity and strength of the capital market. High disclosure standards for public issuers foster investor confidence and thereby contribute to a fair and efficient market. Disclosure also assists the market in valuing accurately a public issuer's share price. However, the disclosure standards will provide inadequate protection if investors are unable to trust in and rely on the integrity and honesty of those who are appointed to serve as directors or occupy senior management positions within a public issuer. The public rightly depend on directors and senior executives to comply with regulatory requirements and to be honest and truthful in the public disclosure they make. It is serious when an officer or director of a public issuer causes it to fail consistently in complying with disclosure requirements.
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> Misconduct like the Respondents' therefore damages investor confidence and, ultimately, the capital market's credibility. When investors are not willing to invest in the capital market, investment capital and liquidity are lost.

[39] Reliable financial statement disclosure is particularly important, as "financial statements form the foundation of a reporting issuer's continuous disclosure record" (*Re Flag Resources (1985) Limited*, 2010 ABASC 143 at para. 19). Its importance is reflected in the specific and extensive financial disclosure requirements demanded of reporting issuers, including the

requirement that they have their annual financial statements audited by an independent auditor registered with the Canadian Public Accountability Board.

[40] Kostelecky's deliberately dishonest conduct was entirely antithetical to the objectives of protecting investors and fostering a fair and efficient capital market in which the public can have confidence. Investors were deprived of the ability to make informed investment decisions based on accurate disclosure and were thereby exposed to financial harm. Kostelecky knew those were the possible repercussions of his deception and persisted anyway, breaching the trust of those who would rely on the information he generated.

[41] For all of these reasons, we conclude that Kostelecky's misconduct was among the most serious kinds of misconduct brought before the ASC. As noted in *Homerun* (at para. 26), "[a]bsent other considerations, the more serious the misconduct, the greater the future risk implied and thus the greater the deterrence required." This factor therefore calls for very significant sanctions.

(b) Kostelecky's Characteristics and History

[42] Kostelecky's characteristics and history – which may include such matters as his educational background, work experience, experience in the capital market, regulatory and disciplinary history, and personal financial circumstances – are relevant because they "may be important indicators of the degree of risk posed and, in turn, the extent of deterrence required". Characteristics and history may also affect the assessment of the proportionality of a contemplated sanction (*Homerun* at paras. 27-28).

[43] Because he declined to participate in either the Merits Hearing or the Sanctions Hearing, we have limited information with respect to Kostelecky's background or present circumstances, and no information with respect to his current financial position. Poseidon's Annual Information Form for the year ended December 31, 2011 told us that, prior to Poseidon, Kostelecky was "President and Chief Operating Officer of Koss Consulting, a private corporate advisory company". However, we do not know the nature of that company's activities, or of Kostelecky's role and responsibilities with it.

[44] Staff referenced an affidavit Kostelecky swore in support of an application he made before a different ASC panel in October 2015 seeking an order setting aside or staying the proceedings against him on the basis of jurisdiction. The affidavit was not tendered as evidence before this panel, but Staff directed us to para. 15 of the decision rendered on the application, cited as *Re Poseidon Concepts Corp.*, 2015 ABASC 933. That paragraph reproduced the following from Kostelecky's affidavit:

> 11. I worked for Poseidon US only. I was employed by Poseidon US and its predecessor for two years, from January 2011 to January 2013, during which time I held various positions.
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> a. I was first hired to be safety representative, and was later made operations manager, and then vice president of operations.
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> b. In November 2011, I was made senior vice president, U.S. division of Poseidon US. . . .

> c. In May 2012, I was made executive vice president of Poseidon US. . . .
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> 12. I worked in the [US]. My primary office was located in [Dickinson], North Dakota, but I also spent time each month working from the Poseidon US office in Denver, Colorado.
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> 13. At all material times, my responsibilities and work pertained to the activities and operations of Poseidon US in the [US], not to the activities or operations of [Poseidon] in Canada.
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> 14. I was at all material times paid by Poseidon US only. . . .
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> 15. I was not at any time an officer or director of [Poseidon], let alone a "certifying officer" within the meaning of National Instrument 52-109.
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> 16. At no time was I employed by either Poseidon US or [Poseidon] to prepare or maintain financial accounts or statements, report on company finances, or provide legal opinions on the enforceability of client contracts, nor did I purport to do any of these things. These roles were not within my job responsibilities. I am not, nor have I ever been, a bookkeeper, accountant, or lawyer, nor do I have the education or experience to perform such functions.
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> 17. I did not prepare business, financial or other public disclosures made by either Poseidon US or [Poseidon]. In particular, I did not prepare the [Poseidon] financial statements referred to in the [notice of hearing]. At no time did I make any certification regarding the accuracy of, or responsibility for or over, either Poseidon company's financial reporting or disclosure.

