January 8, 2008

IN THE MATTER OF: THE SECURITIES ACT

- and -

IN THE MATTER OF: EUSTON CAPITAL CORP.

REASONS FOR DECISION
OF
THE MANITOBA SECURITIES COMMISSION

Panel:

Acting Chair:	Ms. K.E. Hughes
Board Members:	Mr. D.H. Smith

Appearances:

Ms K.G.R. Laycock	)	Counsel for the Commission
	)	No appearance on behalf of the
	)	Respondent

Staff of the Manitoba Securities Commission allege that Euston Capital Corp. (Euston), while not being registered to trade in securities under The Securities Act, and while not having applied for or obtained an exemption order under section 20 of the Act, improperly relied upon the "accredited investor" exemption of MI 45-103 (now NI 45-106) to make eleven trades in its own securities to Manitoba investors (some of whom are identified at the end of these Reasons) between October, 2003 - September 2004.

The hearing (after a teleconference with Mr. Schwartz, the principal of Euston to arrange a mutually agreeable date) was originally scheduled to begin on September 25, 2006. On that date Mr. Schwartz did not appear, and again by teleconference from Toronto, requested an adjournment to better prepare his case because of an amendment to the Notice of Hearing, dated September 22, 2006, requesting compensation for financial loss for several of the investors. Although witnesses, some from several hundred miles distant, had traveled to Winnipeg to give evidence, the panel of the Commission agreed to an adjournment to October 30, 2006, and Mr. Schwartz agreed to the new date. On that date no one appeared for Euston, and the hearing was held without representation from Euston. Euston did request, and was granted, an opportunity to submit written argument at the conclusion of the hearing, as was counsel for the Commission. Both did provide written submissions.

Eight witnesses who had bought shares in Euston testified. All of them were or had been involved in small businesses, many of them in small towns and rural areas of Manitoba.

Generally, each had been contacted by telephone by a representative of Euston, and solicited to purchase shares in the company. Usually several calls were made to each prospective investor, sometimes by more than one representative of Euston. Evidence suggested that the callers were persuasive in promoting the company. The amount invested varied from one purchaser to another, although the price per share was a constant $3.00. The witnesses were told that Euston was a company involved in cross-border prescription drug activity, in the words of one witness "something to do with pharmaceuticals and supplying drugs to large users in the United States".

Evidence received indicated the method of completing the purchase of the shares was the same in all cases. Once an agreement had been reached, 2 copies of a Confirmation form on Euston letterhead were faxed to the buyer, along with a covering letter briefly describing the business and asking the buyer to sign one copy of the confirmation. That copy was to be returned with a cheque for the full purchase price which a courier had been arranged to collect the same day. Some time later, usually several weeks later, the purchaser was sent a share certificate and a Purchase Agreement. He was asked to sign one copy of the Purchase Agreement and return it in the enclosed self-addressed envelope. The agreement's one paragraph stated:

"The undersigned (the Purchaser) hereby irrevocably purchases, subject to the terms and conditions set forth in this Agreement Common Shares of the Company in the principal amount (the "Purchase Price") and with the specific purchase instructions as set forth below. The particulars of the Common shares and certain terms of the sale of the Common Shares are set out in Schedule "A" to this Agreement. Attached as Schedule "B" to this agreement are certain of the representations, warranties and covenants to be made by the Purchaser (on its own behalf and, if applicable, on behalf of others for whom it is contracting hereunder) so that the Company can ensure compliance with applicable securities laws. Each such schedule forms a part of and is incorporated into this Agreement and the Purchaser should review each carefully."

This was the extent of the information provided.

