
Citation: New Brunswick (Financial and Consumer Services Commission) v. Stratus Financial Group International, 2015 NBFCST 2

PROVINCE OF NEW BRUNSWICK
FINANCIAL AND CONSUMER SERVICES TRIBUNAL
IN THE MATTER OF THE *SECURITIES ACT*, S.N.B. 2004, c s-5.5

Date: 2015-01-30
Docket: SE-004-2014

BETWEEN:

Financial and Consumer Services Commission,

Applicant,

-and-

Stratus Financial Group International and Ken Powers,

Respondents.

REASONS FOR DECISION AND ORDER

Restriction on publication: This decision has been anonymized to comply with the *Right to Information and Protection of Privacy Act*, S.N.B. 2009, c R-10.6.

PANEL: John M. Hanson, Q.C., Panel Chair
Jean LeBlanc, Panel Member
Donald C. Moors, Panel Member

DATE OF HEARING: October 21, 2014

WRITTEN REASONS: January 30, 2015

APPEARANCES: Brian Maude for the Applicant
The Respondents did not appear

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REASONS FOR DECISION AND ORDER

I. OVERVIEW

- [1] On October 21, 2014, the Financial and Consumer Services Tribunal (“Tribunal”) held a hearing pursuant to section 184 of the *Securities Act*, S.N.B. 2004, c S-5.5 (“*Securities Act*”) to consider whether Stratus Financial Group International (“Stratus”) and Ken Powers had breached the *Securities Act* and whether it was in the public interest to order sanctions against the Respondents.
- [2] On September 4, 2014, a Statement of Allegations was filed by Staff of the Financial and Consumer Services Commission (“Commission”). The Tribunal issued a Notice of Hearing on October 6, 2014. Staff alleges that in August 2014, the Respondents were involved in trading in derivatives for which registration requirements under the *Securities Act* were not met, and for which the Respondents did not claim any exemptions under New Brunswick Securities law relating to the sale and distribution of derivatives. Staff further alleges that the Respondents made misrepresentations regarding (1) the regulatory requirements on derivatives; (2) that their products did not constitute derivatives; and (3) the potential profitability of an investment.
- [3] For the reasons set out below, the Tribunal finds the Respondents breached paragraph 45(a) and subsection 58(4) of the *Securities Act* and that sanctions under subsection 184(1) of the *Securities Act* are appropriate.

II. FACTS

- [4] The evidence in this matter consists of the Affidavit of Resident 1, a New Brunswick resident, filed on September 4, 2014 and the Certificate of Kevin Hoyt, the Executive Director of Securities for New Brunswick, under subsection 196(1) of the *Securities Act*.
- [5] Stratus purports to be a company incorporated in Tokyo, Japan and based in San Jose, Costa Rica.
- [6] Ken Powers held himself out to be a representative of Stratus at the time of the telephone call set out in paragraph 7 below.
- [7] On or about August 6, 2014, the Respondent Ken Powers contacted Resident 1 by telephone at Resident 1’s residence. Mr. Powers indicated that he had been going through some old files and noted that Resident 1 had requested a call in case any hot investment opportunities came along. During this telephone conversation, Mr. Powers asked Resident 1 whether he expected the cost of heating oil to go up in the coming months. When Resident 1 responded that it was possible, Mr. Powers then explained that “one position controls 42,000 gallons” and that with a 10 per cent fluctuation in price, he could make a \$32,000 profit on a \$10,000 investment. Mr. Ken Powers invited Resident 1 to open an account.
- [8] Resident 1 asked Mr. Powers what the name of his company was and Mr. Powers advised it was Stratus. Resident 1 enquired whether the company name had any other words, such as “Inc.” or “Ltd.” to which Mr. Powers responded in the negative. Mr. Powers advised that Stratus had a website at <http://stratusoffshore.com> and recommended that Resident 1 visit the website.

