ALBERTA SECURITIES COMMISSION

DECISION
(Sanction)

Citation: Workum and Hennig, Re, 2008 ABASC 719 **Date: 20081218**

Theodor Hennig, Peter Jay (or J.) Workum, Cheshire Capital Inc. and Strategic Investments Fund

Panel:	Glenda A. Campbell, QC Jerry A. Bennis, FCA Stephen R. Murison
Representation:	D. Young for Commission Staff
	J. Groia and K. Richard for Peter Workum
	J. Phillips and R. Finn for Theodor Hennig
	R. Normey for the Intervener, the Attorney General of Alberta
Final Submissions:	26 November 2008
Date of Decision:	18 December 2008

I. INTRODUCTION

[1] This decision concludes a lengthy two-part hearing into allegations made by staff ("Staff") of the Alberta Securities Commission (the "Commission") against six respondents. In the first part of the hearing we considered the merits of those allegations. That segment of the hearing ended with our decision on 7 June 2008 (the "Merits Decision", cited as *Re Workum and Hennig*, 2008 ABASC 363). For the reasons set out therein, we found that four of the respondents – Peter Jay (or J.) Workum ("Workum"), Theodor Hennig ("Hennig"; we sometimes refer to Workum and Hennig together as the "Individual Respondents"), Strategic Investments Fund ("Strategic") and Cheshire Capital Inc. ("Cheshire") – had in several respects contravened Alberta securities laws or acted contrary to the public interest, or both, as outlined below. We made no findings against the other two respondents, Lexington Capital Corp. ("Lexington") and Ashland Holdings Corp. ("Ashland").

[2] Staff's allegations were set out in two notices of hearing, both amended on 19 September 2003 (the "First Notice of Hearing" and the "Second Notice of Hearing"; together, the "Notices of Hearing"). Staff alleged conduct contrary to the public interest or contraventions of Alberta securities laws. The allegations in the First Notice of Hearing related to alleged improprieties in certain financial statements of Proprietary Industries Inc. ("PPI"), misrepresentations through further use of that financial statement information, and misrepresentations to Staff. The allegations in the Second Notice of Hearing centred on alleged "Secret Commissions", "Market Manipulation", failures to file reports of insider trades, and misrepresentations to Staff.

[3] As discussed below, we found in the Merits Decision that the Individual Respondents bore responsibility for improper financial disclosure and associated misrepresentations by PPI, and for PPI's failure to disclose to the public certain financial benefits received by the Individual Respondents from PPI. Also as elaborated upon below, we found that the Individual Respondents contrived to manipulate the market price of certain shares, which resulted in artificial prices for those shares during two periods in 2000, and that Strategic and Cheshire also bore responsibility for these manipulations. Finally, we concluded that each of the Individual Respondents contravened insider trade reporting requirements and made misrepresentations to Staff.

[4] The second and final part of this proceeding involves an assessment of what, if any, orders ought to be made in the public interest given our findings in the Merits Decision. We received written submissions from each of Staff, Workum and Hennig. Along with their submissions on sanction and costs, Workum and Hennig each brought forward a "Notice of Constitutional Question", stating their intention "to question the constitutional validity of the application" here of section 199 of the *Securities Act*, R.S.A. 2000, c. S-4 (the "Act"). The Attorney General of Alberta made written submissions as an intervener. Staff and Workum also made oral submissions.

[5] This decision should be read together with the Merits Decision. The facts and findings set out in the Merits Decision are in no way altered by this decision. For convenience in this decision, we use certain capitalized terms that were defined in the Merits Decision and we refer to provisions of the Act using its current section numbering and current wording. Except for the maximum administrative penalty available (discussed below), there have been since the period under consideration in the Merits Decision no other changes to the sanctioning provisions of the Act relevant to the decision below.

[6] For the reasons set out in this decision, we are ordering sanctions and payment of costs against each of Workum, Hennig, Strategic and Cheshire under sections 198, 199 and 202 of the Act, as follows:

- in respect of Workum: permanent cease-trade, denial-of-exemptions and director-and-officer banning orders; a $750 000 administrative penalty; and a $200 000 costs order;

- in respect of Hennig: 20-year cease-trade and denial-of-exemptions orders; a permanent director-and-officer ban; a $400 000 administrative penalty; and a $175 000 costs order; and

- in respect of each of Strategic and Cheshire: permanent cease-trade and denial-of-exemptions orders; a permanent ban on any trading in their securities and exchange contracts; and a $25 000 costs order.

