

Re Berry

IN THE MATTER OF:

**The Rules of the Investment Industry Regulatory Organization of
Canada (IIROC)**

and

The Universal Market Integrity Rules

and

David Berry

2012 IIROC 74

Investment Industry Regulatory Organization of Canada
On behalf of
Market Regulation Services Inc.
Hearing Panel (Ontario District)

Hearing: September 24, 25, 27 and 28, October 1 and 4, December 5, 2012
Decision: January 14, 2013

Hearing Panel:

The Honourable Fred Kaufman, C.M., Q.C., Chair, Mr. Ted Norris, Mr. Guenther Kleberg

Appearances:

Charles Corlett and Diana Iannetta, Senior Enforcement Counsel

Peter Griffin, Linda Fuerst and David Quayat, Counsel - For the Respondent

DECISION

History

¶ 1 This case has a long history, due largely to two preliminary motions brought by the Respondent. The first, which dealt with disclosure issues, was heard by the Chair of the Hearing Panel, whose decision (November 8, 2007) was subsequently reversed by the Ontario Securities Commission (May 21, 2008). The second motion, to permanently stay the proceedings, was heard by the Hearing Panel (December 10, 2007) and dismissed (February 29, 2008). Upon application by the Respondent, the Panel's Decision was reviewed by the Ontario Securities Commission, which dismissed the application (September 23, 2009). This decision was appealed to the Divisional Court of the Ontario Superior Court of Justice, which dismissed the appeal (November 26, 2010). An attempt by the Respondent for a further appeal to the Court of Appeal for Ontario was denied by that Court (March 18, 2011). Appropriate dates then had to be found to have the case heard on the merits.

The Allegations

¶ 2 As set out in the Amended Notice of Hearing (June 12, 2007), IIROC alleges that the Respondent,

1. Between June 3, 2004 and April 18, 2005, ... solicited client orders during the distribution period for new issue securities which resulted in Scotia Capital contravening UMIR 7.7(5) (pre-May 2005

version) on 11 occasions, for which you are liable pursuant to UMIR 10.3(4);”

and

2. Between [the same dates] “you conducted trades that were not printed on a marketplace or recognized exchange which resulted in Scotia Capital contravening UMIR 6.4 on 10 occasions, for which you are liable pursuant to UMIR 10.3(4).”

Particulars

¶ 3 The “Relevant Facts and Conclusions,” as alleged in Appendix “A” of the Amended Notice of Hearing, are as follows:

Overview

¶ 4 In late spring 2005, RS [Market Regulation Services Inc.] conducted a trade desk review at Scotia Capital. The review raised questions by RS with respect to a short position held in Berry’s inventory account (the “08 account”) for the Preferred Share Trading Desk (“the Preferred Desk”).

¶ 5 Scotia Capital subsequently initiated an internal review of the 26 initial public offerings in preferred shares (“new issues”) in which Scotia Capital was involved in the period March 2003 to April 2005. Scotia Capital identified possible breaches of UMIR 6.4 by Berry and his assistant, McQuillen, in relation to these new issues. Scotia Capital reported the results of its internal investigation to RS.

¶ 6 On the basis of the Scotia Capital review, RS conducted an expanded investigation into new issues in which Scotia Capital was involved in the period April 2002 to April 2005 which resulted in the findings below.

¶ 7 In the period April 4, 2002 to April 18, 2005 (the “Relevant Period”), Berry and McQuillen engaged in a pattern of trading as described in paragraph 23 below (the “Trading”) which consisted of Berry and McQuillen:

- (i) soliciting client orders during the distribution of new issues by Scotia Capital contrary to UMIR 7.7(5) (as it existed prior to May 2005); and
- (ii) conducting off-marketplace trades that were not printed on a marketplace or recognized exchange, contrary to UMIR 6.4.

¶ 8 The Trading involved 16 new issues of preferred shares and 20 different clients.

The Preferred Desk

¶ 9 During the Relevant Period, Berry was the Head of Preferred Trading and the registrant responsible for trading Scotia Capital’s proprietary book of preferred shares.

¶ 10 Berry was employed at Scotia Capital from October 1995 until June 30, 2005. During his employment at Scotia Capital, Berry held the following positions and obtained the following securities industry registrations:

- (a) Vice-President;
- (b) Director;
- (c) Registered Representative Non-Retail (March 1996) as sales associate, preferred shares; and
- (d) Institutional Equity Research Associate.

