COURT FILE NO.: 3/03
DATE: 20050525

ONTARIO
SUPERIOR COURT OF JUSTICE

DIVISIONAL COURT

GRAVELY, CARNWATH & MATLOW JJ.

B E T W E E N:	)	
	)	
DERIVATIVE SERVICES INC. and MALCOLM ROBERT BRUCE KYLE	)	*M.L. Biggar*, for the Appellants
	)	
Appellants	)	*Ricardo Codina*, for the Investment Dealers Association of Canada, Respondents
- and -	)	
	)	
INVESTMENT DEALERS ASSOCIATION OF CANADA	)	*Joanna Superina*, for the Ontario Securities Commission
	)	
Respondent	)	
	)	
	)	**HEARD:** September 27, 28 & 29, 2004

CARNWATH J.:

[1] The Investment Dealers Association of Canada has found Derivative Services Inc. and Malcolm Robert Bruce Kyle guilty of failing to provide documents and information for an investigation of their conduct, contrary to By-law 19.5 of the IDA. The IDA's decision was appealed to the Ontario Securities Commission which agreed with the reasons of the IDA. The Appellants now come to the Divisional Court. Since the standard of review of the Ontario Securities Commission's decision is reasonableness, the issue for the court is the reasonableness of the IDA's actions in prosecuting, convicting and fining the Appellants, pursuant to its by-laws.

STATEMENT OF FACTS

[2] **Glossary of Abbreviations**

1. CB/IB – carrying broker/introducing broker;
2. *CFA – Commodity Futures Act*, R.S.O., 1990, c. C. 20;
3. *CFR – Commodity Futures Act* Regulation, R.R.O. 1990, Reg. 90;
4. CIPF – Canadian Investor Protection Fund;
5. DSI – Derivative Services Inc.;
6. FCM – Futures Commission Merchant;
7. IDA – Investment Dealers Association of Canada;
8. Kyle – Malcolm Robert Bruce Kyle;
9. ODC – Ontario District Council of the Investment Dealers Association;
10. O. Reg. 90 – *Commodity Futures Act* Regulation, R.R.O. 1990, Reg. 90;
11. OSC – Ontario Securities Commission;
12. RBC–DS – RBC-Dominion Securities Inc.;
13. *Securities Act – Securities Act*, R.S.O. 1990, c. S. 5;
14. SRO – Self-Regulated Organization;
15. TFE – Toronto Futures Exchange;
16. *TFEA – Toronto Futures Exchange Act*, R.S.O. 1990, c. T. 14;

[3] Derivative Services Inc. ("DSI") was licensed by the Ontario Securities Commission ("OSC") as a Futures Commission Merchant ("FCM") in July, 1995, pursuant to subsection 22(1) of the (former) *Commodity Futures Act* ("*CFA*"). Before June 19, 1998, neither the *CFA* nor the Regulation under the *CFA,* R.R.O. 1990, Reg. 90 ("O.Reg. 90") explicitly required an FCM to be a member of a recognized self-regulatory organization ("SRO") or registered exchange. However, pursuant to section 23 of O.Reg. 90, the OSC required an FCM to participate in a fund approved by the OSC and established by a recognized SRO. Since the only funds approved by the OSC for this purpose were the Toronto Futures Exchange ("TFE") Compensation Fund and the Canadian Investor Protection Fund ("CIPF") established by the IDA, an FCM operating in Ontario had to be a member of either the TFE or the IDA.

[4] Since June 19, 1998, s. 10 of O. Reg 321/98 made under the *CFA* specifically requires an FCM to be a member of an SRO recognized under subsection 15(1) of the *CFA* or a dealer member of a commodity futures exchange registered under s. 19 of the *CFA* as a condition of its licence.

[5] DSI became a dealer member of the TFE in July, 1995. Pursuant to subsection 11(1) of the *Toronto Futures Exchange Act*, R.S.O. 1990, c. T.14 ("*TFEA*"), the Legislature conferred on the board of directors of the TFE the power to govern and regulate the business conduct of its members as well as the power to pass by-laws under Part III of the *Corporations Act*, R.S.O. 1990, c. C.38.

[6] By an agreement dated January 29, 1997, between the Toronto Stock Exchange, the TFE and the IDA (the "Consolidation Agreement"), the TFE and the IDA agreed to "consolidate" their member regulation function as of February 1, 1997. Subsection 11(3) of the *TFEA* confers on the TFE's board of directors the power to pass by-laws *delegating* its authority "to investigate and examine the business conduct of its members...". Accordingly, the Board of Governors of the TFE amended the TFE's By-laws to require TFE members to become members of the IDA or to attorn to its jurisdiction for the purpose of member regulation. In July, 1997, the IDA incorporated sections of the Toronto Stock Exchange and TFE General By-laws into the IDA's Rules.

[7] The Commission has stated that "one of (its) strategic directions is to push down direct regulation of registrants to self-regulatory organizations". It does so by "recognizing" the SRO. The Commission first recognized the IDA as an SRO for the purpose of the *CFA* in 1982. Among other things, the Legislature has conferred on the Commission the power to "oversee" an SRO which it "recognizes". The stated objective of the Commission's oversight function, is "to validate reliance on the SRO for the functions which the Commission has *delegated* to it" (emphasis added).

[8] The ability of the Commission to carry out its objective under the *CFA* is quite different than it is under the *Securities Act*, R.S.O. 1990, c. S.5 ("*Securities Act*"). For instance, pursuant to subsection 21.5(1) of the *Securities Act,* the Commission may "assign" to a recognized SRO any of the powers and duties of the Commission under Part XI which deals with registration. There is no parallel provision under the *CFA*. Further, effective October 10, 1997, the Commission was granted rule-making power with respect to the regulation of SROs under the *Securities Act*. There is no parallel provision under the *CFA*.

[9] As a result of the consolidation, the OSC thus required DSI to apply for membership in the IDA in order to keep its licence as an FCM under the *CFA*. DSI did so by executing the IDA's Membership Application which included a provision whereby DSI agreed to be bound by and to comply with the IDA's rules. Kyle, as a director and officer of DSI, applied to the IDA to become an "Approved Person". In doing so, he agreed to observe and be bound by the By-laws of the IDA.

[10] Accordingly, DSI became a member of the IDA effective February 1, 1997. DSI's membership was limited to acting as an "introducing broker", pursuant to By-law 35 of the IDA. DSI entered into a carrying broker/introducing broker ("CB/IB") agreement with a full-service member of the IDA. In July, 1997, DSI's carrying broker gave notice to the IDA of the termination of the CB/IB agreement, effective November 1, 1997. On October 31, 1997, after DSI notified the IDA that it did not have a new CB/IB agreement in place, the ODC suspended DSI's membership.

[11] In November, 1997, DSI negotiated with the IDA terms for the reinstatement of DSI's membership. DSI agreed to increase its capital and bond coverage to the level required for full membership in the IDA. However, because DSI would continue to lack "back-office" facilities, DSI agreed to carry on business pursuant to a "give-up agreement" with RBC-Dominion Securities Inc. ("RBC-DS"), a full-service member of the IDA.

[12] DSI opened up two accounts at the Montreal institutional accounts office of RBC-DS:

(a) a margin account, which was to be operated as an "error account"; and,

(b) an account which held a quantity of treasury bills to be used as margin in the event that DSI had to hold an error position overnight.

[13] On December 2, 1997, the ODC ordered the re-instatement of DSI's membership conditional upon DSI satisfying the IDA that DSI was in compliance with a list of eleven conditions ("the Re-instatement Order"). On or about December 8, 1997, IDA staff conducted an on-site review of the operations of DSI. By letter faxed to DSI on December 19, 1997, the IDA staff advised DSI that its membership could be re-instated pursuant to the Re-instatement Order.

