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CONTINUOUS DISCLOSURE OBLIGATIONS IN TIMES OF A CONTINUOUS PANDEMIC: CANADIAN SECURITIES REGULATORS' REVIEW OF ISSUERS' DISCLOSURE

— Oleg Stratiev.

The author wishes to thank Gilles Leclerc for his advice and contributions.

"Nothing happens. Nobody comes, nobody goes. It's awful." This quote from Estragon, one of the main characters in Samuel Beckett's play "Waiting for Godot", summarizes well the previous year from an economic and social perspective. Today, while the hopes of a vaccine rollout and economic recovery are looming on the horizon, the Covid-19 pandemic continues to have a material adverse impact on our economy. It poses widespread challenges for many businesses, including challenges in reporting and disclosing the effect of Covid-19 to investors.

In a series of bulletins[1] published last year, we highlighted the guidance provided by both the Canadian Securities Administrators ("**CSA**") and the U.S. Securities Exchange Commission relating to the continuous disclosure obligations of public issuers in the context of Covid-19. On February 25, 2021, CSA issued Staff Notice 51-362 (the "**Staff Notice**") to report the results of their review of the disclosure provided by reporting issuers on the impact of Covid-19 on their business. CSA examined the filings of approximately 90 issuers.

Content of the CSA's Staff Notice

The Staff Notice is divided into "Executive Summary", "Scope and Methodology", and "Results and Key Themes" sections. It also include some examples and guidance to assist issuers and their advisors indisclosing and reporting on the impact of COVID-19 on their business and operations.

The "Executive Summary" section presents the high-level considerations and suggestions of CSA's Staff regarding the disclosures provided by reporting issuers on the impact of COVID-19 on their business, while the "Results and Key Themes" section highlights the areas and documents in which issuers provided quality and detailed disclosures. Concurrently, this section identifies topics for which issuers could improve their disclosure.

In addition, Appendix "A" to the Staff Notice details and expands on the significant issues identified in the Staff's reviews and disclosure guidance, while Appendix "B' provides

[1] (1) https://www.timelydisclosure.com/2020/03/20/risk-factors-and-disclosure-in-the-time-of-covid-19/; (2) https://www.timelydisclosure.com/2020/04/21/update-public-disclosure-in-the-time-of-covid-19/; (3) https://www.timelydisclosure.com/2020/05/12/canadian-securities-regulators-provide-guidance-on-public-disclosure-in-time-of-covid-19/.

examples of deficient disclosure contrasted against improved entity-specific disclosure. The Staff Notice, and more specifically the Appendixes, will be beneficial for issuers preparing the disclosure documents and, in particular, for those with a December 31 year-end that are currently in the middle of finalizing their annual disclosure.

Takeaways from the CSA's Staff Notice

In general, the CSA was encouraged by the quality of disclosure provided by many issuers who have significantly expanded their MD&A to provide detailed operational updates addressing the pandemic's impact.

However, the Staff Notice pointed out that the issuers failed to provide entity-specific details and, more often than not, provided unbalanced and overly promotional disclosure for non-GAAP financial measures and forward-looking information.

That being said, almost a year after Covid-19 was declared a pandemic, issuers must thoroughly assess their operations and favour disclosure of specific facts about the past and the likely future effect of the virus instead of adopting general and broad language that presents the risk in the hypothetical. In other words, just like each Covid-19 variant is country-specific, the disclosure of each issuer must be entity-specific.

Issuers must tailor their disclosures to provide investors with an entity-specific level of insight to understand the operational challenges, financial impacts, risk profile and the issuer's operational responses related to the COVID-19 pandemic. The CSA noted that such information is necessary to meet securities requirements and foster investor confidence in the current environment. In particular, the CSA emphasized the following areas that ought to be considered in the issuers' upcoming continuous disclosures:

- The impact of COVID-19 on the issuer's operations and financial condition (i.e., liquidity and capital resources)
- The key risks that the COVID-19 pandemic presents to the issuer
- Known trends, demands, events, or uncertainties related to the pandemic could materially affect the issuer's future revenues, expenses or projects
- The operational changes and other measures taken by management in response to Covid-19
- Impact of Covid-19 on the issuer's capacity to meet working capital requirements, debt covenants, planned growth or funding of future development activities and capital expenditures
- Impact of Covid-19 on the issuer's areas of financial reporting subject to significant judgement and measurement uncertainty in the current environment
- Impairment of non-financial assets given the extended impact of the pandemic
- Disclosures relating to key assumptions should be both realistic and supportable
- The accounting policy for, the nature and extent of government grants recognized in the financial statements.