At the top of the Purchase Agreement was the following notice:

"THE SECURITIES HEREBY OFFERED ARE BEING PRIVATELY OFFERED TO ACCREDITED INVESTORS AS DEFINED IN PARAGRAPH 1(g)IN ATTACHED SCHEDULE "B", PURSUANT TO EXEMPTIONS FROM THE PROSPECTUS AND REGISTRATION REQUIREMENTS UNDER RULE 45-101 (REVISED) IMPLEMENTED BY THE ONTARIO SECURITIES COMMISSION AND UNDER REVISED MULTILATERAL INSTRUMENT 45-103 IMPLEMENTED BY THE SECURITY REGULATORY AUTHORITIES IN ALBERTA, BRITISH COLUMBIA,MANITOBA, NEWFOUNDLAND & LABRADOR, NORTHWEST TERRITORIES, NOVA SCOTIA, NUNAVUT, PRINCE EDWARD ISLAND AND SASKATCHEWAN.

Schedule "A" was a two page document listing the terms of the offering, and Schedule "B" was a 2 page document of the purchaser's representations, warranties and covenants. Section 1(g) of Schedule "B" was headed Prospectus Exemptions, and contained a definition of an accredited investor.

Some of the witnesses said they had read the agreement, others testified that they did not. Many expressed ignorance of the legal terms and technical language in the document, and said they could not understand it. All had signed and returned the agreement to Euston. As indicated this was, in each case, weeks after the trades had been completed and monies had changed hands.

No one from Euston had explained the definition of an accredited investor, nor explained the reason for the financial requirements, nor canvassed the investors whether they qualified under the definition. During the hearing, each witness was asked if he or she met the definition, and all denied it.

A trade was completed when the confirmation was signed and returned to Euston, along with a cheque for the purchase price. These cheques were, in some instances, cashed immediately, and we have no evidence of any of the monies being held in reserve until the Purchase Agreement was signed and the purchasers certified they were accredited investors. Euston stated in its submission to us that a pool of funds was always available to repay purchasers who were not accredited, but offered no proof to support this claim.

At the time of each of the trades, there was absolutely no indication that any of the investors met the "accredited" definition. In fact they gave evidence that they did not qualify as accredited investors.

Exemptions from securities legislation for dealer registration and prospectus requirements are limited and, according to Companion Policy 45-103CP, do not relieve a registrant from its responsibilities to purchasers under security legislation. In particular, MI 45-103 does not provide an exemption from the "know your client" and suitability rules.

We find that Mr. Schwartz, as principal of Euston, adopted a strategy of deliberately not making enquiries of prospective investors as to their ability to meet the definition of an accredited investor. Indeed, in his submission he states that telemarketers were discouraged from discussing the exemption criteria. He says he did not want to rely on oral submissions and preferred to rely on his own assessment of an investor's ability to meet the criteria, based on the individual's listing in a directory of small business owners. He also relied on his experience verifying asset and income levels while he was an employee of Revenue Canada.

We believe that Mr. Schwartz was willfully blind in not making inquiries when he should have, because he wished to remain ignorant of prospective investors' true financial situation. Quite simply put, the requirements of the Instrument were not met, the exemption was unavailable and clearly the investment was not suitable for these investors.

We find that the allegations of Securities Commission staff have been proven.

In the written submission of Euston Capital, much of the material was in the form of new evidence. This material had not been submitted during the hearing, had not been admitted as evidence and the panel has not considered it in reaching its decision.

Euston also asked us to revisit our decision to proceed with a separate hearing in Manitoba instead of conducting a joint hearing with the Ontario Securities Commission. These are allegations made under the Manitoba Securities Act, the transactions took place in Manitoba and the investors all lived in Manitoba. We see no reason that a joint hearing with the OSC should have been considered.

Euston also makes a claim of a reasonable apprehension of bias because the Chair of the panel used the word "we" in explaining to one of the witnesses the procedure in making a determination on a claim for financial compensation. The panel does not consider the use of the word "we" in the context, to be evidence of bias. The panel went to significant lengths to accommodate Euston and the hearing was conducted in an impartial manner. Euston makes no other allegation of bias during the hearing which lasted for three days.