¶ 11 Berry qualified as a Chartered Financial Analyst in 1998 and completed the Conduct and Practices Handbook examination in January 1996.

¶ 12 McQuillen was Berry’s assistant on the Preferred Desk during the Relevant Period. McQuillen was a fully licensed agency trader. McQuillen has not worked at Scotia Capital since September 22, 2005.

¶ 13 Berry was McQuillen’s immediate supervisor. McQuillen assisted Berry in all aspects of his trading activities, including speaking with clients, completing trade tickets, entering both client trades and inventory trades and assisting with the administrative responsibilities on the Preferred Desk.

¶ 14 Both Berry and McQuillen traded for the 08 account each under their own individual identification number.

¶ 15 Berry approved all trades entered by McQuillen for the 08 account. When Berry was away from the office, McQuillen entered orders and kept Berry advised of such orders while he was away or upon his return to the office.

¶ 16 McQuillen prepared the trade tickets related to the solicitations of client orders and off-marketplace trades in question. An audit trail of the Trading exists at Scotia, stemming from the tickets.

¶ 17 During the Relevant Period approximately 2,000 trade tickets were processed daily for Scotia Capital's Institutional Equity Desk, which included the Preferred Desk. The settlements area reconciled the trading within Scotia Capital on a daily basis, including the Preferred Desk. As part of its regular compliance monitoring and testing, Scotia Capital reviewed trade tickets through random sampling. Because of the random nature of ticket selection, none of the 39 tickets generated by the Trading formed part of the sampling.

¶ 18 During most of the Relevant Period, Berry's compensation generally consisted of a base salary and an incentive plan of 20% of the sum of commissions, new issues sales credits and trading profits and losses generated by him in trading for the Preferred Desk.

¶ 19 During the Relevant Period, McQuillen's compensation consisted of an annual base salary. His incentive plan did not include a percentage component and was fully discretionary.

Solicitation of Purchase Orders and Off-marketplace Trades

¶ 20 The Trading consisted of the following:

- (a) During the Relevant Period, Berry and McQuillen solicited Canadian client buy orders in the new issues on or about the dates the new issues were publicly announced. Clients agreed to pay the distribution prices for the new issues. This was prior to the date on which the securities were assigned a CUSIP number and the new issue began trading on the TSX. McQuillen completed the trade tickets and generally time-stamped them on the dates of the solicitations. These solicitations resulted in contraventions of UMIR 7.7(5) (as it existed prior to May 2005).
- (b) McQuillen kept the trade tickets at the Preferred Desk until the first day of trading for the shares (the next business day after the new issues were listed).
- (c) On the first day of trading, Berry and McQuillen conducted off-marketplace trades in the newly listed shares by selling them short from the 08 account to clients at the distribution price. The trades were not printed on a marketplace or organized regulated market. McQuillen time-stamped the trade tickets again or in some cases, for the first time. In some cases, McQuillen made a handwritten notation on the ticket instead of using a time stamp, indicating a trade on the first day of trading for the newly listed shares.
- (d) McQuillen then sent the trade tickets to the trade processing area.
- (e) Berry and McQuillen subsequently covered the short positions in the newly listed shares created in the 08 account by buying shares in the marketplace, either on the first day of trading for the newly listed shares or at a later date or dates.
- (f) This conduct resulted in Scotia Capital failing to conduct 15 trades by way of entry of an order on a marketplace as required by UMIR 6.4 or pursuant to any exception or exemption in respect thereof.
- (g) The client confirmation notices for the 15 off-marketplace trades stated that the trades were conducted on the first date the securities began trading, with the majority of them noting that Scotia Capital acted as principal, although the trades were not printed.

¶ 21 In some cases during the Relevant Period, Berry solicited buy orders in the new issues for more shares than were ultimately received by the 08 account from the Syndication Desk. In other cases, Berry solicited

client buy orders in the new issue shares when no allocation was ultimately received in the 08 account from the Syndication Desk.

¶ 22 Twenty-four of the client orders which Berry and McQuillen solicited during the distribution period resulted in trades before the security was listed, and were therefore traded in the “grey market”.

