

# Re Zosiak & Brighten

IN THE MATTER OF:

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

**and**

**The By-Laws of the Investment Dealers Association of Canada (IDA)**

**and**

**Carol Ann Zosiak & John Frederick Brighten**

2012 IIROC 59

Investment Industry Regulatory Organization of Canada  
Hearing Panel (Pacific District Council)

Hearing: June 4 – 8, 12 - 13, 2012

Decision: October 26, 2012

**Hearing Panel:**

Leon Getz, Q.C. (Chair), Barbara Fraser and Brian Field

**Appearances:**

Barbara Lohmann for the Investment Industry Regulatory Organization of Canada

Owais Ahmed for Carol Zosiak

Patrick F. Lewis for John Brighten

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## REASONS FOR DECISION

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### A. Introduction

¶ 1 We have been constituted as a hearing panel pursuant to IIROC Dealer Member Rule 20 to consider allegations against Ms. Zosiak and Mr. Brighten. They are set out in a Notice of Hearing dated September 8, 2011.

¶ 2 The allegations against Ms. Zosiak are first, that while employed at Global Securities Corporation (“Global”) she “failed to determine the beneficial owner of two new corporate accounts, contrary to IDA Regulation 1300.1 (a); and second, that between October 2005 and June 2006 (the “Relevant Period”) she failed to perform her role as a gatekeeper to the capital markets and acted contrary to IDA By-law 29.1 and Regulation 1300.1 (a) by facilitating transactions without making diligent inquiries to ensure the legitimacy of the transactions in two client accounts in circumstances which called for such inquiries, thereby facilitating a securities fraud.

¶ 3 The allegation against Mr. Brighten is that during the Relevant Period, while he was the Chief Compliance Officer of Global, he failed to adequately supervise Ms. Zosiak with respect to the opening of and trading in two client accounts to ensure that the true beneficial owners were determined and to ensure that diligent inquiries were made in circumstances which called for such inquiries to be made, contrary to IDA By-laws 29.27 and 38, Regulation 1300.2(a) and Policy 2.

¶ 4 The circumstances that have given rise to these allegations are set out in some detail in the particulars attached to the Notice of Hearing.

¶ 5 For the reasons that we shall set out, we have come to the conclusion that Count 1 fails against each of Ms. Zosiak and Mr. Brighten; that Count 2 against Ms. Zosiak fails; and that Count 3 against Mr. Brighten also fails.

## **B. BACKGROUND: THE CONVICTION OF DAVID HAGEN IN NORTH CAROLINA**

¶ 6 While we have no direct evidence on this, we surmise that the IIROC investigation that resulted in the issuance of the Notice of Hearing originates in the verdict of a North Carolina jury on May 19, 2009 finding David Hagen, a United States resident, guilty of conspiracy to commit securities fraud, conspiracy to commit mail/wire fraud, and conspiracy to commit money laundering. The convictions arose out of his role in a so-called "pump-and-dump" securities fraud scheme, in which he and his co-conspirators acquired control of a company known as GTX Global ("GTX"), made successful efforts to artificially increase its stock price, and then sold the stock at a higher price, bringing in proceeds of approximately \$27 million. Mr. Hagen was sentenced to 45 years in prison.

¶ 7 According to the December 2008 indictment against Mr. Hagen, the alleged "pump and dump" scheme involved a dizzying array of individual conspirators, some unindicted, and, one way or another, corporate entities directly or indirectly organized by them; and was effected through a variety of financial institutions organized, incorporated or headquartered in such diverse jurisdictions as the United States, Anguilla, Bahamas, the Seychelles, the Netherlands Antilles, Cyprus and Panama; and a passel of broker-dealers principally in the United States but also some, including Global, in Canada.

¶ 8 Among the many corporate entities mentioned in the indictment are three Bahamian companies, Montaque Securities International ("Montaque"), Laureate's Way Inc. ("Laureate") and Walcott Indies, Ltd. ("Walcott").<sup>1</sup> It is alleged in the indictment that these companies were controlled by, among others, Mr. Hagen and were among the vehicles used by him and his co-conspirators to effect sales of the shares of GTX as part of the pump and dump operation. Each of these companies had an account at Global and was active in trading shares of GTX through those accounts. Ms. Zosiak was the investment advisor assigned to them. We hasten to add that none of Ms. Zosiak, Mr. Brighten and Mr. Garrod is mentioned in the indictment; and there is nothing in it to suggest that any of them, Global itself or any of Montaque, Laureate or Walcott was a knowing participant in the conspiracy.

¶ 9 We should point out at the outset that there is nothing in the evidence before us to show that, as alleged in the indictment, Mr. Hagen controlled any of Montaque, Laureate or Walcott and we do not think it is a necessary or even a proper inference that he did so from the fact that he was ultimately convicted of the offences with which he was charged.

## **C. THE EVIDENCE AND THE WITNESSES**

¶ 10 The hearing before us focused on what we have described as the Relevant Period. Much of the evidence was documentary but we heard the oral testimony of Ms. Zosiak and Mr. Brighten and also of Mr. Douglas Garrod, the President and Chief Executive Officer of Global. In our opinion each of these witnesses was demonstrably straightforward and honest and each of them testified carefully and responsively about their recollections of the matters that occurred. If there were frailties in those recollections we attribute this not to any attempt on their part to prevaricate or dissemble, but rather to the fact that the hearing took place some seven years after the events in question. Mr. Michael Smith, who was IIROC's principal investigator of the matters under consideration, also testified. He too was straightforward, careful and fair-minded. No issue of credibility has been raised about any of the witnesses nor, in our view, could it be.

## **D. ALLEGED BREACHES IN CONNECTION WITH THE OPENING OF THE LAUREATE AND WALCOTT ACCOUNTS – FAILURE TO DETERMINE BENEFICIAL OWNERSHIP**

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<sup>1</sup> According to the indictment there were (are?) two companies bearing the name "Walcott Indies Ltd.", one incorporated in the Bahamas and the other in Anguilla. It is only the former that is relevant to these proceedings.

¶ 11 The nub of the first of the complaints against Ms. Zosiak is that she failed to make appropriate enquiries with a view to ascertaining the beneficial owners of Laureate and Walcott on the opening of their accounts – specifically, that she failed to identify inconsistencies in the information provided in this connection and to investigate them; and against Mr. Brighten that he failed in his duty to supervise Ms. Zosiak in this connection.

**(a) Background – Montaque, its account and its principals**

¶ 12 As we have noted, the indictment of Mr. Hagen alleged that Montaque was one of the vehicles used by him for his manipulative activities. The knowledge of Ms. Zosiak and Mr. Brighten about Montaque and its principals when the Laureate and Walcott accounts were opened is important context for what happened in connection with that activity.

¶ 13 Montaque apparently became a client of Global around 2000. So far as the evidence goes no question ever arose concerning it or its trading activities. In 2005, however, the investment advisor at Global responsible for Montaque’s account left the firm and in March of that year responsibility for the account was transferred to Ms. Zosiak. This apparently came about because she had been working on the trading desk at Global and generally began work very early in the morning. She frequently fielded telephone calls from clients of other brokers at the firm. Among these were Edison Sumner and, to a lesser extent, Owen Bethel, whom she understood to be the principals of Montaque. We understand that it was at the suggestion or request of Mr. Sumner that she took over the Montaque account when her predecessor left Global.

¶ 14 In accordance with normal practice in the circumstances, Ms. Zosiak had to obtain a completed New Client Application Form (“NCAF”) and to make such other enquiries as would enable her to satisfy her “know-your-client” obligations.

¶ 15 The Montaque NCAF disclosed that Montaque was based in Nassau, Bahamas, maintained a bank account, number 1758149 at the main branch of Barclay’s Bank in Nassau and was an “investment manager” with an estimated net worth of \$525,000 and an approximate annual income from all sources exceeding \$750,000. Other documents filed with the NCAF revealed that Montaque had two directors, Owen Bethel and Edison Sumner, both of whom were described as “financial advisors”, that Mr. Bethel was Montaque’s president and the only person who had a greater than 10% beneficial interest in the company, and that the company was registered with the Securities Commission of the Bahamas as an “Exempted Investment Fund Administrator”. Mr. Sumner was disclosed to be Montaque’s “Chief Operations Officer/Assistant Secretary.” Ms. Zosiak testified that it was her impression that Bethel and Sumner were partners in Montaque’s business and that Sumner held a small minority interest in the company. The NCAF contained a representation that the account with Global was not a “nominee account” and that nobody other than the account holder had any financial interest in it.

¶ 16 Additional material collected, apparently by Ms. Zosiak in March 2005, indicated that Mr. Bethel had worked at the World Bank and the International Monetary Fund, played an instrumental role in the formation of the Bahamas stock exchange and had an extensive history in the field of financial and securities regulation in that jurisdiction. The material suggested that he was prominent in community activities in the Bahamas and well-connected.

¶ 17 Montaque’s “new” account with Ms. Zosiak as its investment advisor was in due course approved and opened without incident or question in March 2005. IIROC has not raised any allegations about this.

**(b) Global’s account opening procedures**

¶ 18 Before discussing what happened in connection with the opening of the Laureate and Walcott accounts, we should briefly describe the account opening procedures for new corporate accounts prescribed in Global’s Policy and Procedures Manual (the “Manual”), a copy of which is in evidence.

¶ 19 The Manual prescribes a list of documents required by Global in connection with the opening of new corporate accounts. For present purposes, that list includes the NCAF and, among other things, a copy of the proposed client’s corporate documentation, including its Certificate of Incorporation, a document entitled “Certificate of Incumbency” and another entitled “New Account Beneficial Ownership Notice” or “NABON”.

It is to be noted that the Certificate of Incumbency certifies, among other things, that “the following are the Beneficial Shareholders of the Company” and the NABON declares that “the following natural person(s) is or are the only person(s) who beneficially own or owns, directly or indirectly, more than 10% of the Company”.

¶ 20 The Manual assigns to the investment advisor responsible for the new account the job of ensuring that the required documents are obtained from the client. It also requires that all mail, even if specifically addressed to a particular investment advisor, and whether personal or “official”, is received in Global’s back office, opened there and re-directed, if appropriate, to the relevant investment advisor or department. In the case of the NCAF, since it requires the advisor’s signature, it is forwarded to him or her for that purpose and, once checked and signed, is returned to Global’s New Accounts Department. Other required documents such as the Certificate of Incumbency and the NABON are retained by that Department and the advisor is either provided with a copy or advised by email as and when they are received.<sup>2</sup>

¶ 21 The manager of documentation in that department at the relevant time was Mr. Ronald Ng who did not give evidence. Mr. Ng reported to Mr. Garrod, Global’s President although as we understood the evidence his daily interactions tended to be with Mr. Brighten.

¶ 22 Mr. Ng’s responsibilities included, as we understand it, ensuring that all documents required in connection with the account opening had been received and were in the proper form before the package was submitted to the person responsible for approving new account openings. In this case that person was Mr. Brighten. Mr. Ng maintained a checklist of what had been provided to him and what was missing or was not in the required form together with any notes that he considered relevant and, as we understood it, would provide a copy of that checklist to Mr. Brighten and use it to keep the advisor informed, generally by email, of what had not been received or although received was not in the prescribed form.

¶ 23 It was not, apparently, a precondition of Mr. Brighten’s approval to open a new account that all of the prescribed documents had been received. The Manual contemplates that an account might be opened without all of the required documents provided that they were received within 25 business days of the opening and subject to the condition that no trading could be effected through the account without specific advance approval. Mr. Ng. would sometimes make notes on the checklist sent to Mr. Brighten advising what he thought might or should be done as a condition of approving the account opening.