- [9] Resident 1 next asked Mr. Powers if he or his firm were registered with any regulator. Mr. Powers advised they were on the “NYMEC market”. Resident 1 enquired whether this was a government authority, to which Mr. Powers responded that it was a platform. Resident 1 again asked Mr. Powers if he was registered and Mr. Powers did not respond.
- [10] Resident 1 had no prior contact with either Ken Powers or Stratus before August 6, 2014.
- [11] Resident 1 conducted a research of the Stratus website on the Whois website. His research indicated that the Registrant of the Stratus website was Eugenia Gatica Mora and that this individual had also registered the websites “balboaforex.net” and megellantradingfx.com”.
- [12] Again, upon further investigation of the Stratus website, Resident 1 discovered the Stratus Financial Group International Account Application & Client Agreement. Clause G on page 5 of the Account Application & Client Agreement is entitled “G. Lack of Regulation” and indicates that Stratus Financial and its employees are not registered as a broker-dealer with any government agency nor have its options been registered with local authorities.
- [13] Resident 1 did not invest with the Respondents.

III. ISSUES

- [14] Staff’s allegations raise the following issues in this matter:
- (a) Did the Respondents trade in derivatives while not registered and not exempted from registration under New Brunswick securities law contrary to paragraph 45(a) of the *Securities Act*?
 - (b) Did the Respondents make misrepresentations contrary to subsection 58(4) of the *Securities Act*?
 - (c) Is the relief sought by Staff in the public interest as required under subsection 184(1) of the *Securities Act*?

IV. ANALYSIS

A. PRELIMINARY ISSUES

1. Failure of the Respondents to Appear

- [15] The Respondents did not file a Response to the Statement of Allegations, as permitted by subsection 13(5) of the Commission’s Local Rule 15-501 *Proceedings Before the Tribunal* (Local Rule 15-501), which governs procedure in proceedings before the Tribunal. The Respondents also did not appear at the October 21, 2014 hearing or present evidence or make submissions.
- [16] The Affidavit of Service of Brian Maude, legal counsel for the Commission, filed on October 15, 2014 indicates that the Respondents were served with the Notice of Hearing, Statement of Allegations

and Affidavit of Resident 1 on October 6, 2014 by e-mail and fax to the e-mail address and fax number indicated on the Stratus website. Attempts were made to further serve the Respondents at their San Jose, Costa Rica, address via FedEx courier, but these attempts were unsuccessful.

- [17] Subsection 5(1) of Local Rule 15-501 stipulates the manner in which a Statement of Allegations may be served on the Respondents. Paragraph 5(1)(e) specifies that documents may be served by prepaid courier to the last known address for the party, while paragraph 5(1)(f) permits service of documents by electronic transmission, which term is defined in subsection 1(1) and means transmission by fax or e-mail.
- [18] The Tribunal is satisfied that the Respondents were properly served with the Notice of Hearing, Statement of Allegations and Affidavit of Resident 1.
- [19] Subsection 14(4) of Local Rule 15-501 deals with non-appearance of a party at a hearing and stipulates:

14(4) Non-appearance of Party – If a Notice of Hearing has been duly served on a Respondent or any other person required to be served and the Respondent or other person does not attend a hearing, the hearing may proceed in his or her absence and the Respondent is not entitled to any further notice of any step in the Proceeding.

- [20] Pursuant to subsection 14(4), the Tribunal was authorized to proceed with the hearing in this matter despite the Respondents' non-appearance.

2. Evidence by Written Submissions

- [21] As no Response was filed in this matter, Staff requested on October 15, 2014, that it be allowed to proceed by way of written submission, in accordance with subsection 13(5.1) of Local Rule 15-501.
- [22] At the commencement of the oral hearing, the Tribunal allowed Staff to present its evidence by way of Affidavit evidence. Staff's evidence consists of the Affidavit of Resident 1, sworn September 4, 2014 and the Certificate of Kevin Hoyt, the Executive Director of Securities for New Brunswick, under subsection 196(1) of the *Securities Act*.

B. PARAGRAPH 45(a) OF THE SECURITIES ACT

- [23] Staff submits that the Respondents traded in derivatives without being registered and not exempted from registration under New Brunswick securities law, contrary to paragraph 45(a) of the *Securities Act*.

1. The Law

- [24] Paragraph 45(a) of the *Securities Act* prohibits trading in securities or derivatives without being registered unless the person is exempted under the regulations. At the material time, paragraph 45(a) read as follows:

45 Unless the person is exempted under the regulations, if a person is not registered in accordance with the regulations in the category that the regulations prescribe for the activity, the person shall not

(a) trade in a security or derivative [...]