Management's Discussion & Analysis Reporting ("MD&A")

Below are some key observations and disclosure considerations noted by the CSA and derived from Appendix A of the Staff Notice.

Operational Status

Many issuers provided "lists" of measures employed to manage operational and liquidity risks, but did not provide sufficient details to address the anticipated impact. The CSA also noted that some of these issuers provided operational updates in press releases but did not include such detailed disclosure in their MD&A filings. The same goes for disclosures regarding the measures taken in responses to the pandemic. Issuers should not merely list the actions taken but should provide sufficient detail to understand the measure's impact on the business.

The CSA recommends providing detailed and transparent discussions on how Covid-19 impacted the issuer's industry and day to day operations. For instance, CSA suggests having a separate "Covid-19" section in the MD&A preceding the discussion of financial results, which could provide a practical framework in understanding the issuer's analysis of financial performance, condition and liquidity.

Here are some considerations to keep in mind:

- Impact of health and safety guidelines on operations
- Impact of the current environment on issuer's demand or ability to provide products and services (both adversely and positively)
- Details of operational closures and restrictions
- Information presenting the impact of shutdowns and closures
- Data to assist with understanding restrictions and other impacts to the issuer's business
- Discussing how customers and suppliers have been impacted and the effect on the issuer
- Discussing the impact for each segment or geographic location to the extent operations are impacted differently
- Explaining how industry and economic factors have uniquely impacted the issuer.

Overall Performance and Operations

CSA highlighted that approximately 20% of reviewed issuers disclosed Covid-19 as the reason for period-over-period variances, but failed to analyze entity-specific factors. In particular, the CSA noted three issues.

First, certain issuers did not clarify how certain costs, in particular restructuring costs, were fully attributable to COVID-19 when the issuer had pre-existing operational problems. Second, issuers that quantitatively disclosed variances related to Covid-19 (e.g., impact to sales) did not explain the methodology used by management in determining that fluctuations were isolated to COVID-19. Finally, many issuers mentioned received government assistance, but did not fully disclose impacts that such assistance 19 had on their performance, operations and cash flows.

The CSA urges issuers to avoid making boilerplate statements attributing negative results to Covid-19. Instead, issuers should provide a meaningful discussion of the pandemic's material impacts (both positive and negative) on the issuer's operations. Issuers should quantify the impact on demand for products and decrease in sales, the number of employees it furloughed, detailed revenues and expenses by segment, the monetary value of cancelled or suspended contracts, the costs incurred in transforming or adapting the business model to COVID-19 operations, deferred capital expenses, etc. For instance, issuers in the retail/service industry are encouraged to disclose the number of store closures, the CSA acknowledged that it may be difficult for an issuer to determine with accuracy the quantitative impact of Covid-19. If a detailed assessment is impossible, issuers should disclose what is available and focus on explaining the methodology used in their calculation and provide information about the judgements.

Here are some considerations to keep in mind:

- Whether and how decreases or increases in demand for products and services impacted financial results
- How costs, including changes in prices, influenced results
- Effect of altered terms with customers, lessees, and borrowers
- Impact on supply chains or distribution channels
- Changes to planned projects and development activities
- Details of restructuring plans and related costs
- A discussion of any breaches of material contracts.

Known Trends and Events that are Reasonably Likely to Affect Future Performance

Out of 90 issuers, approximately 30 provided generic, boilerplate disclosure in this area. It appears that the uncertainty related to Covid-19 makes it too difficult to predict the coronavirus's overall impact on the issuer's future performance.

Although no one can predict the future, it is still essential for issuers to provide transparent and tailored disclosure on general trends and uncertainties that are likely to impact future performance. For instance, issuers should use the

"Outlook" section of the MD&A to discuss (i) how future periods may be affected differently compared to the current period, (ii) whether the coronavirus will continue to impact the issuer's industry post-pandemic, and (iii) whether the issuer anticipates material restructuring charges in the future.

Liquidity and Capital Resources

The majority of issuers reviewed had indicators of liquidity risk, but some disclosure was insufficient again. More specifically, certain issuers did not disclose trends or expected fluctuations in their liquidity and capital resources. Although many issuers discussed various remedies to address liquidity uncertainties, very few actually quantified the impact or said remedies' duration.

No doubt: Covid-19 had a significant impact on many issuers' liquidity and capital resources, creating unique challenges and the need for new financing resources. As such, the CSA recommends that issuers provide a clear picture of their working capital, working capital needs and how those needs relate to business plans and milestones. Moreover, if applicable, issuers should discuss the impact of altered payment terms with customers and lessees. If possible, issuers should also discuss how long other remedies to address liquidity concerns are anticipated to be in effect and the issuer's risks when remedies expire.