*(c) The opening of the Laureate and Walcott accounts*

¶ 24 Around the beginning of October 2005 Mr. Sumner told Ms. Zosiak in a telephone conversation that he and Mr. Bethel wished to open two new corporate accounts, one as a vehicle for his and the other for Mr. Bethel’s personal trading activities. They wished to keep their personal trading activities separate from those of Montaque, which traded on behalf of other clients as an investment manager, in much the same way as Global did. Ms. Zosiak believed or was told that a reason for opening the two accounts at Global was to take advantage of lower commission rates than those charged in the United States. The two new corporate clients were Laureate and Walcott.

¶ 25 Mr. Sumner also told Ms. Zosiak that he and Mr. Bethel were friends of the President of GTX and had participated in private placements of that company’s shares. He explained that it was their intention to deposit those shares into the two accounts for the purposes of sale.

¶ 26 Ms. Zosiak accordingly sent off the NCAFs for completion and, in due course, they were returned to her. Both were dated October 7, 2005. Although the forms seem to have been completed by the same person, Ms. Zosiak did not recognize the handwriting. Each of them seems to have been signed by Mr. Sumner. Both NCAFs disclosed:

- (a) the same business address, telephone number and email address also shared with Montaque;

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<sup>2</sup> Section 3.10.1 of the Manual says that the IA must review and keep copies of the NCAF and the related account-opening documents so as to be satisfied as to the accuracy of the information contained in them. Ms. Zosiak does not appear to have complied with this requirement but nothing in these proceedings seems to turn on that failure.

- (b) identical reasonably significant estimated net liquid assets, net worth and income;
- (c) identical investment objectives (50% short term trading and 50% speculative investments); and
- (d) that the account was not a “nominee account”; and that no-one other than the holder of the account had any financial interest in it.

¶ 27 Each of the NCAFs also disclosed the identical banking information, though it seems that this information may have been inserted, or modified, by Ms. Zosiak after talking to Mr. Sumner (she does not seem to have spoken to Mr. Bethel about the NCAFs), because of some ambiguity or uncertainty about the details. At all events, in their final form as submitted to Mr. Ng, each of them contained the identical banking information - a bank account at Barclay’s Bank in Nassau having an account number identical with the other and with Montaque. The bank account in question seems to have been that of Montaque.

¶ 28 Ms. Zosiak signed each of the NCAFs on October 19, 2005 and forwarded them to Mr. Ng. While the documentation was not at this point complete for either account Mr. Ng seems to have been sufficiently comfortable that the same day he forwarded a package for each to Mr. Brighten to obtain his approval for the opening of the accounts, together in each case with a copy of his checklist. Each of the checklists indicated that among the missing documents was a Certificate of Incumbency. While copies of the applicable Certificates of Incorporation seem to have been included, in both cases they were not notarised as required. Both showed an incorporation date of September 26, 2005. As a precaution, given the state of the documentation, Mr. Ng noted on each of the check lists: “Assign Acct #s to deposit shares first. Turn trading off until all docs received. IA has assured that all documents are in Fedex from Bahamas”. He added: “Please return file to me once open for tracking”. As we understood the evidence, Mr. Ng’s use of the word “tracking” referred to tracking the receipt of the required account opening documents.

¶ 29 The next day Mr. Brighten approved the opening of both accounts subject to the condition, noted on the NCAF, that there should be “no trading until docs complete”.

¶ 30 By October 19 Mr. Ng had received the NABON for Laureate. It is dated October 7, 2005 and identifies Owen Bethel, who signed it as “Authorized Agent”, as the only person with a greater than 10% beneficial interest in that company. He had also received the NABON for Walcott. It, too, is dated October 7, 2005 and identifies Edison Sumner, who signed it as President, as the only person with a greater than 10% beneficial interest in that company.

¶ 31 As we understand it, the restrictions that Mr. Ng. had imposed on the two new accounts (above, paragraph 28) were somehow removed on the client accounting and trading system on November 1, 2005, possibly by another employee in the compliance department, and both accounts then became available for trading. Mr. Brighten was not aware that this had happened and Ms. Zosiak apparently did not know that the restriction had been imposed.

¶ 32 At this point, however, the Certificates of Incumbency for Laureate and Walcott had not been received. They did not arrive until around the end of November or early in December 2005. Each of them is dated November 15, 2005. Both are signed by Mr. Sumner as President and a Constant Godet, who is identified as Laureate’s Secretary. The two companies are certified to have the same sole director, Lucaya Management Nominees Ltd., which is also certified to be the only beneficial owner of the shares of each company. Both appear to have been sent under cover of letters dated November 28, 2005 with identical content and signed on behalf of Mr. Sumner. Both letters were addressed to Ms. Zosiak but, in accordance with the mail handling arrangements described above, were handled through Global’s back office and forwarded to Mr. Ng, who notified Ms. Zosiak by email on December 5, 2005 that they had been received. There is no evidence to suggest that Mr. Ng noticed the disparity between the information about the beneficial ownership of the companies’ shares between the NABONs and the Certificates of Incumbency. In any event, he made no comment on it.

¶ 33 Ms. Zosiak testified that she did not at the time receive copies of either of the Certificates of

Incumbency or the covering letters of November 28, 2005,<sup>3</sup> that she did not ask Mr. Ng for copies of any of these documents and that the first time she saw them was at her interview by Mr. Smith, IIROC's investigator, in December 2009. On July 6, 2006, as a result of an IDA audit inquiry, she emailed Sumner asking for confirmation that he and Bethel were the beneficial owners of Laureates and Walcott respectively. An email response from Sumner on the same day confirmed this ownership.

¶ 34 Mr. Brighten's evidence was that when he approved the opening of an account on the basis of documentation provided to him for this purpose that was incomplete, he would not generally expect Mr. Ng to advise him of the subsequent receipt of the documents formerly missing or provide him with those documents for his review. It was Mr. Ng's responsibility to track the receipt of the necessary documents and Mr. Brighten did not consider it part of his responsibilities to ensure that the outstanding documents were in fact received. Consistent with this Mr. Brighten was not advised of the receipt of the Laureate and Walcott Certificates of Incumbency, was not provided with copies of them, did not ask Mr. Ng for them or review them and so was unaware of the fact that the information in them differed from that which he had earlier seen in the NABONs. As in the case of Ms. Zosiak, he did not see the Certificates of Incumbency until shown them at his interview by Mr. Smith in May 2010. Mr. Brighten testified that this was also the first time he heard of Lucaya Management Nominees Ltd.

¶ 35 In May 2010, the issue of the inconsistency in the beneficial ownership information surfaced at Mr. Garrod's interview by Mr. Smith and so, following the interview, he emailed Mr. Bethel, with a copy to Mr. Sumner, setting out the disconnect and suggesting, in his words as an "educated guess", that "these two documents were not reviewed, but simply filed in Global's Walcott file by a junior clerk". Attached to Mr. Garrod's email was a document, apparently found in Global's Montaque file, headed "Lucaya Management Nominees Ltd." according to which Montaque owned 10 of the 11 outstanding shares of Lucaya and Mr. Bethel held one share. Mr. Garrod noted that "since you personally beneficially owned Montaque<sup>4</sup>, and were the beneficial owner of the one Lucaya share, that would make you (in the absence of information to the contrary), the beneficial owner of Lucaya in July 2007". He accordingly asked Mr. Bethel to clarify the beneficial ownership of Walcott when its account was opened in November 2005, and to explain the conflict between the NABON and the Certificate of Incumbency.

¶ 36 Mr. Bethel responded in June 2010. As to the first question, he explained that the shares had been transferred by him to Lucaya in September 2005; as to the second question, he attributed the inconsistency to a failure to vet the documents carefully in Nassau before they were sent to Global.

**(d) *The allegation in Count 1 in the Notice of Hearing that in October 2005 Ms. Zosiak "failed to determine the beneficial owner" of the Laureate and Walcott accounts contrary to IDA Regulation 1300.1 (a).***

¶ 37 The first count against Ms. Zosiak set out in the Notice of Hearing is on its face quite precise. It has three essential elements: (i) that Ms. Zosiak failed to determine the beneficial owner of the Laureate and Walcott accounts (ii) that this failure occurred in October 2005; and (iii) that this failure was a breach of IDA Regulation 1300.1 (a). IIROC must establish each of these elements on the balance of probabilities. If it fails on any of them, the allegation against Ms. Zosiak must be dismissed.

¶ 38 In our view there is simply no evidence of any failure on the part of Ms. Zosiak in October 2005 to ascertain the beneficial ownership of Laureate and Walcott. On the contrary, she seems to have done exactly what was expected of her in connection with the opening of the accounts at that time. The evidence indicates that the documents required for the opening of the two accounts that she obtained and forwarded to Mr. Ng included the two NABONs. These disclosed that in the case of Laureate, as at October 7, 2005 Mr. Bethel was

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<sup>3</sup> A brief email dated December 13, 2005 to a Tamika Saunders at Montaque from Ms. Zosiak, "re cert. of incumbency" says that the latter "got the orig. for laureate and Walcott". This appears to be at odds with Ms. Zosiak's oral evidence. Given the mail handling practices that we have described above, however, we think it more probable than not that Ms. Zosiak simply mis-spoke in her email.

<sup>4</sup> This information was revealed in Montaque's NABON of March 2005.

“the only person who beneficially owned, directly or indirectly, more than 10% of the company”; and in the case of Walcott, Mr. Sumner was that person on that date.

¶ 39 Global’s Manual says:

All NCAFs for new accounts, updates and internal account reassignments must be signed and dated by the responsible IA. This signifies that the IA has reviewed the information contained in the NCAF, and in the related account opening documents, and is satisfied as to the accuracy of the information.

¶ 40 We have seen nothing to suggest that when Ms. Zosiak reviewed the NABONs prior to forwarding them with the NCAFs to Mr. Ng, she ought not to have been satisfied as to the accuracy of the information concerning beneficial ownership contained in them.

¶ 41 It might be contended that when Ms. Zosiak was notified by Mr. Ng in December 2005 that the Certificates of Incumbency had been received, she should have asked for copies, compared the information in them with what had previously been said in the NABONs, identified the inconsistencies and made further enquiries. Indeed, counsel for IIROC seemed, implicitly at least, to make this contention. It may be correct to say that Ms. Zosiak ought to have asked for a copy of the Certificate of Incumbency. We do not need to decide this; nor do we need to decide whether, having done so and reviewed it, she ought to have compared it with the NABON and, in light of the inconsistencies, made further enquiries. We do not need to decide these matters because they do not relate to the case made against Ms. Zosiak in Count 1 of the Notice of Hearing.

¶ 42 We have reached the conclusion, therefore, that Count 1 of the Notice of Hearing against Ms. Zosiak fails, and must be dismissed.

(e) *Evaluation of the allegation in Count 3 of the Notice of Hearing that between October 2005 and June 2006 Mr. Brighten failed to adequately supervise Ms. Zosiak with respect to the opening of the Laureate and Walcott accounts to ensure that the true beneficial owners were determined*

¶ 43 It follows logically from our conclusion that Ms. Zosiak did not in October 2005 fail to determine the true beneficial ownership of the Laureate and Walcott accounts that the analogous allegation against Mr. Brighten that he failed to supervise her in this connection must also fail.

¶ 44 We should, however, add this. The only detail of this allegation set out in the particulars to the Notice of Hearing is contained in paragraph 96 where it is alleged that Mr. Brighten “failed to question the beneficial ownership of Walcott and Laureate in light of the Certificates of Incumbency.” That failure is clearly established in the evidence, though it did not occur in October 2005 but some weeks later.

¶ 45 The question, however, is whether, whenever it happened, it attracts any disciplinary consequences. In our view, it does not. There is no evidence that Mr. Brighten ever saw the Certificates of Incumbency or that Global’s account opening approval procedures required him to obtain and review them. Nothing that Mr. Brighten saw, became aware of, or ought to have become aware of, therefore, imposed on him the obligation “to ensure that diligent enquiries” were made about beneficial ownership. When he approved the opening of the two accounts he had absolutely no reason to suspect that the information contained in the NABONs was inaccurate. If it is a deficiency in Global’s procedures that they do not require that the approving official should be provided with all documents relative to an account, even those received after the account has been opened, to ensure that the information provided is consistent, that is something to be visited on Global, not on its approving official, in this case Mr. Brighten.