[25] The term “derivative” employed in paragraph 45(a) is defined in subsection 1(1) of the *Securities Act*. That definition is:

“derivative” means

(a) an option, swap, futures contract, forward contract or other financial or commodity contract or instrument whose market price, value, or delivery, payment or settlement obligations are derived from, referenced to or based on an underlying interest, including a value, price, index, event, probability or thing[...]

[26] The term “trade” also found in paragraph 45(a) is also defined in subsection 1(1) and includes:

(b) entering into a derivative or making a material amendment to, terminating, assigning, buying, selling or otherwise acquiring or disposing of a derivative,

[...]

(d) participation as a trader in any transaction in a security or derivative made on or through the facilities of an exchange or reported through the facilities of a quotation and trade reporting system,

(e) participation as a trader in a transaction in a derivative made on or through the facilities of a derivatives trading facility,

(f) the receipt by a registrant of an order to buy or sell a security or an order to buy, sell, enter into, amend, terminate, assign or novate a derivative,

[...]

(h) an act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the activities specified in paragraphs (a) to (g).

2. Findings

[27] There are three elements that must be proven by Staff in order to establish a breach of paragraph 45(a) of the *Securities Act*: (1) that the Respondents were required to be registered with the Securities Division of the Commission; (2) that the heating oil futures for which the Respondents solicited Resident 1 constitute a security or derivative; and (3) that the actions of the Respondents constitute a trade in a security or derivative.

[28] First, with respect to registration, the Tribunal reiterates that the registration requirement constitutes one of the cornerstones of the regulatory framework established by the *Securities Act* [*Re MI Capital*, NBSC 8 August 2012, paragraph 24].

[29] The Tribunal finds that on August 6, 2014, the Respondents were not registered to trade in securities or derivatives. The September 3, 2014, Certificate of Kevin Hoyt, the Executive Director of Securities for New Brunswick, under subsection 196(1) of the *Securities Act* states that Stratus Financial Group International and Ken Powers have never been registered pursuant to section 45 of the *Securities Act* with the New Brunswick Financial and Consumer Services Commission.

[30] Paragraph 196(1)(a) of the *Securities Act* states as follows regarding the admissibility of the Certificate of the Executive Director:

196(1) A certificate containing any of the following statements and purporting to be signed by the Chair of the Commission, another member of the Commission or by the Executive Director is, without proof of the appointment, authority or signature of the person who has signed the certificate, admissible in evidence and is, in the absence of evidence to the contrary, proof of the facts stated in the certificate:

(a) a statement about the registration or non-registration of any person under this Act or the regulations [...]

[31] In addition, the following excerpt of Clause G. "Lack of Regulation" found at page 5 of the Stratus Account Application & Client Agreement is conclusive evidence that the Respondents are not registered with the Securities Division of the Commission:

G. Lack of Regulation

[...] Both STRATUS and its' employees are not registered as a broker-dealer with any government agency nor have the options been registered with its' local authorities. [...] Neither the company or its officers, managers or agents are licensed with any governmental agency. [...]

[32] With respect to an exemption from registration, the onus of proof to establish the existence of a valid exemption falls upon the Respondents. [*Re MI Capital*, NBSC 8 August 2012, paragraph 30]. The Respondents did not file a Response, did not appear at the hearing and have submitted no evidence to the Tribunal. The Tribunal finds the Respondents have not discharged their onus of establishing the existence of an exemption to the registration requirement.

[33] Second, the Tribunal finds the heating oil futures for which the Respondents solicited Resident 1 constitute a derivative as defined in subsection 1(1) of the *Securities Act* as the market price of the futures contract is derived from, referenced to or based on an underlying interest, namely the price of heating fuel.

[34] The Respondents also admit that the heating oil futures constitute a derivative in Clause 1 and 2 of page 2 of the Stratus Account Applicant & Client Agreement, where it is stated:

1. APPOINTMENT OF DERIVATIVES BROKER AND PARTIES

[...] CLIENT hereby appoints Agent as CLIENT'S broker for CLIENT'S purchases and sales of options and futures contracts on the derivative markets by and through an International Brokerage Firm (hereinafter "IBF"), a firm organized

under the laws of a country outside the United States or within, which is engaged in the business of Derivative Options and Futures transactions.[...]