[14] On January 29, 1998, Robert Kyle ("Kyle") telephoned Maysar Al-Samadi ("Al-Samadi"), the Manager of Member Regulation, and advised him that DSI wished to resign its membership with the IDA. There is a conflict in the evidence as to the stated reason. In a letter from DSI to the IDA, Kyle stated: "(d)ue to the demand from our creditor of a subordinated loan and a current capital deficiency we will be unable to maintain the required regulatory capital requirement". However, in an e-mail from Al-Samadi to CIPF, Al-Samadi stated that Kyle had advised him that DSI had incurred a loss on an error position which left DSI with a possible capital deficiency of $50,000. Kyle also confirmed DSI had no client accounts on its books.

[15] The IDA's resignation procedure is set out in its By-law No. 8. Pursuant to By-law 8.5, a member's resignation is not effective if there is a pending complaint or investigation of the Member. At that time, the IDA was not investigating either DSI or Kyle, nor were there any pending disciplinary proceedings against either of them. Further, the resignation was not effective until a Member files an Auditor's Report under By-law 8.2 stating that the Member has sufficient liquid assets to meet its liabilities other than subordinate loans.

[16] On February 9, 1998, Al-Samadi sent an e-mail to Fred Maefs ("Maefs"), the Director of Enforcement at the IDA, to advise him of his telephone conversation on January 29, 1998, with Kyle and the possible capital deficiency of $50,000.

[17] Al-Samadi also advised Maefs that he had received a telephone call from Denis Fouquette ("Fouquette"), DSI's account supervisor at RBC-DS. Al-Samadi wrote to Maefs that Fouquette had advised him that he suspected, but could not be sure, that DSI was using its error account to do principal trading. At the time of the call, Fouquette was not aware that DSI had purported to resign from the IDA. Al-Samadi also advised Maefs that Greg Clarke, then the Vice-President, Member Regulation, advised Al-Samadi that the Enforcement Division ought to immediately investigate whether DSI had violated the ban on principal trading set out in the Re-instatement Order.

[18] On or about February 9, 1998, the ODC ordered the interim suspension of DSI and that DSI cease dealing with the public, pending the completion of the resignation procedures, including the filing of the Auditors' Report pursuant to IDA By-law 8 (the "Interim Suspension Order").

[19] On February 10, 1998, Al-Samadi sent a further e-mail to Douglas Walker, then Chief Enforcement Counsel at the IDA, stating that Fouquette had advised him that Kyle had put on an additional short position that morning. Further, when he advised Kyle that he should no longer trade using DSI's accounts, Kyle argued that, since DSI had resigned from the IDA, he was no longer obligated to comply with the IDA's regulations. Al-Samadi suggested that Mr. Walker telephone Kyle to advise him that he should not trade in the name of DSI until the IDA agreed to terminate his membership, although he could trade personally.

[20] Mike Haddad ("Haddad"), the Director of Investigations at the IDA, testified that, generally, investigations are conducted by the Enforcement Division as a result of complaints received by members of the public. However, between one and ten percent of the cases are generated internally. Where an investigation is opened as a result of an internal "complaint", Haddad testified that he generally made the assessment to determine whether an investigation should be initiated. However, if he didn't have enough information, he referred the matter to a "qualified" investigator.

[21] On March 12, 1998, Haddad provided Wayne Welch ("Welch"), an investigator with the IDA, with internally-generated documents to review and to determine whether an investigation should be initiated. At that time, Welch had been employed by the IDA for a little over two months and had reviewed only one other file. Haddad confirmed that the Enforcement Division did not have a training manual or written policy with respect to how its reviews and investigations should be conducted, despite the Undertaking given by the IDA attached as Schedule "B" to the Commission's Recognition Order dated October 27, 1995, under the *Securities Act*. According to Haddad, investigators are advised of certain "unwritten policies" and learn the ropes by being paired with more senior investigators. However, Welch was not paired with a senior investigator, but rather worked on DSI's case alone, with ongoing dialogue

from Haddad. Welch testified that the "standard investigative practice" of an IDA investigator depends on how each investigator "looked upon things".

[22] In conducting his "review", Welch testified that it was his practice not to interview any witnesses until he had the member's books and records. Further, he testified that he did not need to interview Al-Samadi because the e-mails dated January 29, February 9 and February 10, 1998, upon which Welch relied in subsequently recommending an investigation, were inherently reliable.

[23] On March 18, 1998, Welch did contact Fouquette and asked for copies of the books, records and accounts concerning DSI pursuant to IDA By-law 19.5. No notice of the request was given to DSI. Welch testified that he then literally read to Fouquette the e-mails sent by Al-Samadi on February 9 and 10, 1998, and asked him to confirm whether they were accurate. Welch did nothing more to interview Fouquette.

[24] On March 30, 1998, Welch received from RBC-DS computer printouts showing transactions in DSI's error account for the period December 24, 1997, to February 13, 1998.

[25] On April 1, 1998, Welch asked Fouquette questions concerning the material provided by RBC-DS. During his examination-in-chief, Welch confirmed the statement contained in his memorandum to file dated October 27, 1998, that he received a verbal opinion from Fouquette that the DSI error account was not operating as an error account on that date. However, during cross-examination, Welch produced his notes of this telephone conversation that did not include that statement.

[26] Welch then prepared a memo to Haddad dated April 1, 1998, recommending that DSI be investigated. Welch testified that the memo formed the basis for Haddad's acceptance of Welch's recommendation. On cross-examination, Welch acknowledged that the basis for his statement in this memo that Fouquette had advised him in *March 1998* that "in his opinion the account was not being operated as an error account" was, in fact, Fouquette's confirmation over the telephone that Al-Samadi's e-mail dated February 9, 2000, was accurate. Welch admitted that Fouquette did not make that statement directly.

[27] On April 3 and 8, 1998, Welch requested further information from RBC-DS that he subsequently received on May 4, 1998. Again, that request was made without notice to DSI. In the meantime, during the month of April, 1998, DSI had filed the Auditor's Report required by IDA By-law 8 confirming that DSI had sufficient assets to meet its liabilities. For the resignation to take effect, it was necessary for the IDA auditors to certify that DSI's liabilities were covered. Further, the secretary was required to inquire if any investigation of DSI was pending.

[28] On April 13, 1998, Maefs wrote to advise DSI that the Enforcement Division "has begun an investigation into the operation of Derivative Services Inc. pursuant to an Order issued by the Association indicating the terms and conditions of your membership, dated December 2, 1997". In his two years at the IDA, Haddad was unable to recall any investigation that had been opened to determine whether an IDA Order had been complied with.

[29] After receiving Maefs's letter, Kyle telephoned Welch, asked him to send him a copy of the "complaint" and advised Welch that he would forward copies of DSI's books and records to him.

[30] On May 4, 1998, Welch wrote to DSI to advise Kyle that Maefs' letter dated April 13, 1998, advised him of the matters under investigation. Upon receipt of this letter, Kyle telephoned Welch and reiterated his request for a copy of the complaint. Welch advised Kyle that, pursuant to IDA By-law 19, DSI was entitled to know only that an investigation had been commenced and what matters were under investigation, namely, whether DSI had complied with the Order dated December 2, 1997. Welch testified that the reason he would not be more specific about the matters under investigation was that he felt it might limit the scope of the investigation. During his cross-examination, Welch stated it was an unwritten policy of the IDA's Investigation Unit not to give the person under investigation a copy of any complaint against it/her/him until charges had been laid and disclosure made.

[31] On May 5, 1998, Welch wrote to Fouquette and requested copies of DSI's trading tickets. No notice of the request was given to DSI. He also wrote to Kyle setting out a long list of documents that he asked DSI to provide voluntarily. Upon receipt of his letter, Kyle telephoned Welch and expressed his concern about the volume of documents that Welch was requesting.