¶ 46 This aspect of the allegation against Mr. Brighten in Count 3 of the Notice of Hearing must accordingly be dismissed.

**E. MS. ZOSIAK’S ALLEGED FAILURES IN CONNECTION WITH TRADING IN THE ACCOUNTS OF LAUREATE AND WALCOTT**

(a) *IIROC’s allegation*

¶ 47 To recapitulate, IIROC alleges that during the Relevant Period Ms. Zosiak failed to perform her role as a gatekeeper to the capital markets and acted contrary to IDA By-law 29.1 and Regulation 1300.1 (a) by facilitating transactions without making diligent inquiries to ensure the legitimacy of the transactions in the Laureate and Walcott accounts in circumstances which called for such inquiries, thereby facilitating a securities fraud.

¶ 48 Paragraph 83 of the Particulars alleges that Ms. Zosiak simply acted as an order-taker and failed to fulfill her responsibilities as a gatekeeper to the capital markets thereby facilitating a securities manipulation. We take this to be IIROCs general characterisation of the acts or omissions detailed in paragraph 82 of the Particulars and not a separate breach independently of those particulars.

¶ 49 Paragraph 82 of the Particulars alleges that Ms. Zosiak failed to:

- establish how Laureate and Walcott obtained the GTX shares;
- inquire about why Laureate and Walcott traded almost exclusively in GTX, an OTCBB issuer;
- make inquiries about who Hagen is and his connection, if any to GTX, particularly in light of the nature of the press releases and the reference to a Hagen family trust in the April Info Filer;
- make inquiries about the nature and authenticity of the legal opinion letters;
- question the active selling of large volumes of GTX in Laureate and Walcott;
- question why funds were wired from Laureate and Walcott to a bank account belonging to a third entity.

**(b) The “gatekeeper” role generally**

¶ 50 IIROC invokes, explicitly in connection with Ms. Zosiak (and by implication in the case of Mr. Brighten) the “gatekeeper” concept. It is not a new idea.<sup>5</sup>

¶ 51 By way of general background, we set out here the provisions of IIROC Dealer Member Rule 1300.1 (a) and IDA rule 29.1, both of which are explicitly referred to in Count 2 charged against Ms. Zosiak:

1300.1 (a) Each Dealer Member shall use due diligence to learn and remain informed of the essential facts relative to every customer and to every order or account accepted.

29.1 Dealer Members and each partner, Registered Representative, Investment Representative and employee of a Dealer Member (i) shall observe high standards of ethics and conduct in the transaction of their business (ii) shall not engage in any business conduct or practice which is unbecoming or detrimental to the public interest, and (iii) shall be of such character and business repute and have such experience and training as is consistent with the standards described in clauses (i) and (ii) or as may be prescribed by the Board.

¶ 52 In *Re Georgakopoulos*, [2009] IIROC No. 25, a Hearing Panel, referring to the role of an investment adviser such as Ms. Zosiak, quoted the following passage from a 2005 decision of the Alberta Securities Commission in *Re Wenzel* :

50. Registrants in turn protect investors, and help to sustain the integrity of the capital market. Securities salespersons are meant to know and understand the capital market, securities laws, their client and the client's investment objectives and financial circumstances. They must then apply this knowledge and understanding to ensure that every purchase or sale of a security that they participate in for a client is in accordance with the law, suitable for the client and, in the absence of valid discretionary authority, specifically authorized by the client.

51. All of this is designed to protect the particular client, directly. It also serves a broader purpose. A salesperson who fulfills these obligations to the particular client will be in a position

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<sup>5</sup> Some of the more recent history of the concept is briefly set out in the dissenting decision of Vice-Chair Salvail-Lopez in *Re Pacific International Securities Inc. and others*, 2006 BCSEC 532 at paragraphs 330 to 332;

to spot suspicious or unusual circumstances that could have an effect on the integrity of trading and the capital market. The salesperson can then alert the client (or the employer firm, regulators, or all three) to potential improprieties, inadvertent or otherwise, and decline to participate in or facilitate improper activity. In this way, the registered salesperson is a gatekeeper for the broader public interest.

¶ 53 Similar views were expressed in *Re Kasman*, IDA November 13, 2007 at paragraphs 39 to 41:

[39] Association By-law 21.9 [sic] provides that a registered representative shall observe high standards of ethics and conduct in the transaction of business, not engage in any business conduct or practice which is unbecoming or detrimental to the public interest, and have such experience and training as is consistent with these standards.

[40] In addition to his duties to his client, a registered representative has duties to his firm, and to the marketplace. These duties require a registered representative to undertake various tasks. He must know his client. He must determine that trading is suitable for the client. He must gather and analyze prescribed information. He must keep records. He must supervise assistants. He must analyze and understand markets and the trading he does.

[41] He must make reasonable inquiries and be reasonably satisfied with answers where a duly diligent person would do so in similar circumstances. In this regard a registered representative should have an alert, curious attitude to the tasks his clients ask him to perform. (See, in this regard, *Toban* [2007] I.D.A.C.D. No. 9 Bulletin No. 3615, March 16, 2007.)

The emphasis in the above passage is ours.

**(c) *The Global Manual and the gatekeeper role***

¶ 54 The Global Manual, consistent with industry standards and expectations, explicitly imposes upon employees an obligation to act as “gatekeepers” and points out the importance of being alert to “red flags”. It does so in the following language:

The Canadian stock exchanges and their member shareholders are committed to operating honest, fair and efficient capital markets. The support of all industry participants is key in striving toward this objective. In particular, the role of each dealer and their employees in upholding the integrity of the marketplace (the role of "gatekeeper") is of major importance.

It is the duty of IAs to act in the best interest of their clients. However, IAs must also act in the best interests of their employers and through them, the whole securities industry. Therefore, if an IA becomes aware, through a client or otherwise, that the effect of the trading by a client would be in breach of provincial securities legislation or would impugn the integrity of the market, then it is incumbent on an IA, in the IA's capacity as a "gatekeeper", to draw the matter to the attention of senior management of Global. Senior management will then have to make a determination as to whether the matter should be reported to the appropriate securities regulatory authority. Willful blindness on the part of an IA may be construed as a failure to meet these responsibilities.

Each IA must be aware of potential signs of market manipulation. These include such characteristics as market dominance, price leadership, high closing, and the use of jitneys through several firms. Market manipulation also includes making fictitious trades, match trading and successive uptick or downtick trading. IAs are in the best position to be aware of any market scheme at its outset because of their knowledge of their clients and their trading patterns . . . .

IAs should keep a record of any "gatekeeping" inquiries made of a client, as these types of records will serve to establish that an IA has observed the requirements of the "gatekeeper" obligation.

**(d) *The gatekeeper role in relation to trading in the securities of issuers quoted on the OTC market - Global's policies***

¶ 55 On December 3, 1999, very shortly after he became Global's President and Chief Executive Officer, Mr.

Garrod prepared and distributed to all Global employees a memorandum concerning “OTC Bulletin Board Stock”. The memorandum constitutes important context and background to the allegations against Ms. Zosiak and Mr. Brighten. Each of them acknowledged being familiar with it.

¶ 56 The memorandum identified potential problems with some OTC bulletin board stocks, among them manipulation, which it was said may raise know your client and gatekeeper issues; and unsavoury players having “little or no respect for the integrity of the market”, whose involvement raised not only the same types of concerns as stock manipulation but also posed a threat to Global’s public image. Mr. Garrod emphasised that these problems had led to the adoption of what he described as “special guidelines” for OTC bulletin board stocks, necessitated by a heightened awareness of potential problems associated with such stocks.

¶ 57 These special guidelines form an important part of the context for the activities in the accounts of Laureate and Walcott that are the subject of IIROC’s allegations against Ms. Zosiak and Mr. Brighten, we set them out at length:

(a) **Client:** The "know your client" regulations require more than suitability determinations on the part of an IA. The provisions of these regulations require an IA to assess both the "credit worthiness" of a potential client as well as their "reputation", in particular it must be determined whether the client "is of good business and financial reputation"\* prior to the opening of an account. IAs are in the best position to make assessments of this nature because of the direct contact between the IA and the client. It may perhaps be difficult to make definitive conclusions concerning a client's reputation in the initial dealings between the IA and the client. However, specific enquiries will have to be made if doubts as to whether the client has a good reputation arise subsequent to the opening of the client's account. If an IA has concerns of this nature either during the account opening process or subsequently, the IA should immediately consult with Global's Compliance Department. Where concerns arise about a client's reputation, a Lexus Nexus search may be undertaken by the Compliance Department, at the IA's expense, in order to resolve the concerns.

(b) **the Issuer:** What is the business of the issuer? Is it a lawful undertaking? Does the issuer have an active business or is it a "concept" company? What is the issuer's financial position? Does it require funding in the near future in order to prosecute its business plan? Are there specific business risks associated with an issuer? These and other basic questions about an issuer's business, and its short-term business prospects, must be answered before an account which proposes to trade primarily OTC bulletin board stocks can be opened and before OTC bulletin board stock can be approved for physical delivery. Copies of all news releases published by the issuer during the 90 day period prior to opening of the account or the delivery in, together with copies of the latest financial statements of the issuer, must be obtained. Copies of the company's current promotional literature should also be secured. These copies should be placed in the IA's client file for review by either the person authorized by Global to approve the opening of the account, Compliance Department personnel or Global's credit officer as well as by the Global officer approving the physical delivery of stock.

(c) **the Issuer's Market:** As part of the account opening process, and whenever OTC bulletin board stock is being physically delivered, an IA should obtain trading information showing the daily volumes and price ranges of the issuer's securities over the prior 90 days. This information is often more useful if it is in graphic, as opposed to tabular, form. This information should give an indication of the liquidity of the stock as well as the volatility of its price. This information should be lodged in the IA's client file for review, as above.

(d) **Legal Opinion:** When physical certificates representing OTC bulletin board securities are being delivered in they must be accompanied by an opinion from the issuer’s lawyer or attorney opining that (a) the shares represented by the certificates have been validly issued, (b) the shares represented by the certificates have been fully paid for and (c) the issuer does not have a claim against the shares represented by the certificates. Sample language which Global expects

to see in this regard is as follows:

"We are the attorneys for ABC Minerals Inc. (the "Company") and have made such investigations, and have considered such questions of law, as we have considered necessary for the purpose of rendering this opinion.

In our opinion, the common shares of the Company represented by certificates numbered \_\_\_ to \_\_\_ (inclusive), and registered in the name of \_\_\_\_, have been validly issued by the Company and represent fully paid shares in the capital of the Company. Further it is our opinion that the Company has no claim, at law or in equity, against the foregoing common shares."

It should be observed that physical deliveries of OTC bulletin board stock should be avoided whenever possible.<sup>6</sup> If an inter-member movement through CDS is possible, then the transfer must be effected using this mechanism. As well, if a DTC "direct order" transfer is possible, then that transfer mechanism must be employed.

(e) **Third Party Deliveries/Payments:** Why would a third party (i.e. a person different than the holder account) deliver stock into a client's account, or be the recipient of stock delivered out of that account? Similarly why would a third party deliver funds into an account or be the recipient of a payment from the account? While IAs are not responsible for 'regulating' the private business affairs of their clients, they are in general responsible for ensuring that brokerage accounts maintained at Global are not in essence being used as a pooled account (i.e. an account where several persons other than the account holder have an undisclosed interest in the account) nor as conduits by stock manipulators or money launderers. Accordingly an IA must ascertain the reason(s) for such deliveries and payments, and must record the reason or reasons in the client's file. When an IA becomes concerned about the legitimacy of the transactions, the Compliance Department should be notified. An account exhibiting a pattern of these types of transactions will from time to time be audited by the Compliance Department. When it is concluded that an account is likely being utilized by undisclosed persons who may have an interest in the accounts, or that the nature and extent of stock and/or cash movements raise bona fide suspicions about their legitimacy, the account will be closed.