¶ 23 During the Relevant Period there were instances in which Berry and/or McQuillen forwarded clients’ tickets for a new issue to the Syndication Desk and, as a result, these clients received new issues shares from Syndication according to standard distribution practices.

¶ 24 Schedule “A” provides further particulars of the violations of UMIR 7.7(5) and 6.4.

Effect of the Trading Strategy on Scotia Capital’s Clients and Market Integrity

¶ 25 In the 15 instances of off-marketplace trades, the syndication process was bypassed and, as a consequence, clients purchased newly listed shares from the secondary market through the 08 account. Because clients did not receive new issue shares from the primary market through the Syndication Desk, pursuant to a prospectus, they were deprived of all the inherent rights afforded to such purchasers.

¶ 26 Some clients were aware that they would be receiving shares in the new issue at the distribution price from a transaction with the 08 account which might result in a profit to the 08 account. Some were not.

¶ 27 The majority of the new issue shares involved in the Trading traded in the secondary market at prices lower than the distribution price paid by the clients and never reached the distribution price before any short positions in the 08 account were subsequently covered. Accordingly, the 08 account profited from its short positions in these shares.

¶ 28 By filling client orders by means of the Trading, Berry was not restricted to the allocation formula or guidelines used by Scotia Capital in the normal syndication process. This increased Berry’s opportunity for profit and generated goodwill from clients.

¶ 29 The overall profit to the 08 account from shorting the shares was \$713,959. Berry received 20% of the profit or \$142,792. Scotia Capital’s profit was therefore \$571,167.

¶ 30 The off-marketplace trades precluded other market participants from seeing those trades printed on a marketplace or organized regulated market and resulted in a lack of transparency to other market participants. Transparency is a cornerstone of the maintenance of market integrity.

¶ 31 Market participants had no knowledge of Berry and McQuillen selling shares in the new issue to clients once the shares opened for trading. They only saw Berry and McQuillen buying the shares, which is consistent with an accumulation strategy. This had the potential to mislead other market participants as to the true nature of the demand for the stock, and affect their subsequent investment decisions.

The Respondent’s Reply

¶ 32 In his Amended Reply (March 14, 2007), the Respondent admits “as substantively correct” the allegations contained in paragraphs 12 to 22, excluding, however, the first sentence of paragraph 18, the last sentence of paragraph 20 and paragraph 21. He further admits that he was involved in the trades and solicitations described in Schedule “A to the Allegations – a 23-page very detailed document which includes excerpts from telephone conversations he had with some of his clients – although he “does not admit that they are accurately characterized.”

¶ 33 In essence, as stated in the Amended Reply, the Respondent submits that his trades were exempt from UMIR 6.4 by virtue of UMIR 6.4(a) and 6.4(h), that the trades occurred prior to the listing of the securities, that the trades were in new issue shares pursuant to a prospectus or were distributions of previously unissued securities by an issuer, and that, furthermore, UMIR 7.7(5) “does not apply to the solicitation of purchase orders for shares of a new issue of shares that do not already trade on an exchange.”

The Rules

¶ 34 The relevant Rules provide as follows:

7.7 Restrictions on Trading by a Participant Involved in a Distribution

.....

(5) Prohibited Trading

Except as provided in this section, a Participant, while involved in a distribution, shall not bid for nor purchase the distributed security (or a convertible or underlying security) for its own account, nor solicit purchase orders from clients for a distributed security (or a convertible or underlying security).

6.4 Trades to be on a Marketplace

A Participant acting as principal or agent may not trade or participate in a trade in a security by means other than the entry or an order on a marketplace unless the trade is:

(a) **Unlisted or Non-Quoted Security** – in a security which is not a listed security or a quoted security;

.....

(h) **Prospectus and Exempt Distributions** – pursuant to a prospectus, take-over bid, issuer bid, amalgamation, arrangement or similar transaction including any distribution of previously unissued securities by an issuer.

10.3 Extension of Responsibility

.....

(4) Any officer or employee of a Participant or Access Person or any individual holding a similar position with a Participant or Access Person who engages in conduct that results in the Participant or Access Person contravening a Requirement may be found liable by the Market Regulator for the conduct and be subjected to any penalty or remedy as if such person was the Participant or Access Person.