II. MERITS DECISION

A. Summary of Findings

[7] Our Merits Decision made findings in five areas, summarized as follows (Merits Decision at paras. 1300-07):

> **A. Financial Disclosure**
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> We found that PPI's 1998 Financial Statements, 1999 Financial Statements and 2000 Financial Statements – specifically in respect of the reporting of gains attributed to the Newmex, Orion and Azterra Transactions, respectively – were not prepared in accordance with GAAP [generally accepted accounting principles] and thus were contrary to Alberta securities laws. We also found that those financial statements contained misrepresentations.
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> We further found that in making additional, related inaccurate disclosure in other documents, PPI made further misrepresentations.
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> The issuance of non-GAAP compliant financial statements, and the making of misrepresentations as described, we found to be conduct contrary to the public interest.

We found that the Individual Respondents each bore responsibility for this improper financial disclosure and the associated misrepresentations. We therefore found that they each contravened Alberta securities laws and acted contrary to the public interest.

B. Undisclosed Financial Benefit

We found that the Individual Respondents each obtained financial benefits, from or through the Four Trading Accounts and the Mandolin Offshore Bank Account, which were funded by commission payments made by PPI on private placements and other transactions. Although this was not in itself necessarily improper, the arrangement was not disclosed as required, and this was contrary to the public interest. We found that the Individual Respondents bore responsibility for this and thereby both acted contrary to the public interest.

C. Market Manipulation

We found that the Individual Respondents, Strategic and Cheshire each bore responsibility for securities trading that resulted, or could reasonably be expected to have resulted in, an artificial price for such securities. Their conduct we found to have been contrary to Alberta securities laws and to the public interest.

D. Insider Trade Reporting

We found that the Individual Respondents contravened the insider trade reporting requirements of Alberta securities laws.

E. Misrepresentations to Staff

We found that the Individual Respondents each made misrepresentations to Staff, so numerous as to constitute a pattern of conduct. We found that, in so doing, they each acted contrary to the public interest.

B. Elaboration on Findings

[8] We recapitulate briefly here some of our specific findings in these areas.

Financial Disclosure

[9] We were in no doubt that PPI's defective financial statements were intended to mislead readers as to the financial state of PPI.

[10] We also concluded that a PPI news release and four PPI take-over bid circulars (the "TOB Circulars") contained misrepresentations, which were contrary to the public interest because "[t]he manner in which, and the purpose for which, these additional misrepresentations were made were clearly incompatible with the protection of investors and (in the case of the TOB Circulars) the fairness of the take-over bid process" (Merits Decision at para. 677).

[11] We reproduce certain of our observations and findings on the Individual Respondents' roles in respect of PPI's flawed financial disclosure (Merits Decision at paras. 695-700):

> The Individual Respondents knew the reality of the Newmex, Orion and Azterra Transactions – they designed them and, as time went on, they refined or revised them. They knew what was really happening and what was not, and they therefore knew that in none of the transactions had PPI truly realized a profit on a genuine disposition, as and when it was recorded. This by itself, in our view, suffices for us to conclude – as we do – that Workum and Hennig each knew that PPI's financial disclosure materially misrepresented PPI's financial position and results of operations.
>
> Moreover, we conclude that Hennig, as a chartered accountant, knew that PPI's reported results were contrary to the purpose of GAAP and the Handbook's objective of fair presentation and the underlying concept of "representational faithfulness".
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> Workum, not being a chartered accountant, was likely unfamiliar with the details of accounting practice and may indeed never have read the Handbook. We would be disinclined to attribute to Workum responsibility for contravention of a particularly technical requirement of GAAP. The contraventions here, though, were not mere technicalities. We find nothing so obscure or esoteric in the notions of fair presentation or representational faithfulness that it would surprise or confuse a non-accountant who had even a passing acquaintance with financial information. Workum would have been acquainted with the typical form of auditor's report that refers explicitly to fair presentation of an issuer's financial position and results of operations. We conclude that he knew that the financial statements at issue here could not be said to have been prepared in accordance with GAAP.
>
> . . . the Individual Respondents apparently withheld information from [PPI's auditor] . . . .
>
> We do not accept that anyone in a senior management position with a public company could reasonably consider it proper to withhold information from the company's auditor. We believe that Workum and Hennig apprehended that a more fully informed auditor would not give a favourable opinion on the financial statements at issue.
>
> . . . Moreover, [the Individual Respondents] allowed [PPI's auditor] to operate on the basis of an understanding of the facts that the Individual Respondents knew did not reflect reality. We find that they misled [PPI's auditor], certainly by omission.