(f) **Approvals:** All OTC bulletin board physical stock deliveries must be reviewed by the Compliance Manager and subsequently approved by either the Chief Financial Officer or the President. An IA or IA's assistant who is seeking this approval should complete the attached checklist for review by the Compliance Manager and the Chief Financial Officer or the President.

¶ 58 On July 24, 2000 Mr. Garrod sent to all Global Investment Advisors a memorandum to which there was attached a copy of a joint letter from the Securities Commission and the IDA that he had received. The letter expressed concern that some securities firms may have been used as "conduits for illegal securities trading in United States markets, primarily in securities quoted on the . . . [OTCBB]" and emphasized the importance of firms having in place proper practices and procedures "adequate to deal with the increased risks associated with trading in over the counter securities". In particular, firms were "encouraged" to "ensure that Know Your Client standards are being rigorously applied to offshore accounts". The letter emphasized the importance of verifying information supplied by the client and of having in place procedures "to verify the source of the securities and that they are free trading."

## **F. WHAT MUST IIROC ESTABLISH IN RESPECT OF AN ALLEGED FAILURE TO FULFILL GATEKEEPER RESPONSIBILITIES?**

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<sup>6</sup> In a further Memorandum dated February 24, 2006 Mr. Garrod informed all IAs that effective March 11, 2006, Global would no longer accept stock certificates issued by a company which is not an EDGAR filer (i.e. a reporting company under US federal securities legislation).

¶ 59 In *Re Octagon Capital Corporation*, [2007] IDACD No. 16, a hearing panel of the IDA considered whether a breach of IDA Rule 29.1 (or, by parity of reasoning, Dealer Member Rule 1300.1) is established if it is shown only that someone charged with such a breach has been merely negligent. The Panel began by quoting the following definition of negligence: “The omission to do something, which a reasonable man, guided by those ordinary considerations which ordinarily regulate human affairs, would do, or the doing of something which a reasonable and prudent man would not do.” It found that the respondent in that case had not been negligent within the meaning of that definition and then considered what the position would have been had it been shown that the respondent’s conduct was negligent. The Panel referred to a number of earlier decisions (*Re Gareau*, [2005] IDACC No. 25 and *Re: J.C. Dickson Davidson Partners Ltd.*, [1989] T.S.E.D.D. No. 10, at page 6) in which it had been said that in the absence of evidence that the respondent had “acted unethically or for an improper purpose . . . or had a conflict of interest. . . [or a] dishonest motive or blameworthy conduct”, it was not possible to say that his negligence “was of such a character as to fall within the description of “conduct that is unbecoming” within the meaning of Bylaw 29.1. It concluded:

Octagon was under a regulatory duty which required it to exercise reasonable care. Breach of a duty of care is negligence, but it does not follow that mere negligence constitutes a disciplinary offence. Aggravated negligence or negligent conduct which leads to conduct unbecoming can, in fact, lead to a disciplinary offence. It could be said that Octagon was negligent but that finding, if made, is not sufficient to constitute conduct unbecoming or detrimental to the public interest contrary to By-law 29.1. Only aggravated negligence could lead to that conclusion. . . . In short, negligent conduct may give rise to other remedies but does not constitute conduct unbecoming or detrimental to the general public.”

¶ 60 In *Re Blackmont Capital Inc. and Duke*, 2011 BCSECCOM 490, the British Columbia Securities Commission seems to have accepted the analysis adopted by the Hearing Panel in *Octagon* (which it mistakenly attributed to the Ontario Securities Commission). We have proceeded, accordingly, on the basis that we are bound by that analysis and that to succeed in this case IIROC must show that whatever omissions or failures may properly be brought home to Ms. Zosiak should be characterised as “aggravated negligence” or that she “acted unethically or for an improper purpose . . . or had a conflict of interest. . . [or a] dishonest motive or blameworthy conduct”.

## **G. MS. ZOSIAK’S ALLEGED FAILURES EXAMINED**

¶ 61 Against this background we turn now to an examination of Ms. Zosiak’s acts or omissions in each of the respects in which it is alleged that she failed in her “gatekeeper” responsibilities.

### **(a) *Alleged failure to investigate why the NCAFs for Laureate and Walcott contained virtually identical information***

¶ 62 Paragraph 31 of the Particulars says:

Zosiak did not question why the information on the NAAF’s for Montaque, Laureate and Walcott was virtually identical, including the bank account number, particularly given that she also indicated that the purpose of the Laureate and Walcott accounts was to keep trading separate. Trading in Walcott and Laureate was personal trading for [Sumner] and [Bethel] while Montaque was an “omnibus” account that has a different stature and category than the other accounts.

¶ 63 Although neither the Notice of Hearing nor the Particulars specifically refers to these circumstances as evidence of Ms. Zosiak’s alleged failure to perform her gatekeeper functions, in her final submissions counsel for IIROC explicitly made them part of her case. In her written submission she says that the identity in the information “ought to have been the first red flag for Zosiak”:

While it may not be unusual for clients to use the same bank, the fact that two corporations with separate beneficial owners gave the same account number, at the same bank with a reference to another entity (Montaque), should have caused Zosiak to query her clients. There is no evidence that she did so.

¶ 64 Ms. Zosiak was clearly aware of the parallelism of the information and it is true that she asked no questions about it. According to her evidence, her curiosity was not piqued because the facts made perfect sense to her. Messrs. Edison and Bethel were both “part of Montaque”, which she understood to be an investment manager trading for a number of clients, were “partners” in that business and apparently friends and seemed to be “in the same category wealth-wise”. She said that “it didn’t seem unusual for two partners in the same business working for the same place that they would have pretty much the same information”, including the same bank account as that of the business in which they seemed to be partners, but which they used for the purposes of their separate trading activities.

¶ 65 We do not doubt that Ms. Zosiak genuinely considered that the arrangements made perfect sense. The question is, however, whether they were on their face sufficiently unusual that a reasonable person - someone with the “alert, curious attitude” referred to by the Panel in *Re Kasman* (above, paragraph [53]) - would have made enquiries to determine whether some explanation was called for. *Cf.* in this connection, Section II, Chapter 2 of the Canadian Securities Institute Conduct and Practices Handbook course materials quoted in paragraph 14 of the decision in *Re Georgakopoulos* (above, paragraph [52]).

¶ 66 We have come to the conclusion, though not without some hesitation, that Ms. Zosiak’s failure to make enquiries about the arrangements disclosed did not constitute a breach of By-law 29.1. We have been influenced in reaching this view by the facts that Montaque was a registered dealer in the Bahamas trading on behalf of its own clients, that its record as a client of Global was unblemished, and that Messrs. Sumner and Bethel had impressive credentials and a long history in the financial services industry in the Bahamas.<sup>7</sup> Moreover, there is no evidence that even comes close to suggesting that there was anything improper in the arrangements, that anyone was harmed by them, or that they facilitated any improprieties. While it would no doubt have been preferable if Ms. Zosiak had made further enquiries it is not at all clear to us what relevant information such enquiries would have revealed.

**(b) *Alleged failure to establish how Laureate and Walcott obtained the GTX shares***

¶ 67 As we have noted above (paragraph [25]) Ms. Zosiak testified that in connection with the opening of the two accounts Mr. Sumner told her that it was intended that they would be used to sell certain GTX shares acquired by him and Mr. Bethel in private placements as the result of their friendship with the President of GTX. Ms. Zosiak did not at the time know the identity of the president of GTX and she did not try to find out; nor did she make any enquiries to confirm the accuracy of the claim that the shares were obtained through private placements. In an email of November 15, 2005 she advised Mr. Garrod that she had conferred with Mr. Sumner who told her that “this paper is all private placement paper so it is filed in an 8K, so its public and filed with the SEC”.<sup>8</sup> Though the information that he ostensibly gave her was, apparently, incorrect,<sup>9</sup> her evidence about what he told her was not challenged. She did not make any attempt to verify independently the information she was given.<sup>10</sup>

¶ 68 Although counsel for IIROC contended that Ms. Zosiak should have verified the source of the GTX shares she stopped short of saying what steps should have been taken to this end. Should she have conducted an SEC search to verify that an 8K had been filed? Should she have asked for a copy of the relevant private placement agreements?<sup>11</sup>

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<sup>7</sup> It is also worth noting that shortly after the two accounts were opened Mr. Garrod received a report of certain independent due diligence searches on Montaque and its principals, Messrs. Sumner and Bethel. After discussing the report with Ms. Zosiak she solicited the views of Mr. Bethel. She testified that upon receiving his comments she and Mr. Garrod reviewed the situation and “we came to the conclusion that there was nothing alarming at all about Owen, Edison and Montaque.”

<sup>8</sup> An “8K” is a disclosure document mandated by the SEC for public companies to report major events that investors should know about.

<sup>9</sup> As we understand it GTX never filed a Form 8K for this or any other private placement.

<sup>10</sup> In her interview with Mr. Smith on December 11, 2009 Ms. Zosiak said that she had been told that approximately 1 million GTX shares would be coming in for each account. She also said that she satisfied herself that these shares did not form part of a control block (Transcript, pages 10-32 to 10-33) though she did not explain how she satisfied herself about this.

<sup>11</sup> Ms. Zosiak testified that at the time it was not the practice at Global to require copies of private placement agreements to be provided but that this policy had since changed though she was unsure when this had happened.

¶ 69 Global did have some procedures in place for these purposes. They are set out in Mr. Garrod's Memorandum of December 3, 1999 quoted at paragraph [57]. The starting point is that "physical deliveries of OTC bulletin board stock should be avoided wherever possible." If unavoidable, the Memorandum required the approval of the Compliance Manager and the President; and that a request for such approval is supported by certain documentation identified on and attached to a checklist to be provided to the approving officer. The required documentation included copies of the certificates themselves, a legal opinion in a prescribed form, copies of news releases of or about the issuer, copies of its financial statements and certain market data. As we understand it the IA was responsible for assembling the package, except for, as we understand it, the share certificates themselves and the legal opinions. These were retained in Global's back office which made copies and added them to the IA's package before it was submitted to Messrs. Brighten or Garrod for approval.

¶ 70 If IIROC's position is that the mere fact that Ms. Zosiak was told that the GTX shares were private placement shares was itself a red flag that should have provoked further enquiries, we do not agree with it. The fact itself, taken alone, is quite neutral. Literally understood, the regulators' emphasis, on which IIROC relies, on verifying the "source" of OTCBB shares amounts to an absolute and unvarying requirement to be satisfied, presumably, by obtaining copies of the relevant stock purchase agreements or, possibly, public securities filings. We do not think that even in the case of OTCBB shares it was intended that this should be done as a matter of course in every case. Even if we are wrong about this, however, we do not think that her failure to do any of these things can, taken alone, reasonably be considered to amount to a breach of By-law 29.1 or Regulation 1300.1 (a).

¶ 71 We consider below (at paragraphs [107] to [109]) the effect of certain subsequent developments on this conclusion.

(c) *Alleged failure to make inquiries about the nature and authenticity of the legal opinion letters*

¶ 72 On each occasion on which approval was sought (from Mr. Brighten and Mr. Garrod) to accept certificates for GTX shares for deposit into one of the two accounts, the package accompanying the request included a legal opinion in substantially the form prescribed by Mr. Garrod's Memorandum of December 3, 1999 (see above, paragraph [57]).