2. DESCRIPTION OF PRODUCTS

The CLIENT purchases the derivative options or futures contracts for a specified sum of money or margin deposit, which STRATUS determines based upon prevailing rates with IBF or in the international derivatives market. [...]

[35] Third, the Tribunal finds that the actions of the Respondent Ken Powers on behalf of Stratus constitute a trade in a derivative as defined under subsection 1(1)(h) of the *Securities Act*. This finding is based on the following facts:

- The Respondent Ken Powers contacted Resident 1 by telephone on August 6, 2014, and advised the latter that it was an opportune time to invest in heating oil futures as the price was about to go up and that he could make a \$32,000 profit on a \$10,000 investment with a 10 cent fluctuation in the price of the contract;
- In Clause 1 at page 2 of the Stratus Account Application & Client Agreement, Stratus offers to act as a derivatives broker for the client.

[36] The fact that there was no sale to Resident 1 does not mean that there was no trade. The actions of the Respondents in soliciting business are sufficient to constitute a trade as defined in subsection 1(1) of the *Securities Act*.

[37] The Tribunal concludes that the Respondents breached paragraph 45(a) of the *Securities Act* by trading in derivatives on August 6, 2014 while not registered and not benefiting from an exemption from registration.

C. SUBSECTION 58(4) OF THE SECURITIES ACT

[38] Staff submits that the Respondents made misrepresentations contrary to subsection 58(4) of the *Securities Act* regarding (1) the regulatory requirements on derivatives; (2) that their products did not constitute derivatives as a result of client ownership; and (3) the potential profitability of an investment.

1. The Law

[39] Subsection 58(4) of the *Securities Act* stipulates:

58(4) No person shall, orally or in writing, make a statement about a security, derivative or trade that the person knows or ought reasonably to know is a misrepresentation.

2. Findings

[40] In order to prove a breach of subsection 58(4) of the *Securities Act*, Staff must prove: (1) that a person made a statement orally or in writing; (2) that the statement was about a security or

derivative; (3) that the person knew or ought to have known the statement was a misrepresentation.

- [41] Staff alleges that the Respondent Stratus' representations in its Account Application & Client Agreement regarding the lack of regulatory requirements for derivatives constitute a misrepresentation contrary to subsection 58(4) of the *Securities Act*. The Respondent Stratus represents in Clause G at page 5 of the Agreement that no banking or international authority regulates derivatives options. The relevant portion of Clause G reads:

G. Lack of Regulation

At the current time, no banking or international authority regulates derivative options or the international market. [...]

- [42] This statement is in direct contradiction to the requirement under paragraph 45(a) of the *Securities Act* that "unless the person is exempted under the regulations, if a person is not registered in accordance with the regulations in the category that the regulations prescribe for the activity, the person shall not trade in a security or derivative".

- [43] As for the Respondent Stratus' knowledge that this statement was untrue, one has simply to look at the remainder of Clause G to determine that Stratus knew the statement was untrue.

G. Lack of Regulation

At the current time, no banking or international authority regulates derivative options or the international market. [...] Moreover, STRATUS could become the subject of adverse regulatory actions or determinations by one or more governmental agencies or courts. **At any given time, officers, managers or agents of the company may have had previous regulatory sanctions by governmental agencies. [...] Finally, there is a risk that a government agency could assume regulatory authority over STRATUS or derivative options and That STRATUS could not comply with the resulting regulatory scheme and would have to cease doing business.**[Our emphasis]

- [44] The Tribunal concludes that the Respondent Stratus' statement in Clause G of page 5 of the Account Application & Client Agreement regarding the lack of registration requirement constitutes a misrepresentation contrary to subsection 58(4) of the *Securities Act*.

- [45] Staff also alleges that the Respondent Stratus made misrepresentations to the effect that their products were removed from the definition of securities as a result of client ownership.

- [46] Clause G at page 5 of the Account Application & Client Agreement contains Stratus' statement regarding the nature of their products as follows:

G. Lack of Regulation

[...] STRATUS if of the view that ultimate CLIENT profitability depends on fluctuations in world commodity prices and options markets, but not on the

efforts of STRATUS and that each CLIENT individually owns the options contract (s) thereby removing these vehicles from the definition of securities.