[12] In the result, we found that Workum and Hennig each contravened Alberta securities laws and acted contrary to the public interest, and concluded that they (Merits Decision at paras. 720, 730):

> . . . bore a full measure of responsibility for PPI's improper disclosure relating to the Newmex, Orion and Azterra Transactions in its 1998, 1999 and 2000 Financial Statements and other documents, and the associated contravention of Alberta securities laws and conduct contrary to the public interest. . . .

Undisclosed Financial Benefit

[13] We found in the Merits Decision that the Individual Respondents exercised control and direction over the securities trading accounts of Strategic, Cheshire, Lexington and Ashland (the "Four Trading Accounts", mentioned earlier) and the offshore bank account

of Mandolin Inc. ("Mandolin"; its bank account was the "Mandolin Offshore Bank Account" mentioned earlier) and thus benefited personally from commission payments made by PPI to those five companies (the "Offshore Companies" – Strategic, Cheshire, Lexington, Ashland and Mandolin). We further found that PPI was obliged to disclose the arrangements for paying commissions to the Offshore Companies for the benefit of one or both of the Individual Respondents, but PPI failed to fulfil that obligation; the Individual Respondents bore responsibility for that failure; and the Individual Respondents "deliberately concealed the arrangement from the public" and from Staff and caused PPI instead to issue inaccurate and materially misleading disclosure (Merits Decision at para. 1082).

[14] The amounts involved were significant. PPI paid a total of at least $5 148 750 in commissions under this arrangement. We concluded that the Mandolin Offshore Bank Account and the Four Trading Accounts "were operated to funnel money from PPI to the Individual Respondents" (Merits Decision at para. 1062), at least $2 million passing in this way from PPI to the benefit of the Individual Respondents, primarily Workum.

[15] As a result, we found that the Individual Respondents acted contrary to the public interest.

Market Manipulation

[16] We found in the Merits Decision that trading in shares of PPI subsidiary Newmex Minerals Inc. ("Newmex") during two intervals in 2000 was not motivated by genuine investment intent, but rather by the desire to move the price of those shares (the "Newmex Shares") to certain target levels on certain target dates. We found that the resulting prices were artificial.

[17] We also found that Strategic and Cheshire each contravened the Act because they could not disavow responsibility for this improper trading of Newmex Shares in their respective securities trading accounts. We made similar findings against the Individual Respondents (Merits Decision at para. 1252):

> In sum, the evidence (circumstantial though it was) was clear, convincing and cogent. We find, on the balance of probabilities, that the Individual Respondents enlisted Olnick [a Vancouver securities broker who handled securities trading and money for accounts of Strategic and Cheshire, among others, and who dealt at various times with each of the respondents] to undertake trading to raise the market price of the Newmex Shares to the prices targeted on the dates targeted. With and through Olnick, the Individual Respondents contrived to manipulate the market price of Newmex Shares in a manner that not only may have resulted but, we find, did result, in artificial prices for the Newmex Shares during (in particular, at the end of each of) the February Period and the September Period.

[18] We therefore found that Workum, Hennig, Strategic and Cheshire each contravened Alberta securities laws and acted contrary to the public interest.

Insider Trade Reporting

[19] We found in the Merits Decision (at para. 1273) that the Individual Respondents, although aware of their obligation under Alberta securities laws to report securities trades made as insiders:

> . . . did not fulfil their individual obligations to file reports of being or becoming insiders of Reportable Issuers [PPI, Newmex, Rocky Mountain and Invader] in respect of holdings through the Four Trading Accounts, and reports of purchases and sales of Reportable Securities in the Four Trading Accounts made when they were insiders of the corresponding Reportable Issuers.

[20] In this respect, also, we found that Workum and Hennig each contravened the Act.