Debt Covenants

In general, issuers have properly disclosed compliance with debt covenants, but the level of details varied significantly. The CSA encouraged issuers with debt covenants to discuss the terms and conditions of the debt covenants, especially when a breach of the covenant could trigger a material funding requirement or early repayment. Moreover, if the issuer is on the verge of breaching debt covenants or is at risk of default, such information is material and must be disclosed.

Risk Factors

In our previous review of public disclosure documents filed on SEDAR, we noted that issuers favoured a broad and all-inclusive approach to drafting risks related to disease outbreaks and pandemics, while inserting, where applicable, references to COVID-19.[2] The CSA's Staff Notice appears to arrive at a similar conclusion. More than a third of issuers provided "lists" of risks or disclosures that only touched on general economic or societal impacts of COVID-19 and did not describe entity-specific COVID-19- related risks.

The CSA reiterated the importance of entity-specific risk factor disclosure, which should be sufficiently detailed to allow investors to understand the current and potential impact of COVID-19 on the issuer's business. Below are some risk factors suggested by the CSA, and which should be disclosed in the order of seriousness from the most serious to least severe:

- Disruptions to day-day operations resulting from health and safety measures and government-imposed closures
- Human resource/staff constraints
- Cybersecurity or information technology risks that may be heightened with the pandemic
- Ability to sustain changes in revenues/expenses/negative cash flow from operations
- Changes in consumer demand
- Ability to access government funding
- Requirements under lending agreements
- Changes in commodity prices
- Volatility in the capital markets and access to financing and capital on reasonable terms

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[2] For a more detailed discussion on risk factors stemming from the COVID-19, please refer to our bulletins published on March 20 and April 21, 2020.

- Limitations on the ability of issuers' customers to perform and make timely payments
- Reliance on significant customers that have decreased operations
- Disruption to supply chains
- Temporary or longer-term delays to projects and development plans
- Financial statement impacts related to restructuring, impairment and measurement uncertainty
- Change to consumer behaviour resulting from the pandemic and impact on future operations
- Additional litigation risks resulting from the pandemic
- The issuer's ability to recover from the pandemic that may be unique to the issuer or its industry.

Financial Statements

CSA highlighted specific findings that ought to be carefully considered by management in the Staff Nootice.

First, issuers must adequately update their disclosures and assumptions impacted by the pandemic in the context of (i) testing impairments of goodwill and intangible assets and (ii) measuring fair value and estimating expected credit losses. Perhaps issuers should favour probability-weighted scenarios in making estimates of fair value instead of a single best estimate.

Second, issuers should identify material uncertainties that impair their ability to continue as a going concern in light of a deterioration in their business since the onset of the pandemic. In a similar vein, if an issuer describes "close call" situations, said issuer must also disclose the mitigating actions that impacted its determination. For instance, if the issuer breaches financial covenants during the reporting period, it should (i) tell how the breaches will affect the company's ability to continue as a going concern and (ii) reclassify the loan as a current liability.

Third, although issuers supplement the discussion of significant judgments and measurement uncertainty in the MD&A, they must also do so in the notes to the annual financial statements. The CSA encourages issuers to update their interim and annual financial statements in order to include (i) timely and entity-specific disclosure of significant judgements and measurement uncertainties and (ii) explain the nature of estimation uncertainty and sensitivity analysis to help investors fully understand the potential impact of estimates.

Other Regulatory Matters

Non-GAAP Financial Measures

The CSA noted that less than five per cent of reviewed issuers disclosed non-GAAP measures adjusted for impacts relating to the coronavirus. Among them, certain issuers did not adequately explain how adjustments were attributable to the pandemic. CSA's Staff found a few instances where the disclosure of non-GAAP measures was misleading. As such, issuers are encouraged to thoroughly consider how non-GAAP measures can assist investors and whether they are a valuable and meaningful alternative to explain the pandemic's impact.

Forward-Looking Information and Financial Outlooks

CSA's Staff noted several instances of insufficient disclosure of assumptions and risks related to forward-looking information.

Material Change Reporting

Many issuers issued news releases relating to Covid-19 and its impact on the issuer's business. However, CSA's Staff reminded issuers that the term "material change" is based on a market impact test. In other words, if Covid-19 has an equal effect throughout an issuer's industry, a material change report may not be required. In order to determine whether a filing is necessary, the issuers should refer to their principal regulator's applicable securities legislation for the definition of "material change".