[32] On May 14, 1998, Welch received a letter from M.L. Biggar, counsel for DSI, requesting information concerning the investigation. Welch passed the letter on to Douglas Walker who responded to Ms. Biggar by letter dated May 22, 1998.

[33] On June 5, 1998, Welch issued a formal letter pursuant to IDA By-Law 19.5 demanding the list of the same documents that he had requested voluntarily by letter dated May 5, 1998. DSI did not provide the documents requested by Welch and Welch drafted his investigation report on July 15, 1998, recommending that charges be laid.

[34] On September 8, 1998, Welch interviewed Fouquette. After the ODC refused to issue a subpoena requiring the attendance of Fouquette at the Hearing on the Merits, DSI sought to have the transcript of his interview by Welch introduced into evidence. That request was denied.

[35] The Notices of Hearings herein were served on or about December 1, 1998. On May 7, 1999, DSI and Kyle brought a preliminary motion before the ODC requesting certain declarations and orders that would have effectively terminated the Hearings on the Merits. After hearing argument on the motion, the ODC issued its Preliminary Motion Ruling on June 28, 1999, dismissing all the relief sought.

[36] On September 22, 1999, the Appellants applied to the OSC for a Request for Hearing and Review of the Preliminary Motion Ruling. In reasons issued on October 5, 1999, the OSC dismissed the Appellants' motion, finding it premature.

[37] When the ODC reconvened on November 29, 1999, the Appellants requested an adjournment pending the hearing of certain applications brought by the Appellants in the Superior Court of Justice seeking the declaratory relief considered by the ODC in its Preliminary

Motion Ruling. The Appellants also sought an adjournment pending the hearing of an appeal to the Divisional Court from the Commission's Prematurity Decision. On December 13, 1999, the ODC ruled that the Hearing on the Merits would recommence on January 11 and 12, 2000.

[38] The Appellants appealed the OSC decision of October 5, 1999, to the Divisional Court and simultaneously applied to the Superior Court for essentially the same relief. The IDA and OSC moved successfully before Lederman J. on December 23, 1999, to quash the application to the Superior Court. On January 10, 2000, Southey J. dismissed the Appellants' motion in the Divisional Court to stay the proceedings.

[39] On January 11 and 12, 2000, the ODC conducted its Hearing on the Merits. In its decision issued May 5, 2000, it found DSI and Kyle had failed to provide documents and other information requested for the purposes of an investigation into their conduct. The ODC found the failure to be contrary to By-law 19.5 of the IDA and that DSI and Kyle engaged in conduct that was unbecoming and detrimental to the public interest, contrary to paragraph 29.1 of the By-law.

[40] On June 7, 2000, the ODC convened a Penalty Hearing. In its decision issued June 29, 2000, the ODC fined DSI $35,000 and Kyle $45,000. In addition, DSI's membership in the IDA was terminated on terms that it not be entitled to apply for re-instatement as a member of the Association until the specified fine and the costs awarded to IDA had been paid and until it had complied with the request under paragraph 19.5. Kyle's status as an Approved Person was revoked on terms that no subsequent approval be granted him unless he and DSI had paid the fines imposed and costs awarded and had complied with the request for documents and information pursuant to By-law 19.5. Costs of $5,000 were assessed against DSI and Kyle jointly and severally.

[41] On July 18, 2000, the Appellants moved to the ODC to re-open the question of costs. The ODC refused.

[42] On May 28, 2001, the OSC held a hearing and review of the five rulings of the ODC:

> i. the Preliminary Motion ruling heard May 7, 1999, and issued June 28, 1999;
>
> ii. the Scheduling ruling heard November 29, 1999, and issued December 13, 1999;
>
> iii. the ruling on the Merits of the Hearing January 11 and 12, 2000, issued May 5, 2000;
>
> iv. the Penalty ruling heard June 7, 2000, and issued June 29, 2000; and,
>
> v. the Refusal to Re-Open ruling heard July 18, 2000, and issued on the same day.

In its decision of July 17, 2001, the OSC held that rulings i-iv were beyond its jurisdiction. It held that the Request for Hearing and Review of i-iv were not made within the applicable time period. On the Refusal to Re-Open the costs issue of July 18, 2000, the OSC found no application of an incorrect principle, error in law or the overlooking of material evidence on the part of the ODC. It confirmed the refusal to Re-Open Ruling.

[43] On April 4, 2002, the Divisional Court heard an appeal of the OSC decision of July 17, 2001. The Court held the OSC had erred in finding that the time period for appeal question was a matter of substance. The Court held it was a procedural requirement that could be waived. The Divisional Court remitted rulings i-iv back to the OSC for a hearing and review of those rulings. The Divisional Court confirmed the OSC ruling v, the Refusal to Re-Open Ruling issued July 18, 2000.

[44] On October 21, 2002, the OSC held a hearing and review of the Rulings i-iv and agreed with the reasons of the ODC in each case. The findings of the ODC were confirmed in every instance. It is important to note that in paragraph 1 of the reasons issued December 6, 2002, the reasons refer to a date of July 18, 2000, which was the date of refusal to re-open the ruling on costs. That ruling had been upheld by the Divisional Court. Clearly, the reasons of the OSC issued December 6, 2002, should have referred to the ruling released June 29, 2000, which was the Penalty Ruling and which was clearly intended to be appealed by the Appellants. The OSC's decision was framed as follows:

> The Ontario District Council has rendered carefully considered reasons for the above rulings. We agree with those reasons and accordingly this application for a hearing and review is dismissed.

Investment Dealers Association of Canada

[45] The IDA's mandate is to, *inter alia*, foster and sustain an environment favourable to saving and investing and to encourage, through self-regulation, a high standard of business conduct among its Members and their partners, directors, officers and employees.

[46] The IDA is governed by a Board of Directors ("the IDA Board") comprised of officers of the Members, as well, public representatives. There are no government representatives on the IDA Board. The IDA is funded entirely by its Members and decides its own budget. The IDA is managed and operated day-to-day by a President, other officers, and an in-house staff of professionals.

[47] The IDA Board may adopt by-laws that are binding on the IDA's Members and Approved Persons. The IDA enforces compliance with its by-laws and regulations for the protection of its Members, their clients and the investing public.

[48] By-law 19 empowers IDA staff to conduct examinations and investigations of Members and Approved Persons to determine if they are compliant with IDA rules. Pursuant to By-Law 19.5, Members and Approved Persons are required to provide information and documents requested by IDA staff for the purposes of an examination or investigation.

[49] IDA staff may also initiate disciplinary proceedings against any Member or Approved Person who has failed to comply with IDA rules, including failing to provide information and documents requested for an investigation pursuant to By-law 19.5.

[50] In Ontario, disciplinary proceedings are conducted before a Hearing Panel of the ODC that is composed of at least one investment industry representative and one public representative.