Misrepresentations to Staff

[21] In the Merits Decision, we surveyed several oral and written misrepresentations made to Staff by the Individual Respondents. As we said there (at para. 1294), this was "a pattern of conduct. Stated bluntly, the Individual Respondents repeatedly lied to Staff". We concluded that in this way, too, Workum and Hennig each acted contrary to the public interest.

C. Issues of Sanction and Costs to Be Determined

[22] It remained to be determined in this concluding part of the proceeding whether, in light of our findings in the Merits Decision, it is in the public interest to make orders against any of Workum, Hennig, Strategic or Cheshire and, if so, what order or orders would be appropriate. Also to be determined is what costs orders, if any, would be appropriate.

III. POSITIONS OF THE PARTIES

A. Staff

[23] Staff characterized the misconduct of Workum and Hennig as serious, deceptive and long-term. Staff contended that "the scope, pervasiveness and deceptive nature of the misconduct is of such magnitude that it demands the highest range of possible sanctions" and urged that we order the following:

- against each of Workum and Hennig, permanent bans on trading and purchasing securities or exchange contracts, the use of any exemptions under Alberta securities laws, and acting as a director or officer of any issuer, all coupled with a significant administrative penalty ($1 million against Workum and $500 000 against Hennig); and

- against each of Strategic and Cheshire, permanent bans on trading and purchasing securities or exchange contracts and on the use of any exemption under Alberta securities laws, and a permanent ban on any trading in their respective securities.

[24] Staff also sought orders that the respondents pay a total of $575 000 of the costs of the investigation and hearing, allocated as follows: Workum – $350 000; Hennig – $175 000; Strategic – $25 000; and Cheshire – $25 000.

[25] Staff argued that the sanctions they sought were consistent with sanctioning principles enunciated and applied in other Commission decisions. These include the objectives of specific and general deterrence and the assessment of appropriate sanction in light of factors summarized in *Re Lamoureux*, [2002] A.S.C.D. No. 125 at para. 11 (affirmed on other grounds 2002 ABCA 253).

B. The Respondents

1. General Approach

[26] Although Workum and Hennig did not necessarily accept our findings in the Merits Decision, Workum, in addressing the issues of sanction and costs, made submissions on the basis of the findings in the Merits Decision. Hennig appeared to take a somewhat different approach: he seemed to suggest that some of our Merits Decision findings – which he indicated he disagreed with and might challenge in an appeal – should not form the basis of our assessment of sanction. This suggestion notwithstanding, we base our assessment of sanction, costs and the public interest on our findings in the Merits Decision. In so doing, we acknowledge that neither Individual Respondent's submissions on sanction should be construed as affecting any rights of appeal or any arguments that might be made on appeal.

[27] Strategic and Cheshire did not make any submissions on sanction or costs.

[28] We turn now to the more specific positions taken by Workum and Hennig.

2. Workum

[29] Workum contended that it would be inappropriate for the panel to consider whether any respondent at this stage of a proceeding "accepts findings and/or is remorseful" because, in his submission, that would interfere with a respondent's right to appeal. He stressed that he acknowledged the seriousness of the panel's findings, but rejected Staff's analysis and proposed sanctions – the latter on the basis that they "would be punitive and thus clearly beyond the duties imposed upon the [Commission]".

[30] Workum also framed his position on sanction as an issue of "parity", making comparisons to the outcomes of other enforcement proceedings (including a settlement between Staff and PPI approved on 10 September 2003 (the "PPI Settlement" – see *Re Proprietary Industries Inc.*, [2003] A.S.C.D. No. 1207)) and referring to others – in oral submissions the focus was on PPI and Olnick – involved in this matter who were not subject to a hearing, findings or sanction. Workum contended that, in such circumstances, imposing sanctions on him beyond certain interim orders to which he has

been subject for some six years "would be a breach of the fundamental principles of justice and would significantly risk diminishing the public's confidence in the Alberta capital markets".

[31] Workum characterized himself as having borne only secondary responsibility for certain of the conduct considered in the Merits Decision, notably that relating to financial disclosure by PPI (the primary responsibility for which, he argued, rested with PPI). This distinction, he urged, should be reflected in any sanction orders. Workum also disputed Staff's characterization of the Merits Decision as having found that the Individual Respondents received substantial illegal financial benefits from their misconduct. Workum stressed that the hearing panel focused on whether the financial benefits "were adequately disclosed" and that receiving such benefits was not "in and of itself . . . illegal or improper" (citing the Merits Decision at para. 1064).