[45] The majority of this information spoke to Kostelecky's ties to the US, which was apparently pertinent to the application heard by the other panel. It also provided his position as to his role with Poseidon, much of which was contrary to the evidence adduced at the Merits Hearing and our findings in the Merits Decision. Of some use to the present analysis, however, was the information provided with respect to his lack of formal education, training or experience in bookkeeping, accounting or law.

[46] We have no reason to doubt that that is the case. Nevertheless, the evidence at the Merits Hearing was that Kostelecky knew a signed contract had to be in place before an associated account receivable or revenue was booked. Moreover, we reject the notion that a lack of formal training meant that Kostelecky was unaware of the importance of accurate financial reporting. He occupied a position as one of only four in executive management at Poseidon, and may have held a prior position with executive responsibilities. More importantly than his formal titles, the evidence at the Merits Hearing showed Kostelecky understood financial statements, knew that US results were very significant to Poseidon's bottom line, knew the importance of his contribution to the bottom line, and knew that the results from US operations would be "rolled up" into Poseidon's Canadian results for reporting purposes. He contributed to the information that was ultimately included in Poseidon's public financial disclosure. He gave instructions to US accounting staff with respect to recordkeeping and invoicing, specifically admonishing them, "we are a publicly held company with a fiduciary responsibility to our shareholders". He would have been aware of the erroneous impression of financial health created by overstating Poseidon's US TOP Contract sales.

[47] All of this suggests Kostelecky had sufficient knowledge and experience to have understood the potential ramifications of his misconduct, which underlines its deliberateness and completely removes it from the realm of inadvertence or negligence. Moreover, it is self-evident that evasion and deceit are wrong. Kostelecky did not require formal training or education to appreciate that fact. As stated in *Homerun* at para. 83, "no lack of experience or training explains or justifies misleading investors, or gives any comfort that such misconduct might not recur".

[48] There was no evidence with respect to whether Kostelecky has any past history of sanctions by the ASC or any other Canadian regulator, whether within the securities industry or otherwise. While documents apparently amounting to a settlement agreement between Kostelecky and the US Securities and Exchange Commission (**SEC**) were in evidence, the conduct at issue was the same conduct as was at issue before this panel. As such, these documents did not reflect a prior disciplinary history which might be relevant to our analysis under this factor.

[49] That said, the absence of a disciplinary history does not necessarily mean that there is less need for specific deterrence, nor is it necessarily a mitigating circumstance. Since "no one . . . should engage in sanctionable conduct, . . . an absence of prior sanction does not merit reward" (*Homerun* at para. 85).

[50] Therefore, this factor, on balance, also indicates a need for very significant sanctions.

(c) Benefit Sought or Obtained

[51] No evidence was led at the Merits Hearing or the Sanctions Hearing as to what personal benefit, if any, was either sought or obtained by Kostelecky when he engaged in his misconduct. Presumably he perceived some benefit, as it is otherwise difficult to understand what would have motivated him to act as he did. It is possible the benefit was no more than reputational, bolstered by the appearance of his success in generating so much ostensible business for Poseidon in the US. That in turn could eventually have resulted in financial benefits, whether from Poseidon or a future employer impressed by Kostelecky's ability to achieve results.

[52] However, in the absence of evidence, we consider this a neutral factor.