Conclusion

In conclusion, it appears that the majority of the issuers reviewed by the CSA were proactive in providing quality and detailed disclosures. There is room for improvement, but considering the speed at which the virus spreads and events unfold, this might be easier said than done. However, one thing is certain; the CSA Staff Notice will be a helpful resource for issuers looking to perfect and complete their continuous disclosure documents. Last but not least, although the pandemic is omnipresent in our daily lives, we remind issuers that other events, changes and impacts not related to Covid-19 should be disclosed with equal prominence.

Oleg Stratiev is an associate in Fasken's Montreal corporate and commercial group, working mainly with public, private and institutional clients on a wide range of corporate and commercial matters. He is developing an expertise in securities laws, capital markets, financing, mergers & acquisitions, and regulatory compliance.

CANADIAN SECURITIES ADMINISTRATORS

CSA Staff Notice 23-328

CSA Staff Notice 23-328 *Order Protection Rule: Market Share Threshold for the Period April 1, 2021 to March 31, 2022*, dated February 25, 2021, was issued. For more information, please see CSA Staff Notice 23-328, which will be reproduced in Volume 1 of the *Canadian Securities Law Reporter* at ¶ 2341p.

CSA Staff Notice 45-328

CSA Staff Notice 45-328 *Update on Amendments relating to Syndicated Mortgages: National Instrument 45-106 Prospectus Exemptions and National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and Changes to Companion Policy 45-106CP Prospectus Exemptions and Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations*, dated February 25, 2021, was issued. For more information, please see CSA Staff Notice 45-328, which will be reproduced in Volume 1A of the *Canadian Securities Law Reporter* at ¶ 4558.

CSA Staff Notice 51-362

CSA Staff Notice 51-362 *Staff Review of COVID-19 Disclosures and Guide for Disclosure Improvements*, dated February 25, 2021, was issued. For more information, please see CSA Staff Notice 51-362, which will be reproduced in Volume 1 of the *Canadian Securities Law Reporter* at ¶ 5184g.

PROVINCIAL UPDATES

Northwest Territories

Implementing Rule 11-801

Implementing Rule 11-801 *Syndicated Mortgages* was amended on March 1, 2021. For more information, please see Implementing Rule 11-801, which will be reproduced in Volume 1B of the *Canadian Securities Law Reporter* at ¶ 115-101.

Implementing Rule 31-811

Implementing Rule 31-811 *Syndicated Mortgages*, dated March 1, 2021, was issued. For more information, please see Implementing Rule 31-811, which will be reproduced in Volume 1B of the *Canadian Securities Law Reporter* at ¶ 115-143g.

Blanket Order 81-505

Blanket Order 81-505 *Temporary Exemptions from National Instrument 81-104 Alternative Mutual Funds*, dated January 28, 2021, was issued. For more information, please see Blanket Order 81-505, which will be reproduced in Volume 1B of the *Canadian Securities Law Reporter* at ¶ 115-095d.

New Brunswick

Local Rule 25-501

Local Rule 25-501 *Designation as a Market Participant*, dated March 1, 2021, was issued. For more information, please see Local Rule 25-501, which will be reproduced in Volume 3 of the *Canadian Securities Law Reporter* at ¶ 330-051.

Nova Scotia

Notice No. 45-718

Notice No. 45-718 *Prospectus and Registration Exemptions Relating to Certain Syndicated Mortgages in Nova Scotia*, dated February 26, 2021 was issued. For more information, please see Notice No. 45-718, which will be reproduced in Volume 3 of the *Canadian Securities Law Reporter* at ¶ 430-094.

Blanket Order 45-528

Blanket Order 45-528 *Relief from the Prospectus and Registration Requirements for Certain Syndicated Mortgages*, dated March 1, 2021, was issued. For more information, please see Blanket Order 45-528, which will be reproduced in Volume 3 of the *Canadian Securities Law Reporter* at ¶ 429-439.

Ontario

Ontario Instrument 33-507

Ontario Instrument 33-507 *Exemption from Underwriting Conflicts Disclosure Requirements (Interim Class Order)*, dated February 18, 2021, was issued. For more information, please see Ontario Instrument 33-507, which will be reproduced in Volume 3A of the *Canadian Securities Law Reporter* at ¶ 480-157.