[32] Workum also raised a "Constitutional Question", which we discuss separately below. Seemingly in conjunction with this, he emphasized that an administrative penalty is available only in response to a contravention of Alberta securities laws, not other acts contrary to the public interest, so that only actual breaches can properly be considered when determining an appropriate administrative penalty. To illustrate his point, Workum argued that "it would be improper . . . to impose an administrative penalty . . ., particularly a significantly large penalty, where there has been a finding of a *de minimus* breach of the [Act]" in combination with findings of serious conduct contrary to the public interest.

[33] As to what specific sanctions might be appropriate, he suggested that, based on the Merits Decision findings, an appropriate duration of market-access bans against him would be ten years, but that he should be given "additional credit" for the fact that interim cease-trade and director-and-officer bans have been in place against him since 2002. These orders, he suggested, have already provided considerable general and specific deterrence. Accordingly, he argued that the interim orders should be rescinded and no further market-access bans imposed. He suggested that an administrative penalty of $40 000 would be appropriate – $20 000 relating to market manipulation and $20 000 relating to insider trade reporting. Workum disputed Staff's claimed costs on many grounds and contended that an appropriate costs award against him would be $46 000.

3. Hennig

[34] Hennig's submissions focused primarily on a "Constitutional Question" similar to Workum's. He objected to Staff's position on the ground that the quantum of the administrative penalty they sought exceeded what was permissible at the time of his misconduct found in the Merits Decision. He also contended that the sanctions sought by Staff were "excessive and inappropriate" in light of accepted sanctioning factors. In the alternative (apparently to the former point), Hennig urged the Panel to refrain from making any sanction decision "until such time as constitutional questions related to the

operation of [s]ection 199 of the [Act], and currently under consideration by . . . the Court of Queen's Bench [in a matter unrelated to this proceeding], are finally determined".

[35] Hennig disputed the applicability of many of the *Lamoureux* factors and contended that sanction hearings "ought to be conducted on as highly an individualized basis as possible".

[36] Hennig did not argue for any specific duration for any market-access bans, nor propose any specific quantum of administrative penalty. He contended more generally that the sanctions sought by Staff were too onerous (including for constitutional reasons). He characterized himself as only "a secondary figure" in most of the misconduct found in the Merits Decision and urged therefore that any sanction against him "ought to recognize his diminished role in the conduct alleged and temper the severity of the penalty or penalties imposed". Hennig did not make any submissions on costs.

IV. CONSTITUTIONAL QUESTIONS

[37] As noted, Workum and Hennig each raised Constitutional Questions. Both called into question our authority to order an administrative penalty applying section 199 of the Act as it currently reads – with its prescribed maximum administrative penalty of $1 million per contravention of Alberta securities laws rather than the $100 000 cap that applied prior to Act amendments in 2005. Staff and the Attorney General of Alberta (as intervener) countered that we do have authority to order the new maximum administrative penalty. We discuss the merits of the Individual Respondents' positions on this issue and our conclusions later in this decision.

[38] We address here a point with procedural consequences raised by Hennig. As noted, he referred to similar questions currently under consideration in an unrelated matter before the Court of Queen's Bench of Alberta and submitted that we should refrain from making any decision on sanction here until a final determination in that matter.

[39] We disagree. Hennig seeks what amounts to a stay of proceedings pending the resolution of an unrelated matter in another forum. He did not, however, adduce evidence that would justify a stay or delay. In particular, it is not apparent to us what prejudice he (or any of the other respondents) would suffer were we to proceed now with an uninterrupted consideration of sanction and render our decision. His appeal rights would be unaffected by our proceeding now. Moreover, if the merits portion of this hearing were fundamentally flawed as he suggested in his constitutional submissions, a mere delay would not be a cure.

[40] In our view, the appropriate course of action – in the interests of all parties and the public (which has an interest in seeing enforcement proceedings brought to a conclusion) – is for us to proceed on the basis of the submissions and our understanding of the law,

and to render a final decision. Hennig or any other respondent may then, if they so choose, challenge any and all of our conclusions by way of appeal. Accordingly, we conclude that it is appropriate for us to deal with this matter now, and we do so.