(d) Mitigating or Aggravating Considerations

[53] Since a sanction decision must take into account all relevant circumstances of the case and the particular respondent involved, anything not considered under the previous headings may warrant consideration here. The focus is on "whether something in the circumstances of a case mitigates or aggravates a conclusion that might otherwise be drawn in light of any of the factors just discussed, or more generally affects the assessment of risk and deterrence required" (*Homerun* at para. 39). However, "[a]n absence of mitigation is not the same as an aggravating consideration" (*Homerun* at para. 45). Similarly, an absence of aggravating factors is not mitigation.

[54] Staff argued that there are no mitigating circumstances in this case. Kostelecky's apparent settlement with the SEC may have been one (as a settlement with a regulator could

demonstrate an acceptance of responsibility for the misconduct which might suggest a reduced risk of re-offense), but that settlement appeared to have been reached on a no-fault basis, whereby Kostelecky neither admitted nor denied the SEC's allegations. As part of the settlement, he consented to entry of a judgment against him which included a civil penalty of US$75,000, but there are many possible reasons he may have done so. Acceptance of responsibility may not be among them. That said, we acknowledge the fact that Kostelecky is responsible in another jurisdiction for a monetary penalty related to the same misconduct. We may have considered a larger administrative penalty in the matter before us (see further below) if he were not.

[55] Overall, we discern no significant mitigating or aggravating considerations. As such, our conclusions on the other factors are not altered.

2. Outcomes in Other Proceedings

[56] As noted previously, in the interest of proportionality, it is appropriate to consider the settlements and sanction outcomes in other cases involving similar facts and similar misconduct. We are mindful that we must do so with a measure of caution given the extent to which circumstances vary from case to case; "while past cases can provide useful examples of the range of sanctions awarded for a range of behaviour, no direct correlations can be drawn" (*Re Zieben*, 2014 ABASC 412 at para. 62).

[57] Staff directed us to a number of possible comparators. The first were the settlement agreements entered into by three of the Original Respondents, Michaluk, Wiebe, and MacKenzie: *Re Michaluk*, 2016 ABASC 162; *Re Wiebe*, 2016 ABASC 160; and *Re MacKenzie*, 2016 ABASC 161. Each of those individuals made admissions related to their roles in Poseidon's failure to file Interim Period financial statements prepared in accordance with Canadian generally accepted accounting principles applicable to publicly accountable enterprises (**GAAP**). Michaluk and MacKenzie also admitted to breaches of National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*. Wiebe agreed to a $75,000 payment for settlement and costs and a five-year director-and-officer ban. Michaluk and MacKenzie each agreed to a $150,000 payment and seven-year director-and-officer bans.

[58] Although arising from largely the same facts, as Staff argued, there are several important distinctions between those three respondents and Kostelecky. First, the evidence at the Merits Hearing showed that those three simply relied on the misleading information, whereas Kostelecky was responsible for generating that information while fully aware it was misleading. Second, those three did not admit fraud, whereas Kostelecky has been found liable for fraud under the Act. Third, those three settled with Staff, whereas Kostelecky did not. Settlements typically involve compromise on both sides, and other considerations which may not be apparent to those outside the negotiations.

[59] Therefore, the Michaluk, Wiebe and MacKenzie settlements are of limited use for comparison purposes, other than perhaps to provide an indication as to where the low water mark for sanction may be on these facts in the absence of fraud.

[60] Staff also referred us to the settlement with Frank Andrew Devcich and Gobinder Kular Singh in *Re Devcich*, 2011 ABASC 460 and the settlement with Jacqueline Shan (**Shan**) in *Re Afexa Life Sciences Inc.*, 2009 ABASC 380.

[61] As in this case, *Devcich* involved a reporting issuer which filed interim financial statements that had been not prepared in accordance with GAAP. Those financial statements had incorrectly reported $4.5 million in revenues and had to be restated. Both respondents admitted breaches of section 146 of the Act, but not fraud. Each paid $100,000 in settlement and agreed to seven-year director-and-officer bans.

[62] Also as in this case, *Afexa* involved a reporting issuer which filed financial statements that had not been prepared in accordance with GAAP, again because they incorrectly recognized certain revenues. Again, the financial statements had to be restated. The respondents, including Shan, the issuer's CEO, admitted to breaching section 146, but not fraud. Shan agreed to pay $100,000 in settlement, and to a five-year director-and-officer ban.