RECENT CASES

Freeze Orders

British Columbia Court of Appeal, November 5, 2020

On October 10, 2018, the British Columbia Securities Commission (the "Commission") issued an investigation order (the "Investigation Order") against Party A, Party B, Party C, Party D, and Party E (together, the "Applicants") under section 142 of the British Columbia *Securities Act,* RSBC 1996, c. 418 (the "Act"). In early April 2019, the Chair of the Commission issued freeze orders (the "Freeze Orders") under section 151 of the Act against various Applicant's bank and brokerage accounts and imposed charges on properties in which some Applicants had an interest. The evidence the Commission staff relied upon for the issuance of the Investigation and Freeze Orders was a memorandum (the "Memoranda") that outlined an ongoing investigation involving the Applicants, various issuers, trading subjects, promotions, heavy trade volumes in the issuers, and substantial deposits into accounts held by the Applicants and trading

subjects. On November 21, 2019, a Commission Panel dismissed the application for the revocation of the Freeze Orders (the "Decision"). The Panel relied on the British Columbia Court of Appeal (the "Court") in *Exchange Bank & Trust Inc. v. British Columbia Securities Commission*, 2000 BCCA 389 ("*Exchange Bank*"), which held, among other things, that: the evidentiary burden to obtain an investigation or freeze order was not onerous; the object of a freeze order is to preserve the *status quo* and protect assets in the public interest; it was "not possible to state an evidentiary test that must be met in every case to support a freeze order"; and there was an expectation that Commission staff would review emerging evidence to evaluate the freeze order's appropriateness. The Panel also noted it would only revoke or vary an order if it would not be contrary to the public interest to do so. The Panel found the Freeze Orders had been validly issued and dismissed the application, as the Applicants did not produce evidence that it would not be prejudicial to the public interest to revoke the Freeze Orders. The Applicants sought leave to appeal the Commission's decision on the basis that the Panel erred in law by finding the Freeze Orders were validly issued and dismissing the application to revoke the Freeze Orders pursuant to sections 165 and 171 of the Act. The Applicants also argued that this was an opportunity to create a principled test for the issuance of freeze orders under section 151 (which currently provided no statutory protections), and because there was no guidance, the ability to issue a freeze order was improperly delegated to the Commission's Executive Director. The Commission took the position that the Freeze Orders were validly issued and the constitutional challenge was the more appropriate forum to determine any deficiencies with section 151. On March 27, 2020, significant amendments to the Act came into force that repealed section 151 of the Act and replaced it with new preservation order powers.

Leave to appeal was granted. The Court began its analysis by reviewing the applicable caselaw, and noted that *Queens Plate Development Ltd. v. Vancouver Assessor*, Area 09 (1987), 16 BCLR (2d) 104 ("*Queen's Plate*"), was the binding precedent for leave applications from statutory appeals, with the following factors to be considered: whether the proposed appeal raised a question of general importance regarding the tribunals' jurisdiction; whether the appeal was limited to questions of law involving the application of statutory provisions, statutory interpretation that was important to the litigant, or interpretation of wording that appeared in multiple statutes; if there were differences of opinion in various decisions and merit in putting the issue forward; whether there was a prospect of the appeal succeeding on its merits; if there a clear benefit from the appeal; and whether appellate bodies had considered the issue. Further, *Smolensky v. British Columbia Securities Commission*, 2006 BCCA 254, added that leave applications from statutory tribunals also engaged the standard factors for leave, including whether the appeal would unduly hinder the progress of the action, and in *Smith v. Global Plastics*, 2001 BCCA 152, the Court noted that other factors may be considered, including if there would be "great injustice to a party if leave was not granted". The Court's key findings after assessing the case law factors included that: the appeal raised significant issues to the practice including the Commission's process for issuing freeze orders and whether it was an improper *de facto* delegation to the Executive Director; this was a key issue for the Applicants given the significant amount of property frozen and they stood to benefit from the resolution; there was merit in the appeal as no British Columbia court had rejected a mandatory evidentiary test, and in the *obiter* to *Exchange Bank*, Newbury JA had stated that "the freeze order on its face seems a draconian measure which could bring about a crisis for an innocent party"; the appeal raised a question of law (whether the Commission properly exercised its discretion in refusing to revoke the Freeze Order), with the Commission's decision subject to appellate oversight; there was no evidence the appeal would hinder the investigation or Charter case; and it was in the interest of justice to grant leave given the significance of the issues and the merit of the proposed appeal. In view of the foregoing, the Court granted leave.