[51] In *Morgis* v. *Thomson Kernaghan & Co.* (2003), 174 O.A.C. 104, Cronk J.A., writing for the Ontario Court of Appeal, made the following findings with respect to the IDA at p. 107 *et seq.*:

> [10] Membership in the IDA is voluntary. It is based on the contractual commitment of members to abide by the constitution, regulations, rules and by-laws of the association. The IDA is not created by and does not derive its authority from statute. Rather, it operates under the authority of its own constitution and is recognized under some securities legislation. In Ontario, s. 21.1 of the **Act** provides in part:
>
> > "21.1(1) The [Ontario Securities] Commission may, on the application of a self-regulatory organization, recognize the self-regulatory organization if the Commission is satisfied that to do so would be in the public interest.
> >
> > "(3) A recognized self-regulatory organization shall regulate the operations and the standards of practice and business conduct of its members and their representatives in accordance with its by-laws, rules, regulations, policies, procedures, interpretations and practices.
> >
> > "(4) The Commission may, if it is satisfied that to do so would be in the public interest, make any decision with respect to any by-law, rule, regulation, policy, procedure, interpretation or practice of a recognized self-regulatory organization."
>
> [11] The IDA was recognized by the Ontario Securities Commission (the "Commission") as a self-regulatory organization under s. 21.1 of the **Act** on December 14, 1994: **Investment Dealers Association of Canada, Re** (1994), 17 O.S.C.B. 5961 (Ont. Sec. Comm.). The recitals to that recognition include the following:
>
> > "WHEREAS the IDA is an unincorporated association in which membership is voluntary. It has approximately 111 investment dealers as members, all of whom, to the extent

> they trade in securities or act as underwriters in Ontario, are registrants under the **Act** and subject to regulatory oversight of the Commission. *The IDA represents its members and is organized for the purpose of regulating the operations and the standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest. The IDA regulates the conduct of its members and their trading in securities through rules set forth in its by-laws and regulations.*
>
> "WHEREAS the **Act** and the **Commodity Futures Act** contemplate and encourage self-regulation by registrants, but place the ultimate responsibility for registrants' conduct with the Commission. ...
>
> . . . . .
>
> "*WHEREAS each client of an IDA member is protected by [the Canadian Investor Protection Fund] against losses resulting from dealer failure to a maximum amount per client of $500,000.*" (Emphasis added)

[12] The IDA's 1994 recognition by the Commission was subsequently renewed for the period up to and after October 31, 1995, subject to terms and conditions specified by the Commission. Those terms and conditions vest considerable supervisory control of the IDA in the Commission. For example, they require the IDA to enforce compliance by its members with the rules of the IDA, as a matter of contract and without prejudice to any discipline by the Commission under Ontario securities law. They also require the IDA, among other matters, to report misconduct or apparent misconduct by IDA members to the Commission, to notify the Commission on a monthly basis of investigations and reviews of IDA members and of all complaints which lead to investigations being commenced by the IDA, and to refrain from making fundamental changes to the organizational structure of the IDA which would affect its self-regulatory functions without the prior approval of the Commission: **Investment Dealers Association of Canada, Re** (1995), 18 O.S.C.B. 5294 (Ont. Sec. Comm.).

The Ontario District Council Hearing of May 7, 1999

[52] Faced with a disciplinary hearing, DSI and Kyle moved before the ODC by way of a preliminary motion. The motion raised a series of issues going to the source of the IDA's self-regulatory authority, its investigative jurisdiction and the conduct of its disciplinary proceedings.

[53] DSI and Kyle submitted as follows:

> **(ISSUE 1)** the Reinstatement Order was, in effect, revoked as a matter of contract law by the subsequent interim suspension order of February 9, 1998;
>
> **(ISSUE 2)** the Association Rules were not binding on DSI, and by implication Mr. Kyle, as the doctrine of duress in the law of contract renders its membership contract voidable because DSI was compelled to join the Association;
>
> **(ISSUE 3)** the Association's authority over DSI and Kyle was derived through its recognition as a self-regulatory body under the CFA, with the result that its By-law 19 is invalid because it is not authorized by and is inconsistent with the CFA;
>
> **(ISSUE 4)** the effect of the Association's recognition under the CFA was that its authority derived from the CFA or from a delegation to it by the OSC with the result that its disciplinary decisions were governed by the SPPA;
>
> **(ISSUE 5)** for the same reasons, an Association disciplinary hearing was subject to the *Evidence Act*; and,
>
> **(ISSUE 6)** the Association was a government body subject to the *Charter* and, therefore, DSI and Kyle had "the right to be secure against unreasonable search or seizure" as guaranteed by s. 8 of the *Charter*, and By-law 19 unjustifiably deprived them of that right.

[54] (**ISSUE 1**) Counsel submitted that the Reinstatement Order of December 2, 1997, was a contract which was unilaterally terminated by DSI's letter of resignation dated January 29, 1998, and thus rendered unenforceable. She argued the termination was accepted by the Association when it issued the interim suspension order on consent on February 9, 1998, and the failure to set aside the Reinstatement Order was merely an oversight.

The ODC found the Reinstatement Order established the terms on which DSI was entitled to carry on business as a Member of the Association and DSI did carry on business under it for a period of almost two months. During this period, DSI had an obligation to comply with the terms of the Reinstatement Order, as it did with the provisions of the Association's By-laws

relating to its business. Neither DSI's letter tendering its resignation from the Association nor the interim order of February 9, 1998, altered this obligation retroactively.

The ODC noted By-law 8 of the IDA which requires a resigning Member to file financial information, including a report from the Member's auditor stating that the Member has liquid assets sufficient to meet all of its liabilities other than subordinated loans. No such report was filed by DSI and Kyle until April of 1998. A resignation took effect only when the Association's Secretary receives from the Association's Auditors a report confirming the report of the Member's auditor. Thus, at the time the investigation was undertaken and the requests for information described in the notices made, DSI was still a Member of the Association.

[55] (**ISSUE 2**) Counsel submitted that DSI's membership in the Association was compelled by economic necessity in that it had no choice but to accept the terms of membership in order to maintain its registration as a futures commission merchant. Therefore, the submission ran, DSI cannot be bound by its membership contract in view of the doctrine of duress.

The ODC rejected this submission, noting that in all of the materials referred to by counsel, the illegitimate pressure to enter into a contract was imposed by one of the parties to it. The Council found that any compulsion to join the IDA came not from it, but from the regulatory regime under the *CFA*, which required membership in the TFE or the IDA. Although the IDA agreed to assume responsibility for regulation of all TFE members, this agreement was approved by the OSC and was implemented by the TFE through an amendment of its by-laws. Any compulsion thus came directly from the TFE and the OSC. It found a person who seeks registration as a commodity futures merchant necessarily consents to the regulatory framework involving membership in an RSO, whether the TFE or the IDA, and confirms this acceptance in the membership application, as DSI did in this case. The ODC found that any other conclusion would be inconsistent with s. 15 of the *CFA* and would undermine the self-regulatory structure embodied in the *CFA* by permitting a registrant to walk away from the IDA rules at will.

[56] (**ISSUE 3**) Counsel mounted an attack on the IDA's by-laws. Counsel submitted that the IDA was authorized to adopt its by-laws only through a sub-delegation of authority by the OSC under subsection 15(2) of the *CFA*. Counsel also submitted that the IDA obtained its authority through a delegation pursuant to subsection 15(2). Section 15(2) reads as follows:

> 15(2) The Commission shall, on the application of a person or company proposing to carry on business as a commodity futures exchange in Ontario, register the person or company if the Commission is satisfied that to do so would be in the public interest.

Counsel argued that ss. 15(2) was the only basis on which the IDA could pass by-laws purporting to give the IDA investigative authority. Since s. 6 of the *CFR* dealt only with requirements and conditions of registration, and since the *CFA* does not authorize the OSC to make regulations with respect to investigations, the argument ran that delegation of investigative

authority had not and could not be made and that the IDA therefore lacked authority to adopt By-law 19 to authorize its staff to conduct investigations.

The ODC found this submission to be inconsistent with the theory of self-regulation embodied in the *CFA* and *CF*R. Any SRO would necessarily have by-laws governing its members' activities and, indeed, the OSC could not grant recognition under ss. 15(1) if the IDA did not; s. 6 of the *CF*R requires that the by-laws of an applicant Association be substantially equivalent to the *CF*R's requirements and conditions of registration. In the OSC order recognizing the IDA as an SRO under the *OSA*, the first term of the order requires the IDA to "enforce as a matter of contract compliance by its members and their approved persons" with the rules of the IDA.