The Burden of Proof

¶ 35 It is well-established that the burden of proof lies with IIROC, and that in order to succeed it must prove its case on a balance of probabilities. This, as Rothstein J. said in *F.H. v. McDougall*, [2008] S.C.R. 41, means that the evidence “must always be sufficiently clear, convincing and cogent.”

Admissions by Third Parties

¶ 36 As alleged in the Amended Notice of Hearing, the Respondent’s actions resulted in Scotia Capital (his employer) contravening UMIR 7.7(5) and UMIR 6.4. Scotia Capital admitted liability, and a Settlement Agreement was approved by an RS Panel on February 26, 2007. Marc McQuillen, who had been assigned by Scotia Capital to assist the Respondent – more of that later – also entered into a Settlement Agreement with RS, which was approved by an RS Panel on February 28, 2007.¹

¶ 37 We draw attention to this because an important distinction must be made between the use of third-party settlement documents and decisions in the pre-hearing stages and the hearing itself. In the former, as the OSC noted, while, perhaps, “not clearly relevant, at the very least ... they are not ‘plainly irrelevant’.” However, at the present stage, the fact that both Scotia Capital and McQuillen acknowledged breaches of UMIR 7.7(5) and 6.4 does not in any way affect the Respondent: he is entitled to the presumption of innocence and, in order to succeed, IIROC must prove its case to the required degree. (See, for instance, *R. v. Whalley*, [2010] B.C.J. No. 727, which held that, “as a general rule, the guilty plea of a co-accused is not admissible against an accused where it would affect the issue of guilt or innocence.”)

¹ Details may be found in a decision by the Ontario Securities Commission which ordered the disclosure of certain settlement documents: *Berry* (2008), 31 OSCB 5441.

Discussion

¶ 38 Berry was a highly successful trader of preferred shares. By the time of his termination in 2005, he commanded more than 60% of the preferred share market in Canada. His income had soared to \$15 million a year. In fact, he was so successful that his supervisors asked Compliance to be particularly vigilant, and presumably they were.

¶ 39 What made him so successful? His counsel suggests that, in part, it was “because he was willing to take more risks than his competitors, including by taking short positions.” The evidence supports this view. Indeed, there were recurring arguments about this between him and the syndication desk. Berry would want to short some new issue and Syndication, perhaps being more risk-averse, didn’t. So he did it by himself in the 08 account.

¶ 40 A pattern was established, and the “Further Particulars” set out in Schedule “A” of the Amended Notice of Hearing demonstrate this. For instance, in what is described as “Solicitations 1 and 2”, a press release was issued on April 4, 2005, announcing the George Weston III issue of preferred shares (WN.PR.C), priced at \$25 per share. On the same day, Berry and McQuillen solicited an order for 30,000 shares, and a buy ticket was time-stamped by McQuillen at 10:04:19. That day or the next, Berry and McQuillen solicited an order for 12,000 shares from another client, and a buy ticket for this trade was time-stamped by McQuillen at 10:47:25 on April 5.

¶ 41 The final prospectus for this issue – like all the others, a ‘bought deal’ – was issued on April 11, and the shares were listed at 5:01 p.m. on April 15, with trading to start on April 18, which was the trade date written on each ticket. Also on that date, Berry’s 08 account received an allocation of 21,300 shares from Syndication. The trades between the 08 account and the two clients did not appear on TSX trading data.

¶ 42 The 08 account did not trade on April 18. Since the two sales were for 42,000 shares, the account was short 20,700 shares, and this was covered by July 6, 2005. It was one of Berry’s less successful moves: 08 lost \$4,690. Other short positions, however, did considerably better.

¶ 43 The particulars set out above indicate solicitations by Berry and MacQuillen, with tickets time-stamped by MacQuillen. The evidence shows that Berry, by his own admission, was a poor ticket writer, so MacQuillen was hired to relieve him of that task. In time, they became a team, and while tickets continued to be made out by MacQuillen, he also did some trades and substituted for Berry on days when the latter was away. The evidence also shows, however, that even though MacQuillen was originally hired to do Berry’s ticketing (for which he had received some training), he was somewhat erratic at times and didn’t always enter appropriate trade dates.