- [47] Staff has not elaborated on this argument in either its Statement of Allegations, the Affidavit of Resident 1, the Pre-Hearing Submission or its oral arguments at the hearing. More specifically, Staff has not shown how Stratus' statement regarding client ownership is a misrepresentation.
- [48] The Tribunal concludes Staff has not proven that the Respondent Stratus' statement that their products were removed from the definition of securities as a result of client ownership constitutes a misrepresentation.
- [49] Staff further alleges that the Respondent Ken Powers' August 6, 2014 statements to Resident 1 regarding the profitability of an investment in heating oil futures constitute a misrepresentation.
- [50] The Tribunal accepts the uncontested evidence of Resident 1 that the Respondent Ken Powers stated during the August 6, 2014 telephone conversation that he could make a \$32,000 on a \$10,000 investment with a 10 cent fluctuation in the price of the contract. The Tribunal finds that Mr. Powers' statements to Resident 1 constitute oral statements about a derivative.
- [51] Staff submits the Respondent Ken Powers' statement regarding the potential profitability from an investment constitutes a misrepresentation as in order for this statement to make mathematical sense, the price of the heating oil contract would need to be \$0.03125 for 42,000 barrels of heating oil. According to Staff, this clearly is not possible given the current price of oil.
- [52] While a \$32,000 on a \$10,000 investment appears almost too good to be true, Staff has led no evidence, such as the current price of heating oil, to demonstrate how Mr. Powers' statement constitutes a misrepresentation. Consequently, the Tribunal is not satisfied that Staff has proven that this statement by the Respondent Ken Powers constitutes a misrepresentation within the meaning of subsection 58(4) of the *Securities Act*.

D. SHOULD AN ORDER BE ISSUED?

- [53] In its Statement of Allegations filed September 4, 2014, Staff seeks orders from the Tribunal under paragraphs 184(1)(c), 184(1)(d) and 184(1)(f) and subsection 186(1) of the *Securities Act* as well as costs under paragraph 44(1)(a) of the *Financial and Consumer Services Commission Act*.
- [54] The relevant portions of subsection 184(1) of the *Securities Act* are:

Orders in the public interest

184(1) On the application of the Commission, the Tribunal, if in its opinion it is in the public interest to do so, may make one or more of the following orders:

[...]

(c) an order that

(i) trading in or purchasing cease in respect of any securities, derivatives, class of securities or class of derivatives, or

(ii) a person specified in the order

[...]

(B) is prohibited from acting in a management or consultative capacity in connection with activities in the securities or derivatives market;

(d) an order that any exemptions contained in New Brunswick securities law do not apply to a person permanently or for such period as is specified in the order;

[...]

(f) if the Tribunal is satisfied that New Brunswick securities law has not been complied with, an order that a release, a report, a preliminary prospectus, a prospectus, a return, a financial statement, an information circular, a take-over bid circular, an issuer bid circular, a notice of change or variation in respect of a take-over bid circular or an issuer bid circular, an offering memorandum, a proxy solicitation or any other document described in the order

[...]

(ii) not be provided by a market participant to a person [...].

[55] The Tribunal must determine if the relief sought by Staff is in the public interest. The expression “in the public interest” can be traced to the dual purposes of the *Securities Act* stated as follows:

2 The purposes of this Act are

(a) to provide protection to investors from unfair, improper or fraudulent practices, and

(b) to foster fair and efficient capital and derivatives markets and confidence in capital and derivative markets.

[56] The Supreme Court of Canada succinctly describes the binary nature of securities legislation in its decision *Equal Treatment of Asbestos Minority Shareholder v. Ontario (Securities Commission)*, 2001 SCC 37:

41. Therefore, in considering an order in the public interest, it is an error to focus only on the fair treatment of investors. The effect of an intervention in the public interest on capital market efficiencies and public confidence in the capital markets should also be considered.