Counsel also argued that the investigative powers conferred on the IDA staff by By-law 19 were inconsistent with the OSC's powers under the *CFA* and that By-law 19 was invalid for that reason as well. Paragraph 19.1 of the IDA's by-laws authorized the senior Vice-President, Member Regulation, to conduct an investigation as "he or she considers necessary or desirable in connection with any matter relating to compliance" by an IDA Member or Approved Person with the IDA rules, securities or commodities legislation, or the rules of another SRO. Counsel argued that this power imposed no constraints on the initiation of an investigation by IDA staff.

The ODC rejected this submission pointing out that the *CFA* contained two provisions for OSC investigations. Under ss. 7(1), the OSC has discretion to order any "such investigation as it considers expedient for the due administration" of the *CFA*. Subsection 7(2) simply authorizes the Commission to order such an investigation. The ODC found on a literal reading each subsection enabled the OSC to order an investigation, the former aimed at criminal or quasi-criminal offences and the latter not so confined. The ODC concluded by finding that even if the standard for an investigation order under By-law 19 differed from that under the *CFA*, the by-law would still be enforceable, as the IDA may impose obligations that are more stringent than those under the *CFA*. This conclusion flowed from the IDA's contract with its members and from the premises of the self-regulatory regime under the *CFA*.

[57] **(ISSUE 4)** Counsel sought declarations from the ODC that both the *SPPA* and the *Evidence Act* apply to disciplinary proceedings under By-law 20 of the IDA. The argument was based on the submission that the disciplinary proceedings of the IDA result from the regulatory responsibilities imposed by ss. 15(2) of the *CFA*.

The ODC rejected this submission, repeating its view that recognition under the *CFA* neither constituted the IDA a delegate of the OSC nor replaced the basis of its authority over its members. The ODC found that the *SPPA* applied only to "proceeding by a tribunal in the exercise of a statutory power of decision conferred by or under an Act of the Legislature, where the tribunal is required by or under such Act or otherwise by law to hold or to afford to the parties to the proceeding an opportunity for a hearing before making a decision". Since the IDA's authority to investigate came from its By-laws, the ODC found the IDA was not a tribunal within the meaning of the *Act*.

Counsel's submission on the *Evidence Act* was based on characterization of an IDA disciplinary proceeding as "a prosecution for an offence" against a by-law made under a statute. The ODC found that a contravention of the IDA's By-laws did not involve "an offence" under a statute. The ODC concluded by noting that the purpose of the *SPPA* and the *Evidence Act* was to ensure a fair hearing to parties to a proceeding. The ODC noted that the Association's By-laws contain provisions intended to ensure a fair hearing to all respondents; By-law 20 parallelled the provisions of the *SPPA* applicable to the convening and conduct of hearings by requiring that notice be provided, that a respondent was entitled to appear and be heard, to be represented by counsel, and to call, examine and cross-examine witnesses. It was open to the ODC to look to the provisions of the *SPPA* and to similar standards for assistance.

[58] (**ISSUE 5**) Counsel sought a declaration that the IDA was "government" within the meaning of s. 32 of the *Canadian Charter of Rights and Freedoms* and that paragraph 19.5 of the By-laws was unconstitutional on its face, in that it violated s. 8 of the *Charter* and therefore was of no force and effect. The ODC found that its authority relating to discipline derived from the IDA's By-laws. It found the IDA was not a statutory body and that recognition of the IDA as an SRB did not confer on it any statutory authority. It was the ODC's view that it did not have the authority to refuse to apply an IDA by-law, including By-law 19, on the basis of its purported inconsistency with the *Charter*. However, the ODC did acknowledge that the values reflected in the rights and freedoms guaranteed by the *Charter* might be relevant to the conduct of a hearing.

[59] (**ISSUE 6**) Despite having found its authority was limited with respect to the *Charter*, the ODC considered it appropriate to address the constitutional issues raised by counsel for DSI and Kyle. They did so in the light of the submissions concerning the provisions of By-law 19 and the issues of fairness flowing from the investigative powers conferred by By-law 19. Counsel invited the ODC to refuse to apply By-law 19 on the basis of s. 52(1) of the *Charter*. It declares that "any law that is inconsistent with the provisions of the Constitution is, to the extent of the inconsistency, of no force or effect". The ODC rejected this submission and found the IDA's by-laws not to be "law" within the meaning of the *Charter*.

The ODC further found that the IDA was not a government organization. This was not seriously challenged by counsel for DSI and Kyle. Their argument was premised on the decision in *Eldridge* v. *A.G.B.C.* (1997), 151 D.L.R. (4th) 577 at 602-605 and 607-608. Under the analysis in *Eldridge*, a private entity may become subject to the *Charter* if it engages in activities that are inherently governmental and attributable to government through some form of legislative delegation of authority. The ODC acknowledged that in pursuing its self-regulatory activities with respect to Members who are futures commission merchants, the IDA performed a regulatory function that was contemplated in the scheme of the *CFA*. This, however, was not sufficient for ODC to be persuaded the IDA was "government" with respect to its investigative and disciplinary functions under its by-laws. It found that the only direct delegation of legislative authority to the IDA, the assignment under s. 21(5) of the *OSA*, was limited to registration and renewal of registration of Approved Persons and Member firms under the *OSA*. It found the OSC had not assigned to the IDA any of its investigative or disciplinary authority under the *OSA*, nor was it authorized to do so. The ODC concluded by finding that the regulatory activities on which the notices were based did not derive from legislation and did not

constitute the implementation of a specific governmental policy or program. It found, rather, that they were part of the ordinary self-regulatory processes of the IDA with respect to its Members.

[60] The ODC then considered the argument that By-law 19 was, on its face, unreasonable within the meaning of s. 8 of the *Charter*, in that it violated the guarantee of every one "the right to be secure against unreasonable search or seizure". The ODC relied on the Supreme Court of Canada's decision in *B.C.S.C.* v. *Branch* (1995), 123 D.L.R. (4th) 462 (S.C.C.). In *Branch*, the Court upheld the British Columbia Securities Commission's investigative authority. In that, the issuance of the summonses in question did not unreasonably infringe on "the limited expectation of privacy" of individuals participating "in a highly regulated industry, such as the securities market"; *Branch*, at 488. On the basis of *Branch*, the ODC found By-law 19 not to be unreasonable. The ODC concluded by finding that By-law 19 was not, on its face, contrary to s. 8 of the *Charter*. Any questions concerning the propriety or reasonableness of the exercise of authority under By-law 19 was reserved for the hearing on the merits.

[61] For the reasons outlined in numbers (1) to (6) above, the ODC dismissed the preliminary motion on all grounds.

The Application to the OSC under s. 15(4) of the *CFA*

[62] Under s. 15(4) of the *CFA*, any person or company directly affected by any direction, decision, order or ruling made under any by-law, rule or regulation of such a body may apply to the OSC for a hearing and review. The OSC may then by order confirm the decision under review or make such other order as it considers proper. Counsel for DSI and Kyle moved for a hearing and review of the ODC's decision on the preliminary motion. Counsel for the ODC argued that the proceedings before it should be completed before any review and referred the OSC to the decision of the Divisional Court in *Ontario College of Art et al.* v. *Ontario Human Rights Commission* (1993), 11 O.R. (3d) 798. The OSC extensively considered the principle of prematurity in administrative law matters and concluded it should not proceed with the motion for a hearing and review. It found no "extraordinary circumstances demonstrating that the application must be heard", using the language of *Ontario College of Art*. The OSC decided the proper course was to dismiss the motion and permit the ODC to proceed with the hearing on its merits. The motion was dismissed as being premature.