[63] For the same reasons we distinguished the Michaluk, Wiebe and MacKenzie settlements, we consider the settlements in *Devcich* and *Afexa* of limited use.

[64] Finally, Staff referred us to the decisions reached by ASC panels after contested hearings in *Ironside*, and, more recently, *Zieben*.

[65] As Staff explained, *Ironside* involved large-scale misrepresentation of information, some of it financial, some of it resource-related. There was no finding of fraud, but the two respondents, Blue Range Resource Corporation CEO J. Gordon Ironside (**Ironside**) and CFO Robert W. Ruff (**Ruff**), were found to have engaged in certain deliberately deceitful conduct. Ironside was ordered to pay a $180,000 administrative penalty, and was permanently banned from the use of securities laws exemptions and acting as a director or officer of any issuer. Ruff, who was found less culpable, was ordered to pay a $50,000 administrative penalty, and was banned from acting as a director or officer of any issuer for 10 years.

[66] Given the seriousness of the conduct in *Ironside*, one might see the administrative penalties imposed in that case some 10 years ago as somewhat light by current standards. However, the decision was rendered at a time of change in the applicable section of the Act, when the maximum administrative penalty that could be ordered was raised from $100,000 to $1,000,000 per contravention. The panel in the circumstances of that case concluded it was bound by the lower maximum and issued its orders accordingly. Staff argued that if the same case on the same facts were heard today, the administrative penalties ordered against Ironside and Ruff would be much higher. Further, Staff argued that Kostelecky's misconduct – which included fraud – was significantly more serious. As a result, Staff's position was that Kostelecky should be subject to a greater sanction.

[67] In *Zieben*, the individual respondent was the controlling mind of the corporate respondents. He was found liable for making misrepresentations, failing to comply with the rules around disclosure for mineral projects, and fraud. He was ordered to pay a $250,000 administrative penalty, and received permanent market-access and director-and-officer bans.

Staff argued that Zieben's misconduct was generally comparable to Kostelecky's, but less serious because it involved much smaller companies which did not suffer losses on the scale suffered by Poseidon. We agree that the misconduct in *Zieben* was considerably less serious than that at issue in this case.

[68] In addition to the settlements and decisions referenced by Staff, we have also considered other comparable cases, including *Re Workum and Hennig*, 2008 ABASC 719, *Reeves*, and *Re Optam Holdings Inc.*, 2015 ABASC 996.

[69] There was no finding of fraud in *Workum*, but there was deceptive conduct (including with respect to improper financial disclosure) and market manipulation carried out over a longer period of time, with identifiable financial benefit to the individual respondents. Workum, president, CEO and a director of the subject company, was ordered to pay a $750,000 administrative penalty and was permanently banned from certain activities, including acting as a director or officer. Hennig, also a director and the company's CFO (who was found less culpable than Workum) was ordered to pay a $400,000 administrative penalty, banned from market access for 20 years, and permanently banned from acting as a director or officer.

[70] *Reeves* did not involve issues around mandatory disclosure, but the respondent was found to have fraudulently converted at least $500,000 in investor funds to his own use. Like Kostelecky, his misconduct contributed to the failure of a publicly-traded issuer. Reeves was made subject to a variety of permanent bans and directed to pay $650,000 as an administrative penalty.

[71] *Optam* is a recent case wherein the respondents admitted to illegal trading and distribution as well as fraud, and, with Staff, made a joint recommendation as to sanction. Approximately $10.8 million had been raised over approximately four and a half years, the vast majority of which was diverted to uses not authorized by the investors, including some $800,000 diverted to the personal use of the individual respondent. Observing the '"high degree of deceit and dishonesty"' exhibited by the individual respondent (at para. 31), the panel accepted the joint recommendation that he be made subject to permanent market-access, director-and-officer and other bans, and ordered to pay a $1 million administrative penalty. The panel also observed that this penalty "would fall considerably short of what might be permitted under the Act (given the multiple contraventions)", but considered it "adequate" given the respondent's recognition of the seriousness of his misconduct and his cooperation with Staff (at para. 51). The panel further noted the respondent's agreement and the absence of any evidence to suggest the sanction "would be disproportionate or crushing" (at para. 51).