¶ 73 The relevant evidence concerning these legal opinions is set out in paragraphs 47 to 54 of the Particulars. The salient facts are that during the period between October 2005 and June 2006 there were eight such opinions delivered, all purportedly signed by Edward Ovsenik who in the body of each opinion claimed to be "the attorney for GTX Global" and at the foot of each described himself as "General Counsel for GTX Global Corp., formerly Auto Lease Check." In a number of instances the body of the opinion was preceded and followed by quotation marks. With one exception, none of the opinions was on any corporate or law firm letterhead indicating any address or other contact information. The exception was an opinion of December 1, 2005, on what purported to be a GTX letterhead and which, while indicating that GTX's offices were in Henderson, Nevada seems to have been faxed from a fax machine in North Carolina. We note in passing in this connection that there is in evidence a document headed "Information and Disclosure Statement" dated October 16, 2005 (the "October Filer"), and purportedly prepared by or on behalf of GTX to satisfy certain disclosure requirements in the United States, that identifies an address in Henderson, Nevada as being that of "the principal executive office" of the company, but also indicates that it had an office and a warehouse in North Carolina. According to the October Filer, Mr. Ovsenik was, as his December 1 opinion suggested, based in Henderson, Nevada.

¶ 74 There is also in evidence a later version of the October Filer, dated April 6, 2006 (the "April Filer"). Some of the information in the April Filer differs from that in the October Filer. For example, the April Filer identifies an address in North Carolina as that of GTX's principal executive office; it identifies Mr. Ovsenik, at that address, as being responsible for investor relations and also as the company's interim President, General Counsel and a Director.

¶ 75 The nub of IIROC's case against Ms. Zosiak in this respect is set out in paragraphs 50 and 52 of the Particulars:

50. Zosiak accepted the legal opinion letters at face value without questioning anyone or anything about same. In particular, she did not question the fact that all but one of the legal opinion letters was not on any letterhead, that the letters contained no basis for the legal opinion provided and that the author of the letters was not independent in that he was general counsel for GTX, an officer of that company and had investor relations responsibilities. Zosiak also did not question why the quotation marks were around the body of the letter, particularly since the author did not appear to be quoting anyone.
52. Furthermore, Zosiak did not question that the wording of the legal opinion letters (including the quotations around the body of the letter) is identical to the wording contained in an internal Global memorandum regarding OTCBB stock that was sent to all IAs by Global management.

¶ 76 We note, first, that it is far from clear on the evidence that Ms. Zosiak ever saw any of the legal opinions, albeit that at least one of them was addressed to her. Her evidence was that she did not and this would be consistent with the arrangements for handling incoming mail at Global (see above, paragraph [18]). If she did not, we think it impossible to conclude that her failure to ask the questions identified by IIROC can reasonably be regarded as a default on her part.

¶ 77 This consideration aside, however, there are other grounds for rejecting the charge. First, to describe a document as not being “authentic” is generally intended to convey the idea that it is a forgery. If that is the sense in which IIROC has used the word, there was not one iota of evidence tendered to substantiate the allegation. Alternatively, the asserted lack of “authenticity” might be no more than an attempt to describe the cumulative effect of the other characteristics identified in the Particulars. But that, in our view, does not advance matters. The content of the opinion was prescribed by Global. It is surely unsurprising that the opinions received should have been in the prescribed form and we are at a loss to understand how that fact could sensibly be asserted to be something warranting investigation or enquiry. The use of quotation marks in the opinions indicates nothing more than that Mr. Ovsenik resorted to the somewhat sloppy practice of cutting and pasting from the precedent provided in Mr. Garrod’s December 3, 1999 Memorandum (above, paragraph 53), which included such marks. While that may be eloquent as to Mr. Ovsenik’s professional standards we are not persuaded that the use or non-use of quotation marks or (in the case of the December 1, 2005 opinion) a decorative letterhead can add to or detract from the weight of the opinions expressed or create an obligation of further enquiry.

¶ 78 We are quite unable to fathom the meaning of the complaint that Ms. Zosiak failed to “question that the letters contained no basis for the legal opinion provided”. Each of Mr. Ovsenik’s opinions was expressly based on such investigations and a consideration of such questions of law, as he considered necessary for the purpose. That is commonplace language in legal opinions and is the language specified in Mr. Garrod’s Memorandum. What additional or different language should have been included was never made clear to us. And finally, in this connection, Ms. Zosiak is not a lawyer. We heard no evidence to suggest that she has any credentials to evaluate the quality or weight of the opinions. In the absence of such evidence we do not understand the contention that her failure to question “the basis” for the opinions can be a subject of reasonable complaint.

¶ 79 The final element of IIROC’s complaint in respect of these matters is that Ms. Zosiak failed to question the fact (based on the April Filer) that “the author of the letters was not independent in that he was general counsel for GTX, an officer of that company and had investor relations responsibilities”. She certainly did not question these matters, but as we have already indicated there is no evidence that Ms. Zosiak actually saw any of the legal opinions and there is no evidence that she saw either the October Filer or the April Filer. There is no evidence as to when the April Filer was available to, or received at Global, nor at what point between October and April Mr. Ovsenik’s position with GTX changed. There is no basis, therefore, to conclude that Ms. Zosiak was aware of any facts that might have imposed an obligation of further inquiry upon her in this respect.

¶ 80 In support of its general position on Ms. Zosiak’s alleged failures in connection with Mr. Ovsenik’s legal opinions, counsel for IIROC placed heavily reliance on the decision of the hearing panel in *Re Toban*, November 2006. In that case the legal opinion was, as here, given by someone acting “as counsel for” the

issuer of the shares. The panel held (at paragraph 54) that the opinion was “clearly . . . not an independent opinion from outside counsel” and, as we understand its reasons, considered that this should have provoked some diligence enquiries by Mr. Toban. We express no opinion about that view. In our view, there is an important distinction between that case and this. As we understand the facts of that case the lawyer who gave the opinion was a client of Mr. Toban and, to Mr. Toban’s knowledge, had a direct, personal financial interest in the transaction to which he opined. See *Toban* at paragraphs 51, 54 and 55. There is nothing comparable here.

¶ 81 We should add this. The requirement set out in Mr. Garrod’s Memorandum of December 3, 1999 was for an “opinion from the issuer’s lawyer or attorney”. There is nothing on the face of that requirement to suggest that only an independent outside counsel could give such an opinion<sup>12</sup>; more narrowly, in the absence of an explicit condition to that effect we do not think that Ms. Zosiak’s failure to pursue the matter can reasonably be regarded as a failure of enquiry on her part.

**(d) Alleged failure to question extent of ownership of GTX shares by Laureate and Walcott, the volume of their trading and certain market-related matters**

¶ 82 IIROC’s charge against Ms. Zosiak in connection with the trading in GTX shares by Laureate and Walcott is that she failed to make any enquiries of her clients about their involvement in GTX, why they were accumulating such a large position in that company, why they traded in its shares almost exclusively and why they were such active participants in the market for those shares. See Particulars, paragraphs 45 and 82.

¶ 83 Since this charge is just one of a number of related elements in the broader indictment against Ms. Zosiak as to her performance of her role as a gatekeeper, we consider those elements together.

**(i) Trading activities**

¶ 84 The Particulars contain a number of detailed averments about the percentages of outstanding GTX shares deposited at Global, held by Laureate and Walcott in their accounts, or sold through those accounts on various dates or during various periods. See Particulars, paragraphs 41, 44, 53, 54 and 67. It is sufficient for present purposes to summarize the effect of those details.

¶ 85 We do not think it is necessary to explore these details. On any analysis the Laureate and Walcott accounts were responsible for a significant volume of trading in GTX shares during the Relevant Period. Certificates for some 6.7 million GTX shares were deposited into the accounts; Laureate sold some 3.3 million and Walcott sold approximately 2.3 million GTX shares; and between them they purchased some 625,000 shares.

¶ 86 We have said earlier (see paragraph [70]) that in our view the mere fact that Ms. Zosiak was told that the shares to be delivered into the two accounts were private placement shares did not, in and of itself, impose upon her any obligation of inquiry. We have also noted<sup>13</sup>, however, that she was told, or at any rate had been led to believe, that the number of private placement shares to be deposited was approximately two million. As set out in paragraph 41 of the Particulars, however, the actual numbers of GTX shares deposited during the Relevant Period are as follows:

	Laureate	Walcott	Total
October 2005	300,000	300,000	600,000
November 2005	704,792	0	704,792
December 2005	300,000	600,000	900,000
January 2006	0	0	0
February 2006	600,000	300,000	900,000

<sup>12</sup> Mr. Garrod testified that Global required an opinion “from either the company’s lawyer or the client’s lawyer”. We note that while the hearing Panel in *Re Toban* quoted extensively from Mr. Garrod’s December 3, 1999 Memorandum, the section of that Memorandum dealing with legal opinions is not referred to.

<sup>13</sup> See note 9, above.

March 2006	300,000	0	300,000
April 2006	1,000,000	1,104,792	2,104,792
May 2006	593,500	593,500	1,187,000
<b>Total</b>	<b>3,798,292</b>	<b>2,898,292</b>	<b>6,696,584</b>

¶ 87 By the end of December 2005, then, the shares actually deposited exceeded by some 200,000 the number that Ms. Zosiak had been led to expect and by the end of February 2006 the excess was just over one million.

¶ 88 Moreover, as noted in paragraph 44 of the Particulars:

Collectively, by the end of December 2005, Walcott and Laureate deposited more than 5% of the outstanding shares of GTX. Further, by the end of February 2006, 9.97% of GTX outstanding shares had been deposited at Global. That number increased to 10.93% and 16.92% at the end of March and April 2006 respectively.

**(ii) Global’s internal restrictions with reference to GTX shares**

¶ 89 It is alleged in paragraph 68 of the Particulars that Mr. Garrod imposed “a limit that on a firm wide basis, no more than 100,000 GTX shares per week could be sold.” It is further alleged, in paragraph 73 of the Particulars, that “Zosiak exceeded the imposed 100,000 limit many times.” It is not necessary for us to deal with this here, for no discernible complaint is made against Ms. Zosiak in connection with it. So far as we can see, when all has been said about it (and much was said about it during the hearing) it is not alleged in this connection that she violated any duty as a gatekeeper or otherwise committed a breach of any IDA or IROC rule or policy.<sup>14</sup>

**(iii) The Stocklemon Report of November 14, 2005 and related matters**

¶ 90 On November 14, 2005, an internet website, CitronResearch.com, published a so-called “Stocklemon Report”<sup>15</sup> with the arresting headline: “GTX Global (GTXC.pk): Convicted Felons, Pink Sheets, and Stock Promotion Websites go together like Thanksgiving Turkey, stuffing, and a stomach ache.” This Report raised seemingly serious concerns about GTX and those associated with it, including David Hagen who was alleged to have served time in prison following his conviction on “mail and bankruptcy fraud”.<sup>16</sup> The Report concluded: “It is the belief of Stocklemon that GTX Global is nothing but an ole fashioned stock promotion that will soon meet its fate at the hand of regulators.”<sup>17</sup> The same day, November 15, GTX put out a news release announcing that it had retained counsel, identified by name, to represent it in a legal action against Stocklemon.com.

¶ 91 Ms. Zosiak apparently saw the GTX news release shortly after it appeared and immediately emailed it without comment to Mr. Garrod who responded saying “Oh it’s the ‘lets sue to make them back’ off trick. If it smells, it smells”.

<sup>14</sup> In contrast, it is alleged against Mr. Brighten that his failure to ensure that she did not exceed the prescribed limits was a failure of supervision on his part. See Particulars, paragraph 96. And see below, paragraphs [140] to [141].

<sup>15</sup> Mr. Garrod testified that Stocklemon was “commonly referred to as the shorter’s bible. Stocklemon was known to put out adverse information on stocks that it felt warranted shorting.” Ms. Zosiak testified to a similar impression about Stocklemon. She thought that its reports should be taken “with a grain of salt”.