Party A v. British Columbia (Securities Commission), 2021 CSLR ¶ 900-865

Expert Evidence

Ontario Securities Commission, January 18, 2021

In a Statement of Allegations dated September 26, 2019, Staff of the Ontario Securities Commission (the "Commission") alleged that Solar Income Fund Inc. ("Solar"), Allan Grossman, Charles Mazzacato, and Kenneth Kadonoff (together, the "Respondents") engaged in fraud and the making of misleading statements, contrary to the Ontario *Securities Act*, RSO 1990, c. S.5 (the "Act"). The allegations in brief were that the Respondents raised approximately $57 million from investors in the exempt market through the SIF Solar Energy Income & Growth Fund (the "Fund"). The investors were told that their funds would be used for the acquisition, development, and operation of solar energy installations, with returns paid through the sale of solar energy. Instead, the funds raised were allegedly diverted to other unrelated

purposes, including transfers and loans to other funds controlled by the individual Respondents. To date, over $5 million had not been paid back. The merits hearing was scheduled for March 1, 2021, and Staff moved to introduce the report of an expert witness containing opinions regarding investor expectations and norms in the solar power industry (the "Expert's Report"). The Respondents objected to the Expert's Report being admitted arguing that the opinions were outside the scope of the Statement of Allegations or were otherwise inadmissible, and if they were correct, they did not want to incur the expense to respond to the Expert's Report.

The Expert's Report was held to be inadmissible. The main issue before the Panel was whether part or all of the Expert's Report was admissible, with a collateral issue being whether the issue should be decided before the merits hearing. The Panel made some initial observations, including that relevance was generally determined by the statement of allegations, and the Commission's decision in *Re Mega-C Power Corp*, 2007 ONSEC 4 ("*Mega-C*"), outlined the questions to be asked when determining whether it was appropriate to resolve an issue before a hearing. The Panel applied the *Mega-C* test and found that it was appropriate to hear the motion as it could be resolved without regard to the contested facts and evidence (as the scope of the material issues was already defined in the Statement of Allegations) and resolution of the issue would be more efficient as it would potentially save the Respondents from hiring their own expert to respond to the Expert's Report. Turning to the key issue, the Panel noted that opinion evidence was generally inadmissible, and Staff had to establish that: the Expert's Report was relevant; the expert was qualified to give the opinion evidence; and the evidence was necessary as it was outside the Commission's expertise. There were no issues raised by the Respondents on the second question regarding the expert's qualifications. On the first question, the Panel reviewed the allegations which were the making of misleading statements (including in the Offering Memorandum ("OM")) and fraud. Among other observations, the Panel noted that section 1.3 of the OM, titled "Reallocation", stated: "We intend to spend the available funds as stated. We will reallocate funds only for sound business reasons." The Panel agreed with Staff's submission that "sound business reasons" might enable the Respondents to argue that the impugned transactions involving the investors' funds might meet that standard, making the expert's opinions about the soundness of the transactions to be relevant. However, the Respondents notified the Panel that they waived their right to submit "evidence to support a submission that they reallocated funds for sound business reasons", and this rendered the expert's three opinions on this allegation irrelevant. A fourth opinion in the Expert's Report was in response to "whether loans made by the Fund have been reasonably understood by a solar energy investor to be investments in the acquisition, development, financing and operation of solar energy powered installations as described in the Offering Memorandum?" Staff's submission was that this opinion was to help the Commission understand how "financing" was typically understood by solar energy market investors. The Panel found that how a reasonable investor would assess whether certain transactions conformed to that language was relevant, but it was also squarely within the Commission's expertise and therefore unnecessary. Accordingly, the entire Expert's Report was found to be inadmissible.

Re Solar Income Fund Inc., 2021 CSLR ¶900-866

Reciprocal Orders

Ontario Securities Commission, January 21, 2021

Vernon Ray Fauth (the "Respondent") was found by a panel of the Alberta Securities Commission (the "ASC") to have breached the Alberta *Securities Act,* RSA 2000, c. S-4, by engaging in unregistered dealing, making material misrepresentations about securities, and perpetuating a fraud on investors (see *Re Fauth*, 2018 ABASC 175). The facts in brief were that the Respondent founded and was a senior officer and shareholder of several corporations including Espoir Capital Corporation ("Espoir"). Espoir investors were told, among other things, that their funds were secured by mortgages and were safe. Over a period of approximately 10 years, Espoir raised over $15.5 million, and ASC Staff determined that the investor funds were being used by the Respondent for personal expenses, diverted to his family members, or used to repay principal and interest to other investors in the manner of a Ponzi scheme. Investors lost approximately $12 million with no likelihood of repayment. In a decision dated June 24, 2019, the ASC Panel ordered, among other things, that the Respondent be permanently prohibited from participating in the Alberta capital market, including from acting as a director or officer of any issuer, and that he disgorge $2.5 million and pay an administrative penalty of $400,000 and costs (the "ASC Order"; see 2019 CSLR ¶900-793). Staff of the Ontario Securities Commission (the "Commission") requested a public interest order under subsection 127(1) of the Ontario *Securities Act*, RSO 1990, c. S.5 (the "Act"), mirroring the non-monetary sanctions issued by the ASC Panel pursuant to subsection 127(10) of the Act, which provides that a public

interest order may be made "where a person has been subject to an order by a securities regulatory authority in any jurisdiction that imposes sanctions, conditions, restrictions or requirements."