[72] All of these decisions contain useful points of comparison, but they also feature some important differences. However, even the differences – for example, the absence of a fraud finding or the presence of a clear and wrongfully-taken financial benefit – can be instructive in terms of arriving at a proportionate sanction. Overall, the cases tell us that misconduct of the kind at issue in the matter before us which causes substantial harm will attract significant sanctions, including lengthy bans and administrative penalties. The sanctions increase where the misconduct includes fraud, especially fraud perpetrated by senior officers and directors.

[73] We have placed the conduct in this case within the range of sanctions suggested by these decisions while remaining mindful of the differences in context and circumstances.

3. Conclusion on Appropriate Sanctions

[74] In light of the foregoing, we conclude that sanctions providing strong specific and general deterrence are both appropriate and necessary in the public interest to protect investors and foster a strong and efficient Alberta capital market in which investors can have confidence.

[75] Given that Kostelecky significantly downplayed his role at Poseidon, exhibited a great propensity for evasion, deceit and dishonesty, and failed to acknowledge that his misconduct occurred in and affected our capital market, we believe he presents a clear risk of repeated misconduct and continued disregard for Alberta securities laws. At the same time, we must discourage others who operate in our market (whether locally-based or foreign) from emulating him by sending a message that such conduct – especially fraudulent conduct – will not be tolerated and will lead to serious protective and preventive measures.

[76] We therefore conclude that our capital market will be best protected by permanently removing Kostelecky from participating in it in any leadership capacity or role of authority similar to his position at Poseidon. He abused that role by using it to conceal his deception and order more junior employees to unknowingly assist him, thereby utterly failing to fulfil the duties of a senior officer. Indeed, his failures in that regard were so complete they led to the demise of what may otherwise have been a successful capital market participant. Thus we find that Kostelecky cannot be trusted to act honestly in any future dealings he may have in the Alberta market, and bans of the type and duration sought by Staff are both necessary and appropriate.

[77] As we found in the Merits Decision, Kostelecky had to know that what he was doing was wrong and would be discovered eventually, if only by Poseidon's auditors at year-end. He persisted regardless. Accordingly, we are also persuaded by Staff that to achieve the requisite level of protection through deterrence, Kostelecky must be made subject to an administrative penalty commensurate with the deception, fraud and destructive consequences of his actions.

[78] However, we disagree with Staff on the appropriate quantum of the administrative penalty. While Staff suggested $350,000, we are of the view that this amount will not deliver adequate deterrence and public protection, even in combination with the aforementioned bans. For all of the reasons discussed in this decision, the present circumstances call for a substantially higher amount. As the Court of Appeal in *Maitland* stated, there is no authority to suggest that a panel is bound by the proposal of any party as to sanction; "[o]n the contrary, it [is] ultimately the panel's duty to determine the public interest" (at para. 19; see also *Re Coastal Pacific Mining Corp.*, 2017 ABASC 15 at para. 24).

[79] We therefore conclude that it is in the public interest to order Kostelecky to pay an administrative penalty of $650,000. It is our view that a sum of this magnitude is required to adequately and appropriately serve the protective purpose of the Act and prevent future harm, by Kostelecky and by others who might be of like mind. As in our determination of the appropriate nature and duration of the bans, we have carefully considered the principle of proportionality and

were guided by the ranges suggested by comparable cases. We have also taken into account Kostelecky's obligation to pay US$75,000 in settlement with the SEC.

V. COSTS

A. The Law

[80] Section 202(1) of the Act empowers a hearing panel which has been satisfied that a party has contravened Alberta securities laws or acted contrary to the public interest to order that party to pay the costs related to the hearing, the underlying investigation, or both. The categories of costs which may be included – if the panel is satisfied that they are reasonable in the circumstances – are set out in section 20 of the *Alberta Securities Commission Rules (General)*.

[81] Cost-recovery orders are distinct from sanction orders, and are made for different reasons. Their purpose was succinctly described 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.

[82] Cost-recovery orders therefore relate to the specific misconduct proven against the specific respondent under consideration. This may require some scrutiny of the costs claimed to ensure that they do not include amounts not attributable to that respondent. In some cases it is simple to determine what should be included and excluded, but in others it may be necessary to arrive at reasonably supportable estimates.