<sup>16</sup> One of the respects in which Ms. Zosiak is alleged to have failed in her gatekeeper responsibilities is that, as set out in paragraph 82 of the Particulars, she “failed to make any enquiries about who Hagen is and his connection, if any, to GTX, particularly in the light of the nature of the press releases and the reference to a Hagen family trust in” the April Filer. As we have indicated above – paragraph [79] - there is no evidence that Ms. Zosiak ever saw the April Filer. At some point in late October 2005 she apparently made a call to GTX. According to an email message from Global’s receptionist to her, Mr. Hagen returned her call and left a number at which he could be reached. Ms. Zosiak has no recollection of making her call or receiving the message. She is quite sure she never returned the call and forgot the message. The reference to Mr. Hagen in the Stocklemon Report of November 14, 2005 did not jog her memory or stimulate her to make any enquiries about him.

<sup>17</sup> Stocklemon’s confidence was well founded. The “ole fashioned stock promotion” led to the indictment against Mr. Hagen in December 2008 and ultimately to his conviction in May 2009. The indictment describes in some detail the operations of the “Stock Promotion Websites” referred to in the Stocklemon Report.

¶ 92 The evidence about what happened next is a little confusing. In an email to Mr. Garrod that morning Ms. Zosiak advised him that she had spoken to Mr. Sumner to obtain some reaction to the Stocklemon Report. He assured her that he knew the president of GTX, had seen the company's "product", was satisfied that it was a "real company" and that he had no reason to think otherwise and that the Stocklemon allegations were false. She also, apparently spoke to Mr. Ovsenik who told her that GTX had retained outside counsel to represent it in litigation against Stocklemon and gave her that counsel's telephone number. She tried, without success, to reach him and left a message which was not returned. Ms. Zosiak also told Mr. Garrod that she had confirmed that GTX's telephones were working and its website appeared to be operational. It is not clear why she thought these facts important.

¶ 93 Not long afterwards Stocklemon published an "update" on its website announcing that it had received an email from David J. Levenson, "attorney for GTX corporation" (not the lawyer identified in the GTX release) saying that the information contained in the Stocklemon Report on that company was false, and demanding that the report be removed from the website, failing which "I will recommend that the company pursue its legal rights and remedies against you."<sup>18</sup>

¶ 94 Ms. Zosiak did not take any other steps or make any other enquiries as the result of the Stocklemon Report. Her evidence was that while the Report might be considered a "red flag", "the stock itself did not behave in a manner that caused me to question it". Trading was active, there were quite a number of market-makers "and it did not appear to be manipulated from what I could see." The evidence is that from the opening of the two accounts in October 2005 to the end of that year, Laureate and Walcott between them sold some 5,700,000• shares.

**(iv) The GTX news release of December 29, 2005**

¶ 95 On December 29, 2005 GTX issued another news release headlined "GTX Global Responds to Dow Jones Newswire and Stocklemon". This response was largely devoted to a blanket rejection of various previously published statements made about it as "old news". The release disclosed that "recently pinksheets.com removed the company's stock quote from their pages stating they believed the company was directly or indirectly engaged in promotional activity." The release denied this and noted that a request had been made for reinstatement. It also disclosed that GTX had posted a "revised" Information Statement dated December 27, 2005 at pinksheets.com. Finally, the release announced the company's "plans to become fully reporting on the Amex or NASDAQ exchanges". The latter information was confirmed in a letter from Mr. Ovsenik to Messrs. Garrod and Brighten in February 2006.

¶ 96 Ms. Zosiak thought that she "probably" saw this news release but so far as she could recall it did not stimulate her to make any enquiries about the matters referred to in it. There is no evidence that she or anyone else at Global saw the "revised" information statement; and it is not in evidence before us.

¶ 97 On March 16, 2006 Ms. Zosiak enquired of Mr. Sumner whether he could suggest a name of someone at the SEC whom she or Mr. Garrod could contact with a view to discussing GTX's pending "application"<sup>19</sup> for full reporting status. Global was concerned about the status of this application because in early February, 2006 Mr. Garrod had reissued his Memorandum of December 3, 1999 concerning OTC shares with some changes to be effective as of March 13, 2006. The principal change was that "unless an issuer is a reporting company under US federal securities legislation, it will not be an EDGAR filer. *Global will not accept stock certificates issued by a company which is not an EDGAR filer.*" (Our emphasis).

¶ 98 There is no evidence that Ms. Zosiak made any other follow up enquiries arising out of the information contained in the GTX press release.

**(v) The Dow Jones Newswires Column of April 19, 2006**

¶ 99 On April 19, 2006 Dow Jones Newswires reported:

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<sup>18</sup> We have no evidence that any such proceedings were in fact instituted or that Ms. Zosiak made any enquiries about this.

<sup>19</sup> There is no evidence that such an application was ever made.

A criminal investigation into penny stock company Absolute Health and Fitness Inc. (AHFI) and people alleged to have manipulated its stock, has expanded.

The U.S. Attorney's Office for the U.S. District Court for the Western District in North Carolina began looking into possible criminal violations surrounding Absolute Health stock late last year after the gym company attracted scrutiny and its stock collapsed.

Last month, the criminal prosecutor in charge of the investigation sent out a new round of subpoenas in connection with a grand jury investigation. One subpoena reviewed by Dow Jones Newswires shows that the federal government is now looking for information about more than 100 people and entities, including another small cap company with ties to North Carolina, GTX Global Corp. (GTXC).

¶ 100 Absolute Health and Fitness Inc. had been identified in the Stocklemon Report of November 14<sup>th</sup>, 2005 about GTX (above, paragraph [90]) as one of two companies halted by the SEC "that had identical stock promotions and web design layout as the promotions behind GTX Global".

¶ 101 Ms. Zosiak saw the Dow Jones report. She said that it had raised questions in her mind. She pasted it into an email and sent it, without comment, to Mr. Sumner. She also tried, apparently unsuccessfully, to speak to someone at the company but instead managed to reach Mr. Sumner, who told her that as far as he knew there was nothing to the report but that if he heard otherwise he would contact her. It will be recalled that he made a similar response to her enquiries following the appearance of the Stocklemon Report. See above, paragraph [90]. She also, apparently, discussed the matter with Mr. Garrod who told her to see what else she could find out. We have no evidence as to what steps, if any, she took pursuant to this advice or what, if anything, she discovered.

¶ 102 Laureate and Walcott continued to be active participants in the GTX market in the first quarter of 2006.

**(vi) Due diligence in May 2006**

¶ 103 Mr. Garrod's revised requirements, in effect as of March 13, 2006, for dealing with share certificates of OTC issuers created something of a problem in relation to GTX since it was not, as far as anyone knew, a reporting company in the United States. Mr. Garrod testified that he was willing to "grandfather" GTX, at least for a while.

¶ 104 On May 23<sup>rd</sup>, 2006, however, in response to a request from Ms. Zosiak for his approval to sell some GTX shares for the accounts Mr. Garrod noted in an email response: "As I recall it, this company was to apply for reporting status. It hasn't done so yet. What's the deal? As an aside, apart from the company's news release announcing the lawsuit against Stock Lemon, have you looked at and/or talked to the company about Stock Lemon's allegations?" Ms. Zosiak responded that she had enquired about the "reporting company" issue and had been told that it was in process but that she had not pursued the Stocklemon matter, except to confirm that GTX had retained counsel and that it was planning to issue a news release. She sought Mr. Garrod's advice about whether she should pursue this matter with her client. Mr. Garrod responded saying "The Stock Lemon article was quite specific in some respects and I think we should do some due diligence by making an enquiry of the company on the specific aspects so that we can get some comfort as an agent/gatekeeper seeking this advice."

¶ 105 The next day Mr. Garrod emailed Ms. Zosiak saying that he had spoken to Mr. Ovsenik<sup>20</sup> "who had no knowledge of the anti-OTCBB regulatory landscape up here". Mr. Ovsenik had told him that Stocklemon wanted to settle the litigation<sup>21</sup> and that there was no truth to the allegation that GTX was being promoted by two promoters who had previously got into trouble with the SEC. Mr. Garrod expressed some concern about the extent of Global's sales of GTX shares, but conceded that he did not "have anything to hang my hat on right now." He added that based on her previous assurances that she had done "extensive due diligence" he was

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<sup>20</sup> Mr. Garrod thought that Mr. Ovsenik had initiated the telephone conversation.

<sup>21</sup> As we have noted above, there is no evidence that Ms. Zosiak made any inquiries about the purported litigation or that it had in fact been commenced.

content “for the time being”. Ms. Zosiak replied: “I have done as much due diligence as I know how. I am not sure what else to do”. Mr. Garrod’s response: “the key is knowing exactly who your client is and how he/she got the stock they are selling and who is promoting the company and their backgrounds. All the rest is window-dressing”. Later that day Ms. Zosiak reported that she had been told by Montaque (she testified that she spoke to Mr. Sumner) that GTX was going to put out a news release in the next day or two answering all the allegations. The same day, May 24, GTX issued a news release announcing that it was “moving towards fully reporting status”, essentially what it had announced five months earlier. Nothing in the May 24 news release purported to answer any, let alone all, of Stocklemon’s allegations.

¶ 106 Ms. Zosiak did not take any other steps or make any other enquiries about GTX, its principals or the source of the shares her clients were selling or about the allegations contained in the Stocklemon reports or the “facts” disclosed in the GTX news release.

**(vii) Conclusions concerning Ms. Zosiak’s conduct in respect of trading-related matters**

¶ 107 We have considered the matters canvassed in paragraphs [83] to [106] above, both separately and together. We think that at some point – at the latest in the spring of 2006 - the cumulative weight of a number of facts should have provoked Ms. Zosiak to be more insistent and persistent in trying to find out just what her clients might be up to and whether there were grounds for concern about their activities. We refer, in this connection, to: (i) the disparity between what she had been told about the number of shares that would be coming in and the numbers actually deposited; (ii) the fact that the large number of shares deposited were purportedly acquired through private placements; (iii) the large number of shares traded through the accounts; (iv) the allegations in the Stocklemon report; (v) the Dow-Jones report; and (vi) the repeated unfulfilled assurances concerning the imminent acquisition of “reporting company” status by GTX. While we do not need to specify just when this should have happened, we think that at the very latest it was probably some time in the spring of 2006. It is of course easy to say this. It is more difficult, however, to say what precisely she should have done in the circumstances. But the fact is that she did virtually nothing.

¶ 108 In reaching this conclusion we have not ignored what counsel for Mr. Brighten described in his written submissions as “the entrenched principle of law in these matters that conduct in issue is to be judged as at the time it occurred and not through the lens of later-acquired knowledge”. We think that the proposition may be too broadly stated. In support of it we were referred to certain observations of the majority of the panel in *Re Pacific International Securities Inc.*, 2006 BCSECCOM 532, at paragraphs 274 to 276. The concern there, however, was with an attempt to apply hindsight “to connect a number of *unrelated* events” (at paragraph 274). That is not the case here. All the elements related to what was in essence a single subject – the affairs of GTX and the market for its shares.

¶ 109 Whatever Ms. Zosiak’s failures may have been, however, having regard to the jurisprudence described in paragraphs 59 and 60 above, we are not persuaded on the evidence that we heard that they rise to the level of a breach of her gatekeeper obligations, of IDA Bylaw 29.1 or of Dealer Member Regulation 1300.1.

**(e) Wiring funds**

¶ 110 Between the opening of the two accounts in October 2005 and June 2006, Global wired an aggregate of some \$26,634,000 to the Montaque account at Barclay’s Bank in Nassau that each of Laureate and Walcott had designated (see above, paragraph [26] in their respective NCAFs. These funds were wired on the basis of letters of instruction received from each of the two companies “to debit the subject account on a daily basis and wire transfer all available funds to the same coordinates”.