¶ 44 This raises the question of when a trade occurs. The Ontario *Securities Act*, R.S.O. 1990, c. S.5, to which, by implication, UMIR refers in Rule 1.2(2), defines “trade”, *inter alia*, as “any sale or disposition of a security for valuable consideration” and, furthermore, as “any act, advertisement, solicitation conduct or negotiation directly or indirectly in furtherance of the foregoing.” The broad reach of this definition was emphasized by the Ontario Securities Commission in *Re First Federal Capital (Canada) Corp.*, (2004) 27 OSCB 1603, which held (in para. 50) that

... we believe the intention of the Act is that any act in furtherance of a trade becomes a trade within the extended meaning at the time the act occurs. We have no difficulty in concluding that the precedents were correct in treating an act in furtherance of a trade as a trade regardless of whether the anticipated trade actually occurred.

¶ 45 The evidence shows that Berry obtained commitments from his clients, generally on the day of the press release, to buy a defined number of shares at the listed price. Some sales went through Syndication, others through the 08 account. No commission was charged, an indication that this was a new issue. Some clients knew (or ought to have known from their conversations with Berry) that their shares did not come from Syndication but rather from “our stock” or “from us” and that “nobody’ll see that, like that’ll just be uh, that

won't go on the book.”²

¶ 46 Berry explained that this was of particular importance to some institutional clients who “really wanted to keep their dealings private.”³ This, of course, could not be achieved if the trade went through Syndication.

¶ 47 The point, however, is that, regardless from which account clients were getting their shares, in our view, as pointed out above, the “trade” was done on the day on which the expression of interest was made, and it didn't matter what date was given on the ticket. This is not to say, of course, that accurate ticketing is of a minor concern, but we are not dealing here with violations of the Universal Market Integrity Rules or with breaches of ticketing rules and regulations.

¶ 48 IIROC is correct that most trade confirmations did not show the usual new issue trailer “if, as and when issued.” But the absence of the trailer or the failure of the clients to receive a prospectus did not invalidate the clients' right of withdrawal and/or the right of rescission, since everyone concerned understood that they were trading a new issue.

¶ 49 New issue shares can be shorted. This does not constitute, as enforcement counsel submitted, “creating shares out of the ether.” Underwriters are generally allowed to over-allot new issue shares to satisfy demand, and that is accomplished by shorting the security: see, for instance, IDA Syndicate Practices Handbook, p. 10, which provides that in preferred and equity financing

... the syndicate manager is authorized, in its discretion, and in compliance with applicable laws and regulations, to purchase and sell securities of the issuer in the open market, *for long or short account*, at such prices as the syndicate manager may determine, and to over-allot underwritten securities, and may liquidate any such position.

(Emphasis added.)

The only caveat to this provision is that “at any time such positions do not exceed 15% of the underwriting obligation.

¶ 50 The rule cited above clearly states that this type of over-allotment may be done by the “syndicate manager.” This excludes Berry, but he is not charged with violating Syndicate policies, which he may well have, but on which we pass no judgment. We note, however, that prior to his dismissal, his employer had no written syndication process policies or procedures.

¶ 51 IIROC recognizes that shares could be sold short, but only when there is demand. In our view, Berry's sales to clients constituted demand. Berry represented to his clients the availability of a new issue and clients understood that they were buying a new issue. He therefore, on behalf of his firm, made a commitment to deliver new issue shares, and what he sold, long or short, were new issue shares. That he “ran his own parallel new issue book,” as enforcement counsel suggests, we do not disagree with but, once again, he is not charged with violating syndication procedures.

¶ 52 Finally, IIROC submits that clients did not know that they were purchasing against shorts. True, but clients never know that they are buying from a short seller, and there is no requirement to disclose this to a purchaser.

¶ 53 Much time was spent at the hearing exploring the atmosphere which existed at Scotia Capital towards the end of Berry's employment there. It is clear that serious issues, mostly relating to his compensation, had arisen. There are also strong differences of opinion whether his immediate superiors knew of his tactics. The preponderance of evidence suggests that they did, although this is strongly denied by James Mountain, the Head of Institutional Equity. However, whatever the situation may have been, it does not affect the outcome of this case. It is our view that the Respondent traded in a new, unlisted security and he did not, therefore, cause Scotia Capital to contravene UMIR 6.4.

² The quotations are taken from transcripts of telephone conversations which were routinely taped.

³ Transcript of Evidence, October 3, 2012, p. 894.