42. Second, it is important to recognize that s. 127 is a regulatory provision. In this regard, I agree with Laskin J.A. that “[t]he purpose of the Commission’s public interest jurisdiction is neither remedial nor punitive; it is protective and preventive, intended to be exercised to prevent likely future harm to Ontario’s

capital markets” (p. 272). This interpretation of s. 127 powers is consistent with the previous jurisprudence of the OSC in cases such as *Canadian Tire*, supra, aff’d (1987), 59 O.R. (2d) 79 (Div. Ct.); leave to appeal to C.A. denied (1987), 35 B.L.R. xx, in which it was held that no breach of the Act is required to trigger s. 127. It is also consistent with the objective of regulatory legislation in general. The focus of regulatory law is on the protection of societal interests, not punishment of an individual’s moral faults: see *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154, at p. 219.

- [57] The former New Brunswick Securities Commission and the Financial and Consumer Services Tribunal have consistently followed this interpretation of the phrase “in the public interest”.
- [58] The purpose of section 184 is thus one that is protective and preventative, rather than remedial or punitive, and intended to be exercised to prevent likely future harm to capital markets [*Re Mithras Management Ltd.* (1990), 13 O.S.C.B. 1600 (Ont. Securities Commission), cited with approval in *Committee for Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37].
- [59] The powers set out in section 184 may be exercised even absent a breach of the *Securities Act* [*Canadian Tire Corp. v. C.T.C. Dealer Holdings Ltd.*, affirmed (1987), 59 O.R. (2d) (Ont. Div. Ct.)]. In the within matter, specific breaches of paragraph 45(a) and subsection 58(4) of the *Securities Act* have been established by Staff.
- [60] Based on the whole of the evidence, the Tribunal is satisfied that New Brunswick residents require protection from the actions of the Respondents and it is appropriate for the Tribunal to exercise its public interest jurisdiction pursuant to subsection 184(1) of the *Securities Act*. The Respondents’ failure to register with the Securities Division of the Commission and its misrepresentations regarding its obligation to register are serious breaches of the *Securities Act*. Consequently, the Tribunal is of the view that the Respondents’ total disregard for the registration requirements under securities legislation merits permanent sanctions.
- [61] Turning now to the imposition of an administrative penalty under subsection 186(1) of the *Securities Act* and costs under paragraph 44(1)(a) of the *Financial and Consumer Services Commission Act*, the Tribunal questions the appropriateness of these remedies. At the October 21, 2014 hearing of this matter, Staff took the position that the name “Ken Powers” was likely an alias. In addition, at the hearing, Staff indicated that the address provided for Stratus in San Jose, Costa Rica did not correspond with a building, but rather with an intersection. Staff indicated that Stratus was likely a typical boiler room that exists in theory only, and may or may not have a physical presence anywhere.
- [62] The Tribunal concludes that it is not appropriate to impose an administrative penalty or make an award of costs as this would not further the purposes of the *Securities Act*.

V. DECISION AND ORDER

- [63] For the reasons set out above, the Tribunal concludes that the Respondents have breached New Brunswick securities law. The Tribunal concludes it is in the public interest to make an Order against the Respondents under subsection 184(1) of the *Securities Act* as follows:

- (a) pursuant to sub-paragraph 184(1)(c)(ii) of the *Securities Act*, that the Respondents cease trading in securities or derivatives in New Brunswick permanently;
- (b) pursuant to sub-paragraph 184(1)(c)(i) of the *Securities Act*, that all trading in securities or derivatives offered by the Respondents cease permanently;
- (c) pursuant to clause 184(1)(c)(ii)(B) of the *Securities Act*, that the Respondent Ken Powers is prohibited from acting in a management or consultative capacity in connection with activities in the securities or derivatives market;
- (d) pursuant to paragraph 184(1)(d) of the *Securities Act*, that any exemptions under New Brunswick securities law do not apply to the Respondents permanently; and
- (e) pursuant to sub-paragraph 184(1)(f)(ii) of the *Securities Act*, the Respondents are prohibited from disseminating to the public, or authorizing the dissemination to the public of any information or material of any kind that pertains to the trading of securities or derivatives.

Dated this 30th day of January, 2015.

"original signed by"

John M. Hanson, Q.C., Panel Chair

"original signed by"

Donald C. Moors, Panel Member

"original signed by"

Jean LeBlanc, Panel Member