The ODC Hearing on the Merits of January 11 and 12, 2000

[63] The ODC identified the issue before it as whether the IDA properly exercised its authority to initiate and conduct an investigation under By-law 19. By-law 19.1 authorizes the IDA staff to investigate the conduct of a Member or an Approved Person as the staff considers necessary in connection with any matter relating to compliance with the IDA By-laws.

[64] By-law 19.2 says any such investigation may be started on the basis of a complaint received relating to a Member's conduct.

[65] By-law 19.6 says that once an investigation is started, the IDA staff is entitled to free access of all records of the Member concerned.

[66] In its Preliminary Motion Ruling of May 7, 1999, (issued June 28, 1999) the ODC accepted the proposition that the initiation of the investigation and its conduct must be reasonable.

[67] The investigation was triggered by Fouquette, Vice-President of Futures of RBC-DS. He told IDA staff in February of 1998 he suspected DSI was conducting principal trading in its error account, an activity prohibited by DSI's Re-Instatement Order of December 2, 1997. Following his assignment as investigator, Wayne Welch confirmed with Fouquette the latter's opinion that DSI was abusing the error account.

[68] Welch noted that Kyle had told IDA staff in January of 1998 that he was going to "resign his membership" and "close his firm down". Kyle referred to a loss on an error position resulting in "a possible capital deficiency of $50,000". Welch received copies of DSI's transactions in the RBC-DS error account. He obtained Fouquette's confirmation that the account was being used for principal trading by DSI.

[69] Welch prepared a memorandum saying he believed that the error account was being abused and further investigation of DSI was required. The memo prompted the Enforcement Division to begin an investigation into the operation of DSI.

[70] The ODC found that all that was necessary to demonstrate the reasonableness of an IDA investigation was that information received by the IDA indicated the possibility of a violation of its By-laws or other rules. The ODC found that the standard was satisfied by Welch's memorandum of April 1, 1998. It listed information available to the IDA which indicated a real possibility that DSI's error account had been used for principal trading, contrary to the condition in the Re-Instatement Order. The memorandum summarized Fouquette's statement to the IDA staff which Welch confirmed directly with him. The memorandum also set out the trading in the error account which confirmed the suspicion that it was being abused. This was sufficient support for the decision to order a formal investigation.

[71] The ODC then turned its attention to whether the conduct of the investigation was reasonable under the circumstances. By-law 19.5 required the IDA to advise any persons subject to an investigation in writing "of the matters under investigation". Counsel for the Appellants submitted that the IDA failed to satisfy this requirement and that the failure justified DSI's and Kyle's failure to satisfy Welch's request for documents and other material.

[72] Notice of the investigation was sent to DSI and Kyle in a letter dated April 13, 1998. The letter stated that the Enforcement Division had "begun an investigation into the operation of Derivative Services Inc. pursuant to an order issued by the Association indicating the terms and conditions of your membership, dated December 2, 1997". Counsel argued this letter mentioned only the Re-Instatement Order without disclosing the nature of the complaint or the specific matter being investigated. The ODC found the standard of disclosure required by paragraph 19.5 was an objective one. It was satisfied if the person who was the subject of an investigation was

provided with information that would enable a reasonable person to discern the nature of the matters under investigation. The ODC found that the letter of April 13, 1998, met this test by referring to the operation of DSI under the terms of the Re-Instatement Order. The information was reasonably sufficient to alert Kyle to the subject of the IDA investigation, namely, the handling of the error account with RBC-DS. The majority of the eleven conditions in the Re-Instatement Order had been satisfied before DSI's re-instatement. A reasonable person would have understood that the investigation centred on the minimum risk adjusted capital of $50,000 and the requirement that DSI not engage in principal trading without IDA's prior approval. The ODC noted that Kyle had indicated an understanding of this on May 1, 1998, when he suggested to Welch that the complaint must have come from RBC-DS. Under the circumstances and in the absence of any evidence adduced by DSI and Kyle of Kyle's actual understanding, the ODC was satisfied that the notice requirements in paragraph 19.5 were satisfied.

[73] The ODC concluded that DSI and Kyle had failed to provide documents and other information for the purposes of the investigation and that they had therefore engaged in conduct that was unbecoming and detrimental to the public interest, contrary to paragraph 29.1 of the By-laws. The ODC ruled that a Penalty Hearing be scheduled at the earliest convenient date.

Procedural Rulings Made During the Hearing on the Merits

[74] During the course of the two-day Hearing on the Merits, the ODC ruled on several motions made by counsel for the Appellants, some ten in number. Of those, Rulings 1 and 2 were resolved, leaving Rulings 3 – 10, inclusive, to be decided by the ODC.

> **Ruling 3** – Counsel moved for an order requiring Fouquette to attend and testify on the trading in DSI's Error Account, whether Welch told him he was obliged to disclose the trading in the Error Account, and to explain alleged inconsistencies with Welch's evidence. The ODC ruled the information sought did not go to the reasonableness of the investigation, but rather the actual transactions in the Error Account and Fouquette's belief concerning them. The motion was rejected with a willingness to reconsider if, subsequently, a basis for requiring his evidence was shown.
>
> **Ruling 4** – Counsel moved to require the production of the transcript of Fouquette's interview with Welch. The ODC rejected the motion, finding the request related to the alleged inconsistencies and not to the issue of reasonableness.
>
> **Ruling 5** – Counsel moved the ODC to reconsider its ruling on the attendance of Fouquette. The ODC denied the request.
>
> **Ruling 6** – Counsel moved the ODC to require the attendance of four members of the IDA staff, Al-Samadi, Walker, Nippak, and Clarke. The ODC rejected the request, ruling there was no evidence to suggest impropriety in the investigation.

Rulings 7, 8 & 9 – Counsel for the Appellants wanted to call Walker, Nippak and Clarke as witnesses. The ODC denied the request. Its ruling was based on its view it needed only to hear from the IDA staff person who made the decision to initiate the investigation based on Welch's recommendation of April 1, 1997. This person was Haddad and he was made available to testify.

Ruling 10 – Following counsel's interview of Haddad, she asked the ODC to declare him an adverse witness. The ODC did so, granting leave to counsel to ask him leading questions and cross-examine.

The Penalty Hearing of June 7, 2000 Issued June 29, 2000

[75] Counsel for the Appellants submitted several mitigating factors:

(a) Counsel submitted that a very small number of investigations had been initiated without a prior complaint and that the IDA had not previously conducted an investigation based on compliance with a Re-Instatement Order. The ODC found that the novelty of the circumstances leading to an investigation or the nature of the violation was not a mitigating factor;

(b) Counsel submitted the only way to test the issues raised in the Preliminary Motion was to refuse to comply with the request under By-law 19.5. The ODC found that while an individual or a Member firm is entitled to rely on its rights and seek a determination of them in a hearing, such conduct is not necessarily a mitigating factor. The ODC found that a conscious intention to test the rules carried with it acceptance of the risk that penalties would follow;

(c) Counsel submitted that since legal advice played a part in the Appellants' decision that this should be a mitigating factor. The ODC found there was no evidence before the ODC on the advice received by the Appellants or the manner in which that advice affected their decision not to comply with the request for documents. It refused to give any weight to this submission;

(d) It was submitted that Kyle believed the Appellants had no continuing obligation to the Association after he submitted the resignation letter of January 29, 1998. The ODC had referred to this evidence in its Hearing on the Merits, stating it might be relevant to an appropriate penalty, having heard from Kyle on the matter. The Appellants determined not to call Kyle to give evidence and he did not

otherwise attempt to explain his belief or any of the other elements relating to the decision not to provide the requested documents. The ODC had previously found that any such belief was in error, as the Respondents had a continuing obligation to comply with an investigation request. The ODC agreed that a genuine belief, even if mistaken, might constitute a mitigating factor. However, in the circumstances of the case before it, it chose to give no weight to Kyle's alleged belief in view of the limited amount of evidence to support its existence and the lack of any evidence on the manner in which it affected the Appellants' decision;

(e) The ODC found that DSI's letter of resignation might suggest that the prior disciplinary proceedings had had an impact and that DSI was attempting to address a similar difficulty expeditiously in a manner that protected both it and its clients. In the ODC's view, the attempt to resign was, arguably, a mitigating factor although it did not carry much weight in the circumstances.