[41] Our analysis and conclusions on the other aspects of the Constitutional Questions are discussed below, in connection with our discussion of administrative penalties generally.

V. SANCTIONS

A. The Law – Sanctioning Principles and Factors

[42] The Commission is responsible for the administration of securities laws in Alberta. In furtherance of that mandate, we act in the public interest to protect investors, the integrity of the Alberta capital market and confidence in that market. In the context of enforcement proceedings, if we determine that the public interest requires that sanctions be ordered, our orders are to be protective and preventative, not punitive or remedial. Therefore, in determining whether sanctions should be imposed in response to a finding of misconduct, we consider first whether it is necessary to prevent a recurrence of the misconduct and, if so, what sanction or combination of sanctions would best achieve that result. In so doing we consider both specific deterrence (directed at deterring a repetition of misconduct by the particular respondent) and general deterrence (directed to others who might be tempted to act similarly) – see, for example, *Re Cartaway Resources Corp.*, 2004 SCC 26 at paras. 52-62; and *Re Podorieszach*, 2004 ABASC 567 at para. 17.

[43] In our assessment of appropriate sanction, we are guided by the principles set out by this Commission in *Lamoureux* and refined in later decisions. These factors include:

- the seriousness of the findings against the respondent and the respondent's recognition of that seriousness;
- characteristics of the respondent, including capital market experience and activity and any prior sanctions;
- any benefits received by the respondent and any harm to which investors or the capital market generally were exposed by the misconduct found;
- the risk to investors and the capital market if the respondent were to continue to operate unimpeded in the capital market or if others were to emulate the respondent's conduct;
- decisions or outcomes in other matters; and
- any mitigating considerations.

[44] The Act contemplates – and Staff here seek – an array of possible sanctions, including various types of capital market access restrictions and direct monetary administrative penalties. In determining what, if any, sanctions against a particular respondent are appropriate (in nature and quantum), we consider the contemplated sanctions as a package, rather than in isolation. Our objective is to ascertain what

combination of orders best achieves our deterrent (protective and preventative) aims and fulfils our public interest mandate.

B. Consideration of Sanctioning Principles and Factors

[45] We turn now to our analysis of the principles and factors relevant to sanction, applied to our findings in the Merits Decision as a whole. Although we do not repeat those findings here, we outline some that are particularly relevant to our decision on sanction. As will be seen, significant sanctions are called for here.

[46] We refer to positions expressed by Workum, Hennig and Staff; as mentioned, Strategic and Cheshire made no submissions.

1. Seriousness and Recognition of Seriousness

(a) Serious Misconduct

[47] Each of Workum, Hennig, Strategic and Cheshire contravened Alberta securities laws and acted contrary to the public interest. Their actions clearly included serious misconduct, as we now discuss.

(i) Financial Disclosure

Importance of Disclosure

[48] Disclosure by public companies to investors is central to our securities regulatory system. Alberta securities laws do not purport to tell investors what investment decisions to make or what risks to take, but rather are designed to give investors information with which to make informed decisions as to whether, given their own investment objectives and risk tolerances, to buy, sell or continue to hold a particular security of a particular issuer. Public companies are therefore required to make periodic and timely disclosure of information that is material to investors. That disclosure must, above all, be truthful. Untruthful disclosure and failures to make required disclosure can obviously hinder particular investors' abilities to make sound investment decisions and, more broadly, undermine the efficient working of the capital market (which depends on timely and reliable information) and investor confidence in that market.

Financial Disclosure

[49] Financial statements are a key component of public company disclosure. The importance attributed to these statements is highlighted by the requirement that the annual financial statements be audited by an independent professional, whose report attests to their fair presentation of the company's financial position and results of operations. Here, PPI's 1998, 1999 and 2000 Financial Statements failed to satisfy legal requirements as they were not prepared in accordance with GAAP. They also presented a misleading picture. Consequently investors contemplating an investment regarding PPI securities were deprived of the ability to make an informed investment decision – "[t]his could have affected investment decisions of those who relied on the improper financial statements" (Merits Decision at para. 673). Not only were those investors directly