The order was granted. The Commission Panel began its analysis by noting that even if the precondition to making an order under subsection 127(10) of the Act was met, it still had to consider whether it was in the public interest to do so. The factors to consider included: the seriousness of the misconduct, investor harm, specific and general deterrence, and aggravating and mitigating factors. Further, orders were to be "protective and preventative" to restrain future misconduct that could harm the Ontario market (see *Re Belteco Holdings Inc.* (1998), 21 OSCB 7743). The Panel was satisfied that the precondition was met, as the Respondent was subject to the ASC Order, and key findings by the Panel included that: the Respondent's misconduct was extremely serious as fraud was recognized as one of the most serious breaches of securities legislation, and the fraud in this case took place over 10 years and involved a significant amount and a number of investors; the Respondent had extensive capital market experience as a former Alberta registrant and knew about the requirements; and the investors, including Ontarians, suffered significant hardship as a result of the fraud, including the loss of life savings close to or in retirement. The Panel concluded it was necessary to impose the requested sanctions to protect the Ontario market and to deter the Respondent and others from similar misconduct.

Re Fauth, 2021 CSLR ¶ 900-867

Market Manipulation

Alberta Securities Commission, February 2, 2021

Avatar Solutions Inc. was incorporated as an international business company in Belize in May 2011. On March 28, 2013, it changed its name to Kilimanjaro Capital Ltd. ("Kilimanjaro"). Zulfikar Hussein Rashid ("Rashid"), an Alberta resident, had incorporated Kilimanjaro Capital Ltd ("Kilimanjaro Canada") in 2010 in Alberta and was also a director, Chief Executive Officer, and Control Person of Kilimanjaro. Ashmit S. Patel ("Patel") was an Ontario resident and from November 2012 to October 2014 (the "Relevant Period") he resided in the United States with a license to practice law in Illinois; he held himself out as Kilimanjaro's Chief Operating Officer. Jonathan Harris Levy ("Levy") was a resident of South Carolina with a license to practice law in California and the District of Columbia; he held himself out as Kilimanjaro's general counsel and legal representative for various government in exile who entered into agreements with Kilimanjaro Canada during the Relevant Period. Gregory Scott Buczynski ("Buczynski", together with Kilimanjaro, Patel, Levy, and Rashid, the "Respondents") audited Kilimanjaro's financial statements. In the fall of 2012, Levy and Panel had begun a search for a shell company for a project involving future contingent oil, gas, and mineral rights in Africa (the "FCAs"). Rashid had expressed interest and offered Kilimanjaro Canada. From late 2012 to early 2013, Kilimanjaro Canada began issuing news releases that, among other things, announced assignment agreements with various governments in exile. On March 28, 2013, Kilimanjaro acquired Kilimanjaro Canada to support Kilimanjaro's listing on the GXG Markets ("GXG"), a Danish-regulated microcap stock exchange. On April 29, 2013, Kilimanjaro's board of directors approved Kilimanjaro's audited financial statements for the fiscal years ended 2011 and 2012 (the "Statements"), with the audits conducted by Buczynski's firm, Gregory Scott International. Among other things, the Statements provided that: Kilimanjaro conducted its business through Kilimanjaro Canada; Kilimanjaro's balance sheet included cash and cash equivalents of nearly US$8 million resulting from a private placement; and "a representation on behalf of Kilimanjaro that it had sufficient working capital for its present requirements and for the next 12 months." Kilimanjaro began trading on the GXG from August 2013 until June 2014 and traded on the OTC Markets from October 2013. Kilimanjaro was also deemed to be a reporting issuer in Alberta. Starting in August 2013, Kilimanjaro shares were issued to the individual Respondents as well as other individuals and entities, and a share split was announced in February 2014. A substantial amount of the shares were eventually deposited into accounts over which Patel had direct or indirect control, and, in some cases, the share transfers were supported by false documentation. Other significant events included that: in November 2013, Kilimanjaro engaged Chapman Petroleum Engineering to prepare a valuation of one of Kilimanjaro's assets, which resulted in a report and news release that Patel prepared that did not conform to National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities* (NI 51-101) (the "Chapman Release"); on April 3, 2014, the Commission issued a cease trade order (the "CTO") against Kilimanjaro for failing to make required filings and Staff had identified significant trading of Kilimanjaro shares in an account; on May 12, 2014, Patel purchased 100,000 Kilimanjaro shares and shortly thereafter sold over 33 million; from March 27, 2014 to August 20, 2014, 97 promotional touts for Kilimanjaro were disseminated by various stock promoters (the "Tout Campaign"), and at the same time, Kilimanjaro was issuing news releases prepared by Patel;