Five of the complainants have filed claims for financial compensation with the Director of the MSC who has requested the panel to make orders that Euston pay compensation for financial loss for these complainants.

s. 148.2(3) of the Act reads:

When so requested by the director, the commission may order the person or company to pay the claimant compensation of not more than $100,000. for the claimant's financial loss, if after the hearing the commission

(a) determines that the person or company has contravened or failed to comply with:

> (i) a provision of the Act or the regulations,
>
> (ii) a direction, decision, order or ruling of the commission, or a rule made under ss. 149.1(1),
>
> (iii) a written undertaking made by the person or company to the commission or the director, or
>
> (iv) a term or condition of the person or company's registration;

(b) is able to determine the amount of the financial loss on the evidence; and

(c) finds that the person or company's contravention or failure caused the financial loss in whole or in part.

Staff counsel argues that all the requirements of this section have been met. Euston contravened a provision of the legislation by selling to investors who were not accredited. As there is no evidence of any funds being recovered, staff counsel argued that the amount of the loss of each investor should be determined to be the amount each invested. Staff also argued in each case the financial loss resulted directly from Euston's contravention of the legislation.

Euston argues that no losses were suffered by investors as a result of Euston's conduct. It states that the Purchase Agreement was a contract which each of the witnesses signed and it was their responsibility to read the document, including the representation that they were accredited investors. But the trade took place at the time, at least several weeks earlier, when each investor signed a Confirmation and gave a cheque to a courier the same day he received the Confirmation by fax. Euston also argues that the witnesses undertook to purchase shares in a high risk venture which entailed the possible total loss of their investment, but the evidence at the hearing indicates that this was not their understanding at all. To the contrary, these relatively unsophisticated small business people were advised and believed that this was a safe, secure investment. They were not prepared to lose all the money they had invested, did not expect to lose all the money they had invested and most understood they would be able to redeem their investment after three months.

Euston also claims that as an issuer it had no duty of care to look behind their written representations , and cites *Abrams v. Sprott Securities Ltd., 2003 CanLII 27136 (Ont. C.A.)* That case involved a completely different type of investor - someone who made as many as 69 trades in a month, dealing with millions of dollars, who signed very detailed subscription agreements in which he acknowledged his investment experience and financial ability to sustain the possible loss of his complete investment. He was also not a new client of the firm. Even so, the broker was found liable, and the brokerage firm was held vicariously liable, for half the loss. We do not see how this case advances Euston's position.

Euston also claims that the investors can not be said to have suffered losses equal to their full investments, because the Purchase Agreements they signed contained a clause in which they agreed to indemnify Euston for the costs in defending a proceeding. Euston argues that the computation of investor loss must take into account Euston's costs of defending itself against a claim. Although the panel doubts the legal validity of a clause that requires victims of improper activity to indemnify the perpetrator, there is no need to deal with this defense as no evidence of the cost of defending was provided.

Staff counsel provided evidence as to the MSC cost of the investigation and hearing to be $20,325.56. Counsel also requested that an administrative penalty of $15,000.00 be imposed. Under the circumstances of this case the panel accepts this request. Finally, the panel was asked to deny Euston access to the exemptions under the Act. We find that the conduct of Euston warrants this sanction.

1. We order compensation for financial loss to be paid by Euston as follows:

Herbert Brock	$ 3,000.00
Randy Gelsinger	$ 6,000.00
Peter Goodwin	$30,000.00
Ted Korte	$ 3,000.00
Ed Toews	$ 6,000.00

2. We also order that, pursuant to the Manitoba Securities Act, s. 19(5), Euston Capital Corp. is not entitled to the exemptions from registration under ss. 19(1), 19(2), and 19(3) of the Act for 10 years from the date of this decision.

3. We order that Euston Capital Corp. pay an administrative penalty of $15,000.00.

4. We order that Euston Capital Corp. pay costs of the hearing in the amount of $20,325.56

"K.E. Hughes""
K.E. Hughes
Chair

"D.H. Smith"
D.H. Smith
Member