[83] Another consideration relevant to the present case is the extent to which costs relating to the same matter have already been recovered from other respondents, as in the case of settlements concluded prior to a hearing or decision. However, that is not to say that where a breach is committed by more than one respondent, each should bear the related costs in equal proportion. The activities of one or another may have been such as to have consumed more investigation or hearing time (or both). Similarly, and as alluded to in *Marcotte*, different respondents may have made greater or lesser contributions to the efficient conduct of the proceeding, both before and during a hearing. That too may impact the order made.

[84] In view of the foregoing, less than full recovery of the total costs claimed may well be appropriate.

B. Position of Staff

[85] As mentioned, Staff adduced as evidence a document titled "Investigation & Hearing Costs" (the **Costs Document**). The Costs Document included a table summarizing the investigative and litigation Staff time spent on this matter and certain disbursements. Also included were comprehensive sets of documentation supporting the items in the table.

[86] The total of the costs shown in the summary table was $363,743.43. At the Sanctions Hearing, Staff counsel explained the assumptions and rough calculations that led to his

conclusion that $100,000 was the amount reasonably attributable to proving the allegations against Kostelecky. In essence:

(i) all litigation Staff time specifically attributable to negotiating and concluding the settlements with Michaluk, Wiebe and MacKenzie was excluded;
(ii) all litigation Staff time specifically attributable to issues directly relating to Kostelecky (whether for legal research, responding to an application, negotiating, or conducting the Merits Hearing) was separated out; and
(iii) the balance was divided by five (being the number of Original Respondents).

The total under (ii) and Kostelecky's one-fifth share under (iii) were added together for a sum of $115,785, which was then rounded down to $100,000 to allow for any errors or contingencies not already factored into the calculations.

[87] Staff further submitted that by not participating in these proceedings, Kostelecky neither helped nor hindered their efficient resolution. Accordingly, Staff counsel argued that that consideration was essentially neutral.

C. Analysis and Conclusion on Costs

[88] As a starting point, after review of the Costs Document, we are satisfied that the total of $363,743.43 shown in the summary table represents the investigation and hearing costs actually incurred by Staff in this matter. We are also satisfied that those costs are all of the kind recoverable under section 202(1) of the Act.

[89] As Staff acknowledged, the next step – determining how much of the total is reasonably attributable to the allegations proved against a particular respondent – is not always capable of precise mathematical calculation, especially when a proceeding involves multiple allegations against multiple parties with varying levels of involvement. The calculation is complicated further when different parties reach early resolutions and exit the proceedings at different times.

[90] That said, we are satisfied that Staff fairly made such calculations where possible, and devised a reasonable method of estimating and dividing responsibility for the rest. If anything, Staff has erred on the side of caution in Kostelecky's favour by dividing responsibility evenly among the Original Respondents. Kostelecky had by far the most significant role in the misconduct found, and was the only party found to have perpetrated a fraud. He was also the only respondent with respect to whom a full hearing was conducted. Logically, this means that more time and effort were expended investigating and proving the allegations against him, all of which we sustained in the Merits Decision.

[91] We further agree with Staff that, at best, Kostelecky's non-participation in these proceedings is a neutral consideration. While he was entitled to take the position on jurisdiction that he did, non-participation is not the same as positively contributing to an efficient conclusion (*Coastal* at para. 31).

[92] There was no other behaviour on Kostelecky's part that might militate in favour of a reduced cost-recovery order.

[93] In the result, therefore, we conclude that $100,000 in costs are fairly recoverable from Kostelecky.

VI. CONCLUSION

[94] For the reasons given above, we make the following orders against Kostelecky:

- under sections 198(1)(d) and (e) of the Act, he must resign all positions he holds as a director or officer of any issuer, and he is prohibited from becoming or acting as a director or officer (or both) of any issuer, permanently;

- 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, permanently;

- under section 199, he must pay an administrative penalty of $650,000; and

- under section 202, he must pay $100,000 of the costs of the investigation and hearing.

[95] This proceeding is concluded.

June 6, 2017

For the Commission:

"original signed by"
Fred Snell, FCA

"original signed by"
Ian Beddis