¶ 111 There was a large number of separate requisitions each essentially a simple form with blanks to be filled in. Ms. Zosiak’s role in this connection was apparently limited to preparing the requisitions and forwarding them to the Compliance Department for its approval. The evidence is not clear as to just who in that Department was authorized to give approval. The actual transmission of the funds required, as we understand it, a “sign-off” from an authorized signing officer. Neither Mr. Brighten nor Mr. Garrod appears to have been involved in any aspect of this process, at least on a routine basis.

¶ 112 The Particulars (paragraph 82) say that one of the respects in which Ms. Zosiak did not perform her gatekeeper responsibilities was that she “failed to question why funds were wired from Laureate and Walcott to a bank account belonging to a third party.” The evidence abundantly supports this assertion and Ms. Zosiak did not dispute it. She made no inquiries in connection with this aspect of the matter.

¶ 113 Counsel for IROC pressed Ms. Zosiak on why she did not make these inquiries and in support of its contention that she ought to have done so, referred to a passage in Mr. Garrod’s Memorandum of December 3, 1999 concerning OTC Bulletin Board Stock. It is repeated, with changes that are immaterial, in his Memorandum of February 2006. The relevant passage is this (we quote here from the earlier version):

[W]hy would a third party deliver funds to an account or be the recipient of a payment from the account? While IAs are not responsible for ‘regulating’ the private business affairs of their clients, they are in general responsible for ensuring that brokerage accounts maintained at Global are not in essence being used as . . . conduits by stock manipulators or money launderers. Accordingly, an IA must ascertain the reason(s) for such . . . payments, and must record the reason or reasons in the client’s file.

Reference was also made to the joint letter from the securities regulatory authorities (above paragraph [58]) which Mr. Garrod had sent to all IAs in July 2000, in which the regulators had referred to deficiencies in brokers’ practices with respect to, among other things, “permitting wire transfers of cash from client accounts to persons other than the accountholders, often to offshore jurisdictions.”

¶ 114 Ms. Zosiak’s explanation for why she made no inquiries about the wiring arrangements is really a restatement of her explanation (see paragraph [64] above) for not having questioned the fact that the information in the two NCAFs was identical. It all made perfect sense to her. The requisitions for the wiring of the funds were consistent with that information and the instructions that she received. We should add that Mr. Garrod told us that he did not have any concerns about the wiring of funds from the two Global accounts to the Montaque bank account in Nassau. Because the beneficial owners of the three accounts were, one way or another, the same, he did not consider the transactions to raise any “third party” issues. Mr. Brighten’s evidence was to substantially the same effect. In our view, given the facts about Montaque, Walcott and Laureate and the interconnections among their principals, we think that Mr. Garrod’s view of the matter (which is essentially the same view as taken by Ms. Zosiak, though perhaps expressed more precisely) is reasonable.

¶ 115 In the circumstances, to the extent that it is based on the wiring of funds issue, we do not think that IROC succeeds in its case against Ms. Zosiak.

## **H. OVERALL CONCLUSION CONCERNING THE ALLEGATIONS AGAINST MS. ZOSIAK**

¶ 116 We have tried to evaluate the evidence concerning Ms. Zosiak’s conduct during the Relevant Period, and the allegations against her in connection with that conduct, in two ways. First, we have considered each of the specific failures alleged against her separately, as if they were independent counts in a notice of hearing, and have concluded that whatever her failings may have been in none of the respects alleged did she commit the breaches claimed. We have also, however, considered the specific failures on a cumulative basis – that is, we have asked ourselves whether later facts or events would have led a reasonable person, and should have led Ms. Zosiak to reevaluate earlier facts or events and to consider whether, cumulatively, in the light of the unfolding story, there was more that she should have done. We have suggested, in paragraph [107] above, that a time did come – in around the spring of 2006 – when the accumulation of factors should have suggested to her that there was reason to be concerned about GTX, the market for its shares and the role of her clients in that market. As we have pointed out, however, she did not respond this way. In the light of the jurisprudence summarized in paragraphs [59] and [60] above, however, we have concluded that she did not commit a breach of her obligations under IDA By-law 29.1 and Dealer Member Rule 1300.1, as alleged in Count 2 against her.<sup>22</sup>

¶ 117 We accordingly dismiss Count 2 of the Notice of Hearing. We should add this. We did not hear any

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<sup>22</sup> In our view an examination of this kind is different from the exercise in hindsight criticised by the majority of the Securities Commission in the *Pacific International* case. See above, paragraph [108].

evidence to support the claim in Count 2 that Ms. Zosiak's acts or omissions "facilitated" either transactions that were not "legitimate" or a "securities fraud". Our conclusions on her specific alleged transgressions make it unnecessary to decide whether, had we reached different conclusions, this gap in the evidence would in any event have precluded an adverse finding on Count 2.

¶ 118 The impression that Ms. Zosiak made on us in giving evidence was of an honest and decent but unsophisticated and somewhat credulous person. Although she has worked in the securities industry since graduating from high school in 1980 she only became registered as an IA in 1998 having worked on the trading desk for most of the preceding period. At the commencement of the Relevant Period she had been licensed for only about 7 years. While it may not be strictly accurate to describe her as "inexperienced" the evidence does not reveal the extent of her experience as an IA actually handling client accounts. She was perhaps unduly impressed by the biographies of Messrs. Sumner and Bethel (and Mr. Ovsenik), and unduly inclined to accept at face value whatever they told her – for example about the allegations in the Stocklemon Report and GTX's repeated claims, over a period of some months, of imminent attainment of reporting company status. We hasten to add, however, that there is no evidence that any of these people was involved in the market manipulation of which Mr. Hagen was found guilty.

**I. MR. BRIGHTEN'S ALLEGED FAILURE TO ADEQUATELY SUPERVISE MS. ZOSIAK TO ENSURE THAT DILIGENT ENQUIRIES WERE MADE IN CIRCUMSTANCES WHICH CALLED FOR SUCH INQUIRIES, CONTRARY TO IDA BYLAW 29.27 AND 38, IIROC REGULATION 1300.2 (a) and Policy 2 – COUNT 3**

*(a) A preliminary comment on the Notice of Hearing*

¶ 119 While the explicit complaint against Mr. Brighten in Count 3 is that he failed to supervise Ms. Zosiak in certain respects, some of the allegations in the Particulars seem to go further and allege that, quite aside from his alleged supervisory failures, Mr. Brighten should himself have made the inquiries that Ms. Zosiak allegedly failed to make. Paragraph 90, for example, says that Mr. Brighten "did not make any effort to independently confirm or verify the veracity of any of the information contained in the" Stocklemon articles and Paragraph 92, while asserting a failure to supervise Ms. Zosiak, particularizes this by saying that he "did not verify the veracity of the information" in those articles.

¶ 120 Although this seeming ambiguity creates something of a quandary as to just what must be determined in connection with Count 3, no issue was raised about it before us. We have therefore treated allegations such as those in paragraphs 90 and 92 as if they were a form of shorthand version of the basic charge in Count 3 that Mr. Brighten failed to supervise Ms. Zosiak in the respects indicated.

*(b) The relevant regulatory provisions*

¶ 121 We begin by setting out the by-law and regulation provisions invoked by IIROC in its case against Mr. Brighten.

¶ 122 The relevant part of IDA Bylaw 29.27 is paragraph (b). It says:

Each partner, director, officer, registered representative or agent who has supervisory authority . . . shall fully and properly supervise . . . in accordance with the written policies and procedures of the Member so as to ensure their compliance with the by-laws, regulations and policies of the Association and all other laws, regulations and policies applicable to the Member's securities and commodity futures business.

¶ 123 IDA Bylaw 38 deals with the responsibilities of a so-called Ultimate Designated Person ("UDP") who is vested with supervisory responsibility and who is responsible to the applicable self-regulatory organization for the conduct of the firm and the supervision of its employees. The principal relevant parts of that bylaw are paragraphs 10 and 11, which are as follows:

38.10 The UDP shall ensure that policies and procedures are developed and implemented which adequately reflect the regulatory requirements of the Member.

38.11 The CCO (Chief Compliance Officer) shall monitor adherence to the Member's policies and procedures as necessary to ensure that the management of the compliance function is effective and to provide reasonable assurance that the standards of the applicable self-regulatory organization are met.

¶ 124 IIROC Dealer Member Regulation 1300.2 (a) says:

A Dealer Member must designate a Supervisor to be responsible for the opening of new accounts and for establishing and maintaining procedures acceptable to the Corporation for account supervision to ensure that the handling of client business is within the bounds of ethical conduct, consistent with just and equitable principles of trade and not detrimental to the interests of the securities industry.

IIROC Policy 2 is a general policy that sets out “minimum standards for retail account supervision.” It does not, we think, add much to an understanding of the issues raised by the complaints against Mr. Brighten.

(c) *The nature and extent of the obligation of supervision*

¶ 125 *Re Richard Mills*, September 13, 2000 (Ontario District Council) is a leading decision on the performance of supervisory obligations. The Council wrote (at page 14):

The issue . . . is whether Mr. Mills' supervisory efforts were reasonable in the circumstances of this case. . . . Did Mr. Mills take the supervisory steps that were reasonably required in light of the information available to him and his obligations under the Policy [2]?

¶ 126 That this is the proper test seems generally accepted: see, for example, *Re Frank Youden*, December 22, 2005 (Nova Scotia District Council) and *Re Simon Schillaci*, January 16, 2007. And see *Re Pacific International Securities Inc.* 2006 BCSECCOM 532 and *Re Douglas Garrod*, December 20, 2011.

¶ 127 In *Pacific International Securities* the majority of the British Columbia Securities Commission hearing panel said (at paragraph 233):

In each case, the conduct alleged in the indictments and complaints referred to in this decision took place outside Pacific International. It included conduct such as making misrepresentations to potential investors, bribing or coercing US brokers and failure to disclose compensation for investor relations services. Where conduct occurred outside Pacific International without its knowledge, it cannot be shown that Pacific International failed in its duty to supervise the trading in its accounts.

And again (at paragraph 320):

The know your client and public interest obligations do not, as the Executive Director argued, extend to activities of a client outside of their account at the firm, unless the firm has knowledge of those activities. In that case, we say the registrant would have an obligation to make inquiries of the client under the know your client rule, if those activities cause doubt as to the business or financial reputation of the client.

We think that in assessing the reasonableness of what Mr. Brighten did or failed to do in the discharge of his supervisory responsibilities vis a vis Ms. Zosiak, it is important to consider, among other things, whether there were any reasonable grounds for him to believe that either Laureate or Walcott was engaged in any illicit activity through their respective Global accounts and whether the “securities fraud” referred to in Count 3, was “facilitated” by any acts or omissions of Ms. Zosiak or Mr. Brighten. That fraud was, of course, the subject of the indictment against and subsequent conviction of Mr. Hagen. As we have noted, Laureate and Walcott, and Global, were referred to in the indictment of Mr. Hagen, as was Montaque. None of them, however, was indicted or charged as a co-conspirator with him.<sup>23</sup> Nor were any of Messrs. Sumner, Bethel or Ovsenik.

**J. MR. BRIGHTEN'S POSITION and responsibilities AT GLOBAL during the relevant period**

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<sup>23</sup> See *Re Garrod*, October 6, 2011, paragraph 9.

(a) **Introduction**

¶ 128 Mr. Brighten has been performing senior compliance functions in the securities industry for a considerable number of years and may fairly be described as an experienced veteran in the field. He joined Global in March 2001 initially as Vice President, Compliance and shortly thereafter was appointed the Chief Compliance Officer. He has occupied both positions since, and in particular did so during the Relevant Period. During that period there were two other people in the compliance department, both of whom reported to Mr. Brighten. He in turn reports to Mr. Garrod, Global's President and Chief Executive Officer.