[76] The ODC found the Appellants' failure to respond to the request under By-law 19.5 was a serious violation. It was all the more so in view of the Appellants' prior disciplinary history. The ODC determined that it was appropriate to impose a fine on each of the Appellants recognizing that any fine paid by DSI would be borne, in part, by Kyle through his partial shareholding in DSI. The ODC then fined DSI $35,000 and Kyle $45,000. It acknowledged the fines were toward the higher end of the range recommended in the TSE guidelines reflecting the Appellants' intentional violations despite the knowledge of their responsibilities concerning an investigation which was, or should have been, impressed on them in the prior disciplinary proceedings. The ODC then imposed the terms against re-instatement and re-approval until the fines and costs under the Penalty decision were paid and the request for documents and information complied with. The ODC directed that costs of $5,000 be paid jointly and severally by the Appellants.

[77] Following the Penalty decision, counsel for the Appellants asked the ODC to re-open the proceeding with respect to costs. The ODC refused, since it was the practice in disciplinary proceedings to address costs at the same time as the penalty. It was this aspect of the Penalty Hearing that was considered by the Divisional Court on April 4, 2002 (issued April 29, 2002). As noted above, the Divisional Court rejected the Appellants' submission on this point and confirmed the ODC's decision not to re-open the question of costs. I need not deal with it.

The Nature of the OSC "Hearing and Review" on October 21, 2002

[78] Section 15(4) of the *CFA* (now s. 21.1(1)) confers a right on "any person or company directly affected...by any decision, order or ruling made under any by-law, rule...of a self-

regulatory organization may apply to the Commission for a hearing and review of the direction, decision, order or ruling". It was under this section of the *CFA* that the Appellants sought a hearing and review of the rulings (i)-(v) made by the ODC. Section 15(4) goes on to provide that s. 4 of the *CFA* applies to the hearing and review in the same manner as to the hearing and review of a decision of the director.

[79] Any doubt as to whether the hearing before the OSC on October 21, 2002, was the "application" or the "hearing and review" is resolved by reference to s. 4 of the *CFA*. Section 4(2) of the *CFA* provides that any person or company directly affected by a decision of the Director may, by notice in writing request and be entitled to a hearing and review thereof by the Commission. We find that the entitlement to a hearing and review in s. 4 makes it clear the hearing and review is triggered by the request to have such a hearing and review. In other words, it is not open to the OSC to refuse an "application" to hold a hearing and review.

[80] The material filed on the appeal makes it clear that the OSC had before it the record of proceedings to the date of the hearing, together with the written submissions of the parties. In addition, extensive oral submissions were made during the course of the hearing. We find that the OSC conducted a hearing and review on October 21, 2002, relating to those matters raised by the Appellants in their requests for such a hearing and review. Therefore, where the reasons of the OSC issued December 6, 2002, say that "this application for a hearing and review is dismissed", I take this to mean that the OSC refused to grant the relief sought in the Request for a Hearing and Review.

The Court's Jurisdiction

[81] Pursuant to s. 9 of the *Securities Act*, R.S.O. 1990, c. S. 5, a party may appeal a final decision of the Commission to the Divisional Court:

> s. 9(1) A person or company directly affected by a final decision of the Commission, other than a decision under section 74, may appeal to the Divisional Court within thirty days after the later of the making of the final decision or the issuing of the reasons for the final decision. 1994, c. 11, s. 356(1)

Standard of Review

[82] The Supreme Court of Canada has established the deference that should be shown to Securities Commissions. In *Committee for the Equal Treatment of Asbestos Minority Shareholders* v. *Ontario (Securities Commission)*, [2001] 2 S.C.R. 132, Iacobucci J. held, at pp. 152-153:

> ¶49 ... [T]he OSC is a specialized tribunal with a wide discretion to intervene in the public interest and that the protection of the public interest is a matter falling within the core of the OSC's expertise. Therefore, although there is no privative clause shielding the decisions of the OSC from review by the courts, that

> body's relative expertise in the regulation of the capital markets, the purpose of the Act as a whole and s. 127(1) in particular, and the nature of the problem before the OSC, all militate in favour of a high degree of curial deference. However, as there is a statutory right of appeal from the decision of the OSC to the courts, when this factor is considered with all the other factors, an intermediate standard of review is indicated. Accordingly, the standard of review in this case is one of reasonableness.

[83] The decision of the OSC, to which curial deference is owed, adopted the reasons and results contained in the various decisions and Rulings of the ODC. Those reasons and results must therefore be examined in the light of their reasonableness except questions of law, where correctness governs. As will be shown in the following analysis, I find the decision of the OSC was reasonable in every particular.

Were the findings of the ODC on the preliminary motion of May 7, 1999 unreasonable?

[84] (**ISSUE 1**) I find no merit in the submission that the Reinstatement Order of December 2, 1997, was a contract unilaterally terminated by DSI's letter of resignation. The IDA's By-law set out a procedure to be followed for a Member to resign. It was not followed. Any submissions based on a purported resignation must fail. The ODC's decision was reasonable.

[85] (**ISSUE 2**) I find no merit in the submission that DSI's membership was compelled by economic necessity. The ODC was reasonable in finding that compulsion, if any, came from the regulatory scheme of the *CFA*, which required membership in the IDA. Any other conclusion would undermine the self-regulatory scheme of the *CFA*. The ODC's decision was reasonable.

[86] (**ISSUE 3**) I reject the submission that the IDA was unauthorized to adopt its By-laws only through a sub-delegation of authority by the OSC under s. 15.(2) of the *CFA*. The ODC correctly found this submission also to be inconsistent with the regulatory scheme. Not only would an SRO necessarily have by-laws governing its members activities, s. 6 of the *CFR* requires the by-laws of an applicant SRO to be substantially equivalent to the requirements of registration. I also reject the submission that By-law 19 is invalid because it is inconsistent with the OSC's powers under the *CFA*. The ODC was correct in finding that the *CFA* has two provisions for OSC investigations, one under s. 7.(1), the other initiated by an SRO, pursuant to its by-laws, such as By-law 19. There is no requirement for consistency in the regulatory scheme.

[87] (**ISSUE 4**) The ODC rejected the submission that both the *SPPA* and the *Evidence Act* apply to disciplinary proceedings under By-law B 20 of the IDA. I find it was both reasonable and correct in doing so. The IDA is not a tribunal within the meaning of the *SPPA*. A contravention of the IDA's by-laws does not involve an "offence" under a statute.

However, the ODC did not stop at that point noting that the purpose of the *SPPA* and of the *Evidence Act* is, in broader terms, to ensure a fair hearing to parties to a proceeding. The ODC noted that the IDA by-laws contain provisions intended to ensure a fair hearing to all respondents. By-law 20 parallels the provisions of the *SPPA* applicable to the convening and conduct of hearings by requiring that notice be provided to a respondent and that a respondent is entitled to appear and be heard, to be represented by counsel and to call, examine and cross-examine witnesses. The ODC concluded that in conducting a hearing it may look to the provisions of the *SPPA* and to similar standards for assistance.

[88] **(ISSUE 5)** The ODC was both reasonable and correct in finding that the IDA was not government within the meaning of s. 32 of the *Charter*. There could be no violation of s. 8 of the *Charter* and no remedy.