during and prior to the Tout Campaign, there were emails from Patel to an individual, Zang (who eventually entered into a settlement agreement with the Commission in connection with his Kilimanjaro involvement), about the promotional campaign commencing, and Zang loaned money to pay for the promotion; and Patel ultimately sold more than 113.5 million Kilimanjaro shares through brokerage accounts he controlled. Staff of the Alberta Securities Commission (the "Commission") began investigating Kilimanjaro in late 2013 and issued a Notice of Hearing on November 11, 2017 alleging that: the Respondents had engaged in market manipulation contrary to subsection 93(1)(*a*) of the Alberta *Securities Act*, RSA 2000, c. S-4 (the "Act"); Kilimanjaro and Patel violated a cease trade order; Rashid obstructed justice and mislead Staff; and the Respondents' conduct was contrary to the public interest.

The Respondents were found to have breached the Act. The Panel began by noting, among other things, that: market activity that creates a false impression of security's value "is inconsistent with a fair and efficient capital market (see Re *Workum and Hennig*, 2008 ABASC 363); to establish a contravention of subsection 93(1)(*a*) of the Act, staff must prove, on a balance of probabilities, that the respondent's activity was an act or practice relating to a security that contributed or resulted in "a false or misleading appearance of trading activity or an artificial price for the security, which the respondent knew or reasonably ought to have known of" (see *Re De Gouveia*, 2013 ABASC 106); analysing whether there was a misleading appearance of trading activity required scrutiny of the respondent's conduct as a whole (see *Re Siddiqi*, 2005 BCSECCOM 416); a causal connection had to be established between the impugned activity and the potential that the activity resulted in a misleading appearance of trading activity or artificial price (see *Re Lim*, 2017 BCSECCOM 196); section 93(1)(*a*) of the Act "casts a potentially wide net", capturing both direct and indirect conduct that must result in or contribute to market manipulation; and indicators of market manipulation included market domination, wash trades, uneconomic trading, and disseminating information or misinformation to make a security appear more valuable than it is and distorting supply and demand. Staff also introduced expert testimony on microcap liquidation schemes, which is generally the "coordinated effort of a small group of individuals who secretly exercise control over an issuer and its share transactions", and elements typically included: a third party, often hidden, having control over an issuer (and directors merely acting as nominees); an orchestrated promotional campaign; control over the issuer's securities through brokerage accounts controlled by undisclosed persons; the issuer's shares being listed on an OTC market; public disclosures with misrepresentations; failures to comply with regulatory requirements; and evidence of deceptive trading practices. In the expert's view, Kilimanjaro was a microcap liquidation scheme. Key findings made by the Panel regarding Patel included that: his purchase of 100,000 shares was an act contributing to a misleading appearance of trading activity as it was uneconomic, did not meaningfully increase his holdings, and was timed with touts to make it appear there was interest in Kilimanjaro's shares; he artificially increased Kilimanjaro's share price by issuing the news releases and likely directed the Tout Campaign; and he knew his actions would contribute to artificial share price as the scheme's "architect" and did so "to profit at the expense of an unwitting market." Turning to Rashid, the Panel found that, after allowing himself to be appointed president and CEO, Rashid could not disavow himself of the responsibilities those roles carried, and he had enough warnings that Kilimanjaro was being used for a market manipulation scheme and should have known his actions (such as fund raising and approving news releases) were contributing to an artificial price for Kilimanjaro's shares. The Panel also found that Staff failed to prove the allegations against Levy and Buczynski, Kilimanjaro and Patel had breached the cease trade order, and Rashid had misled Staff.

Re Kilimanjaro Capital Ltd., 2021 CSLR ¶ 900-868

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For LexisNexis Canada Inc.

Jaime Latner, LLB,
Content Development Associate
905-479-2665
email: jaime.latner@lexisnexis.ca

Customer Support
Phone: 1-800-387-0899
Email: service@lexisnexis.ca
Customer Service is available from 7 a.m. to 11 p.m. (ET) Monday to Friday, and from 9 a.m. to 11 p.m. (ET) on Weekends.

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111 Gordon Baker Road
Suite 900
Toronto, Ontario
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