¶ 54 Nor do we believe that he Respondent caused his employer to contravene UMIR 7.7(5).

¶ 55 As noted above, he solicited orders and obtained ‘expressions of interest’ from his clients. That is what he was engaged to do: see, for instance, the evidence of Mr. Mountain, Scotia Capital’s Head of Institutional Equities at the relevant time:

Mr. Berry’s role in distributing new issue securities was very simple. He was to call clients and solicit communications of interest. If he received an indication of interest from a client, he was to reflect that to the syndication department, which was the sole book runner. And this is in those instances when Scotia was the book runner. And when Scotia was the book runner, Mr. Berry would have the responsibility of soliciting all of the institutional clients across the country for indications of interest. If he got an order, or an indication of interest, as it was technically called, it was clearly to be reflected to syndication.⁴

¶ 56 But, as enforcement counsel pointed out in his opening statement, Berry sometimes “engaged in trading for his institutional clients that bypassed the syndication process.” We agree – and have already said so – that in so doing Berry ran a parallel book, an undertaking that may have been in contravention of syndication rules and practices. But, we repeat, that is not what he is charged with, and it would, therefore, be inappropriate to make any further comment on this aspect.

¶ 57 UMIR Rule 7.7(5) does not cover this behaviour. It refers to the solicitation of purchase orders for a distributed security. What Berry did, when using the 08 account, was identical with what he did when following the syndication rules: he solicited expressions of interest (tantamount to an order). Only here, some of the shares came from stock already in the account, while others were obtained later when the short position was covered. Clients did not suffer: the price they paid was the price fixed by the syndicate and no commission was charged.

¶ 58 John Carson, an acknowledged expert in the operation and regulation of the capital markets in Canada, testified on behalf of the Respondent. His evidence traced the development of Rule 7.7(5), which had its origin in the 1992 version of section 11.11 of the general by-laws of the Toronto Stock Exchange, entitled “Restrictions on Trading by Members Involved in a Distribution.” Its purpose was, in Mr. Carson’s words, “to prevent the price of a stock that was trading on the stock market at the time from being manipulated if the company – the issuer of the security – decided to do an additional issue of the same security.”⁵ This point of view reflected the advice given in the Exchange’s Notice to Members⁶ which, in D(3), under the heading “What is not Restricted,” lists, *inter alia*, “Transactions in unlisted securities.” In Mr. Carson’s view, this, too, is the purpose of Rule 7.7(5).

¶ 59 The following exchange is relevant to the discussion:

Q. And based on your marketing experience, Mr. Carson, are solicitations of client purchases of new issue shares at the new issue price prior to the commencement of trading on an exchange capable of influencing the price of shares trading on the exchange?

A. Well, let’s clarify whether in this example there’s a current issue on the exchange. Shares – the same shares are already trading on the exchange, I mean. I think that in the instant that we’re speaking of, there are no shares trading on the exchange which are the same as the issue in distribution.

Q. And that’s because you understand that in respect of the allegations at issue here, they’re all preferred share new issues; is that correct?

A. Correct.

⁴ Transcript of Evidence, October 4, 2012, p.1065.

⁵ Transcript of Evidence, October 1, 2012, p. 770.

⁶ Notice to Members No. 91, August 30, 1991, Exhibit 15.

Q. And ---

A. So if you solicit orders in a new issue of securities and there are – none of those shares are already trading on the stock exchange, then you would not be capable of influencing the price of a traded security, obviously. And secondly, you wouldn't be capable of influencing the price of the new issue because, of course, that issue is a fixed price offering.⁷

¶ 60 We agree with this view. We also agree that Rule 7.7(5), as it existed at the time, can, without doing violence to the wording, be interpreted in a manner consistent with the evil designed to be cured by its predecessor, that is to say manipulation of the price of existing shares.

¶ 61 In the result, it is our view that IIROC has failed to make out its case against the Respondent, and the charges are, therefore, dismissed.

¶ 62 We would like to thank all counsel for the clear and efficient manner in which they dealt with the complexities of this case, which was of great assistance to the panel.

Dated: January 14, 2013

Hon. Fred Kaufman, Chair

Mr. Ted Norris, Industry Representative

Mr. Guenther Kleberg, Industry Representative

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⁷ Transcript of Evidence, October 1, 2012, p. 778.