Morgis, supra, at paras. 31 & 32

[89] **(ISSUE 6)** Nevertheless, the ODC went on to consider whether By-law 19 was, on its face, unreasonable within the meaning of s. 8 of the *Charter*. On the authority of *B.C.S.C.* v. *Branch* (1995), 123 D.L.R. (4th) 462 (S.C.C.), the ODC found the investigative powers under By-law 19 did not infringe "the limited expectation of privacy" of individuals participating "in a highly regulated industry as the securities market". This finding of the ODC was reasonable.

Was the refusal of an adjournment on November 29, 1999 unreasonable?

[90] I find it was reasonable for the ODC to refuse the Appellants' request for an adjournment heard November 29, 1999, and issued December 13, 1999 (erroneously dated December 13, 2000 in the reasons of the OSC issued December 6, 2002). Counsel for the Appellants had moved in three different courts to stop the proceedings. The ODC properly considered and applied the principles in *RJR-MacDonald* v. *A.G. Canada* (1994), 111 D.L.R. (4th) 385 (S.C.C.). Its decision to schedule the hearings of January 11 and 12, 2000, was reasonable.

It was reasonable for the ODC to require all staff members involved in the investigation to be available to give evidence at the hearing, but not to require the attendance of an officer of RBC-DS. Such an officer would have no relevant evidence to give on the question of refusal to provide documents.

Were the findings of the ODC at the hearing on the merits reasonable?

[91] The ODC found there to have been a reasonable basis for the investigation under By-law 19. It found further that all that was necessary to demonstrate the reasonableness of the IDA investigation was the receipt of information indicating the possibility of a violation of its by-laws. The ODC found this standard was met by Welch's memorandum. I find the decision of the ODC on this point to be reasonable, as the memorandum summarized information received indicating a real possibility that DSI's Error Account had been used for principal trading. Nothing further was needed to order a formal investigation.

[92] The ODC found the notice of investigation was reasonable under the circumstances. It concluded that a reasonable person would have understood that the investigation centred on the minimum risk adjusted capital of $50,000 and the requirement that DSI not engage in principal trading without the IDA's prior approval. In the absence of any evidence adduced by DSI and Kyle of Kyle's actual understanding, the ODC was satisfied that the notice requirements were met. The finding was reasonable.

[93] The ODC found DSI and Kyle had failed to provide documents and other information for the purposes of the investigation and that they had engaged in conduct unbecoming and detrimental to the public interest. It could have come to no other conclusion. I find the conclusion was reasonable.

Were the procedural rulings made during the hearing on the merits reasonable?

[94] **Rulings 3 & 5**

The ODC refused to order Fouquette to attend and testify on the trading in DSI's Error Account. It found the information sought did not bear on the reasonableness of the investigation. I find its decision reasonable as was its refusal to reconsider the request. Fouquette's evidence had nothing to do with the reasonableness of the investigation.

[95] **Ruling 4**

The ODC refused to require the production of the transcript of Fouquette's interview with Welch. It found the request went to alleged inconsistencies in Welch's investigation, not to the reasonableness of the investigation. The ODC's refusal was reasonable.

[96] **Ruling 6**

Counsel for the Appellants wanted to call Al-Samadi, Walker, Nippak and Clarke. Counsel suggested there may have been improprieties in the investigation. The ODC found there was no evidence from which to infer any impropriety in the course of the investigation. Given that finding, the ODC's decision was reasonable.

[97] **Rulings 7, 8 & 9**

Counsel for the Appellants wanted to call Walker, Nippak and Clarke to question them about various conversations each had leading up to the investigation. The ODC denied the request for Walker's attendance as he had no relevant evidence to provide. In the ODC's view, the conversation of December 19, 1997, relating to the handling of DSI's accounts at RBC-DS under the Re-Instatement Order was not relevant to the initiation of the investigation in April of 1998. It was not necessary to seek corroboration from Walker of IDA policies on the conduct of investigations; the alleged conversation with Kyle was not relevant in view of the fact that Welch testified that the investigation was not premised on a complaint. The ODC denied the request to call Nippak as the conversation on December 19, 1997, was found not to be relevant to the issues it had to decide.

The ODC rejected the request to have Clarke testify once it learned that it was Haddad who had made the decision to start the investigation.

The ODC had already noted in Ruling 6 that there was no basis for inferring any impropriety had occurred in the course of the IDA investigation. It stated that this conclusion also informed subsequent rulings concerning counsel's requests to require Walker and Nippak to testify.

Were the penalties imposed reasonable?

[98] The ODC identified the main factors in determining an appropriate penalty as protection of the investing public, protection of the IDA's membership and protection of the integrity of the IDA's processes, and the protection of securities markets. It instructed itself that the penalty should reflect the ODC's assessment of the measures necessary in the specific case to accomplish these goals, ranging from a reprimand to an absolute bar. The ODC instructed itself to take into account the seriousness of the Appellants' conduct and specific and general deterrence.

[99] In aggravation, the IDA submitted a record of a prior infraction, that the conduct was intentional, that the refusal was complete, and that there was no indication of a willingness to comply. The ODC accepted these submissions in aggravation.

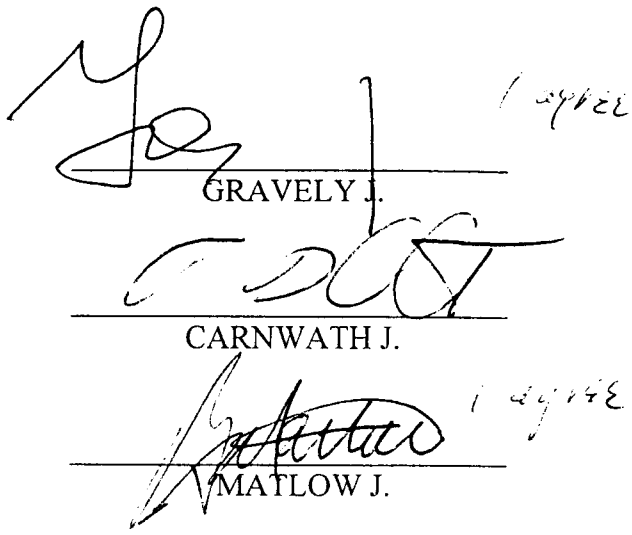
[100] In mitigation, counsel for the Appellants characterized the prosecution as selective, that the Appellants relied on their rights and on legal advice, and that they made efforts to comply. The ODC did not accept these submissions in mitigation.

[101] It found the refusal to comply a serious infraction. It noted the importance of full co-operation with a request, if the IDA was to fulfill its self-regulatory supervisory function. It found the failure to provide information undermined the integrity of the self-regulatory system. On the basis of these findings, the fines noted above were imposed.

[102] Taken individually and collectively, the findings of the ODC on the Penalty Hearing are eminently reasonable. The proper principles were considered, each submission was canvassed and dealt with and the fines were responsive to the offence.

[103] The appeal is dismissed and the decision of the OSC is confirmed.

[104] The Respondent has thirty days to make submissions as to costs and the Appellants have fifteen days thereafter to make submissions as to costs.



GRAVELY J.

CARNWATH J.

MATLOW J.

Released: 20050525

COURT FILE NO.: 3/03
DATE: 20050525

ONTARIO
SUPERIOR COURT OF JUSTICE

DIVISIONAL COURT

GRAVELY, CARNWATH & MATLOW JJ.

B E T W E E N:

DERIVATIVE SERVICES INC. and MALCOLM ROBERT BRUCE KYLE

Appellants

- and -

INVESTMENT DEALERS ASSOCIATION OF CANADA

Respondents

JUDGMENT

CARNWATH J.

Released: 20050525