(b) **Mr. Brighten's responsibilities**

¶ 129 Mr. Brighten's duties during the Relevant Period were:

New account openings

Mr. Brighten's approval was necessary for the opening of a new client account. He would give his approval on receiving the required documents from Mr. Ng (above, paragraph [33]) though approval could apparently be given even if all the required documents had not been received so long as there was some comfort that they would be received within a relatively short time. It was not part of Mr. Brighten's duties, however, to keep track of the arrival of "post-approval" receipt of documentation. That was Mr. Ng's responsibility. According to the evidence, Mr. Ng reported to Mr. Garrod. Mr. Brighten's evidence was that he was not routinely informed by Mr. Ng of the status of the documentation. Once he had given his approval his responsibilities in this connection were at an end.

Monitoring trading activity

Mr. Brighten, together with another fairly senior person working in the Compliance Department, apparently shared responsibility for daily and monthly monitoring of trading activity. Without going into detail about the sorts of factors that they would examine, these would include factors that might suggest that a market was being manipulated, that there was inadequate liquidity in the market, and so on.

Reviewing packages received from IAs seeking approval to deal with physical share certificates of OTC companies received by Global

Mr. Brighten's role in this connection was to review the material provided by the IAs seeking approval to accept such share certificates and, in the absence of any ground for concern, to give his "first level" approval, subject to further review and final approval by Mr. Garrod.

Approving wire transfers

Mr. Brighten's role here was to give his approval, if appropriate, of requisitions from IAs for wire transfers of funds from client accounts. This responsibility was shared with a colleague in the Compliance Department, but in either event was not final since the actual wiring of funds required the approval of one of Global's designated signing officers.

**K. The specific failures of supervision alleged against Mr. Brighten**

¶ 130 Paragraph 96 of the Particulars says:

Brighten failed to properly supervise the activities of Zosiak in respect of the Laureate and Walcott accounts. In particular, he did not:

- Verify the veracity of the information in the Stocklemon.com articles;
- Take steps to confirm the authenticity of the legal opinion letters and the basis for the opinions expressed therein;
- Question why money was wired from Laureate and Walcott to a third party bank account;
- Question the volume of sales of GTX at Global;

- Ensure that Zosiak complied with Global’s internal limit of sales of no more than 100,000 shares per week of GTX;
- Question the beneficial ownership of Walcott and Laureate in light of the Certificates of Incumbency for those accounts;
- Permitted trading in the Walcott and Laureate accounts to commence with incomplete account documentation notwithstanding the note on the NAAFs that trading should not commence until documentation was complete.

We shall deal with each of these matters in turn.

**(a) *Failure to ensure that Ms. Zosiak made enquiries to determine the veracity of the information in the Stocklemon articles***

¶ 131 Mr. Garrod testified that once the Stocklemon articles were drawn to his attention, although he and Mr. Brighten may from time to time have talked about the matter, and probably did so, “I took conduct of the matter; I ran with the ball on the Stocklemon matter to the exclusion of Mr. Brighten” and the latter was fully aware of this. Mr. Brighten’s evidence was to the same general effect. He said that he was told that the articles had been given to Mr. Garrod. He did look into whether Global had any record of any of the persons or companies named in the articles and discovered that none of them were. In these circumstances, and knowing that Mr. Garrod was dealing with the matter, he did nothing further.

¶ 132 In her final submissions to us in this connection counsel for IIROC observed that Mr. Brighten never “expressed concern” about the Stocklemon allegations or recommended that Global discontinue trading in GTX shares. So far as the evidence goes, this seems to be correct. In our view, however, it falls conspicuously short of supporting the claim that Mr. Brighten failed in his supervisory responsibilities. Mr. Garrod had taken on directly the role of dealing with Ms. Zosiak and the accounts, and was Mr. Brighten’s superior. Mr. Garrod was Global’s UDP. It stands to reason, therefore, that a duplication of supervisory reviews was unnecessary. Although this does not relieve Mr. Brighten entirely of his supervisory responsibilities, he was conversant with Mr. Garrod's inquiries, directions and concerns.

¶ 133 In our view, accordingly, this complaint is without merit and must fail.

**(b) *Failure to take steps to confirm the authenticity of the legal opinion letters and the basis for the opinions expressed therein***

¶ 134 In our view this complaint also fails, and for several reasons. First, it fails for virtually all of the reasons that we gave in paragraphs [77] to [81] above in rejecting a similar complaint about Ms. Zosiak. Secondly, there is no evidence to show that Mr. Ovsenik, the author of the opinions, was not what he purported to be – a lawyer and the general counsel to GTX. His status as a lawyer was confirmed by Mr. Brighten through a search on Martindale.com, a well-known and, we understand, generally reliable source of information about lawyers. Martindale.com identified Mr. Ovsenik as a lawyer admitted to practice in North Carolina which, on the then available evidence, was the principal operating location of GTX. It is also relevant to the question as to whether Mr. Brighten did his job in this connection that, as explained in paragraph [69], the legal opinions were required in support of an application to Mr. Brighten and Mr. Garrod to approve the acceptance by Global of share certificates of OTCBB companies.

¶ 135 In all of the circumstances we can find no basis to conclude that Mr. Brighten failed in his responsibilities concerning the legal opinions and this complaint accordingly fails.

**(c) *Failure to supervise Ms. Zosiak in connection with the wiring of money from Laureate and Walcott to a third party bank account***

¶ 136 Paragraph 93 of the Particulars alleges that Mr. Brighten “approved the wire transfers from Laureate and Walcott to Montaque’s bank account. He did not question the purpose of wiring funds to a third party”. The evidence supports both statements. The question is: what flows from this? Or, to put it differently, was it unreasonable for Mr. Brighten to approve the wire transfers and not to pursue with Ms. Zosiak the reason for

the arrangements.

¶ 137 For substantially the same reasons, set out in paragraphs [111] to [1123] above, that led us to reject IIROC's complaint about Ms. Zosiak in this connection, we reject its complaint against Mr. Brighten. We do not think that IIROC has made out its case that Mr. Brighten failed in his supervisory responsibilities in this connection. We are not persuaded that in the circumstances the wiring arrangements were suspicious or should have been viewed with skepticism and concern and we are not persuaded, therefore, that Mr. Brighten should have taken any steps that he did not take, whether directly or by way of supervision of Ms. Zosiak.

**(d) Failure to question the volume of sales of GTX at Global**

¶ 138 Paragraph 92 of the Particulars says:

Brighten maintained a spreadsheet to keep track of how many GTX shares were being accepted to be sure that Global did not exceed 10% of the shares outstanding. However as the table set out earlier herein shows, in four months during the Relevant Period, Global sold over 10% of the market volume of GTX. This is in spite of Garrod's stance that Global ought not to be a dominant player in the market in a given OTCBB or Pink Sheet security. This is in spite of the October Filer and the April Info Filer which stated that no party (except the Hagen Trust) beneficially owned more than 5% of the outstanding GTX shares.

¶ 139 There is no evidence as to the existence of a spreadsheet maintained by Mr. Brighten "to keep track of how many GTX shares were being accepted", or that the purpose of the spreadsheet was, as alleged, to ensure that Global did not exceed 10% of the shares outstanding". Mr. Smith gave no evidence about this nor did Mr. Brighten and we heard no submissions on the subject from IIROC's counsel.<sup>24</sup> It is true that when he gave his approval to the acceptance of GTX share certificates delivered to Global, Mr. Brighten did sometimes note on the approval packages the total number of certificates received to date and sometimes indicated certain percentages of purchases and sales, there is no evidence that he did so for the purpose of ensuring that Global did not exceed 10% of the shares outstanding. It is not even made clear what significance should be ascribed to the fact that, as alleged, "in four months during the Relevant Period, Global sold over 10% of the market volume of GTX." Moreover, there is no evidence that an alleged 10% ceiling bore any relationship to Mr. Garrod's "stance that Global ought not to be a dominant player in the market." He gave no evidence to this effect; indeed, he was asked no questions about it. Moreover, his evidence was that he was concerned that Global remain below 25% of the market. In the circumstances we are quite unable to make sense of the allegation and accordingly decline to make any determination about it. Certainly, we heard nothing to warrant a conclusion adverse to Mr. Brighten in this connection.

¶ 140 We are equally at a loss to understand the concluding sentence of Paragraph 92 – "This is in spite of the October Filer and the April Info Filer which stated that no party (except the Hagen Trust) beneficially owned more than 5% of the outstanding GTX shares." The evidence is that the occasions when Global exceeded the 5% threshold all occurred in 2006; and that Mr. Brighten did not see the April Filer until after the end of the Relevant Period. As to the October Filer, while he saw it, he properly pointed out that the information in it is as of a particular date that preceded the "excess" sales.

¶ 141 In our view, therefore, there is no sensible complaint open to IIROC in this connection; and no sensible basis for any conclusion adverse to Mr. Brighten in respect of his discharge of his supervisory obligations in this respect.

**(e) Failure to ensure that Ms. Zosiak complied with Global's internal limit of sales of no more than 100,000 shares per week of GTX;**

¶ 142 Paragraph 68 of the Particulars asserts that Mr. Garrod "imposed a limit that on a firm wide basis, no more than 100,000 GTX shares per week could be sold" and paragraph 73 alleges in substance that Ms. Zosiak

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<sup>24</sup> The only reference to "10%" is to be found in the NCAFs in which clients were asked to indicate whether "singularly or as part of a group" they controlled more than 10% of the votes of a publicly traded issuer". Both Laureate and Walcott answered "no".

exceeded that limit on sales “many times”. Paragraph 91 claims that Mr. Brighten was aware of the “100,000 weekly limit on sales” of GTX imposed by Mr. Garrod and made no effort to enforce this limit”. For reasons that we will explain, we think this complaint rests on a misapprehension of what Mr. Garrod did.

¶ 143 As we have indicated (above, paragraph [69]) the approval of both Mr. Brighten and Mr. Garrod was required before Global would accept deposit of physical certificates for shares of OTCBB companies. To obtain such approval the IA assembled a package of documents for their review. Early in November 2005 Ms. Zosiak assembled such a package to obtain approval for the acceptance of a single certificate for 100,000 GTX shares. Mr. Brighten reviewed the package and noted on it “many more to come” before giving his approval and forwarding it to Mr. Garrod. As we understood the evidence Mr. Brighten made this notation because he had been told that further share certificate deliveries were expected. In any event, upon giving his approval Mr. Garrod wrote the following note: “MAX 100,000 per week on this stock for Laureate’s Way”.

¶ 144 On its face, Mr. Garrod’s notation is in several respects ambiguous – for example, it is not immediately clear whether it related to the number of deposits that would be accepted (i.e. approved) in any week or the number of shares which, once accepted, could be sold. And, as we shall see, that ambiguity gave rise to some confusion as to its meaning.

¶ 145 Mr. Garrod gave evidence about this notation. He explained that he was concerned that Global should not be a significant player on the sell side of the market in GTX shares and he “did not wish to see Ms. Zosiak or the account having large amounts of stock – free trading stock in it which could be sold.” He accordingly adopted what he described as a rule “for no more than 25 per cent on the sell side”. This, it appears, was a firm-wide “rule”. He continued:

And what I did here was to restrict Laureate's Way to not -- Global would not approve more than 100,000 shares for Laureate's Way. And also my intention was for Walcott in this stock. The purpose of the 100,000 share instruction was to ensure that even though stock had been delivered in, that it wasn't immediately available for sale on -- so that there was a large amount of stock in the account which, if it had been sold, may well represent more than 25 percent of the sell side of the market.

¶ 146 Mr. Brighten understood the purpose of the 100,000 share restriction. It was, he said, “an additional tool” in aid of maintaining the 25% ceiling. But he understood it to relate to sales of shares, not approvals for acceptance of deliveries of certificates, and he explained to Ms. Zosiak that “Doug had put a company-wide limit on the amount to be sold in any week of 100,000”. Mr. Brighten acknowledged that he was mistaken on two counts: first, Garrod’s “limit” had nothing to do with the sales per week, but it had to do with the approvals per week; and second it was a “per account” limitation, and not, as he told Ms. Zosiak, a firm-wide limitation. Putting this another way, it seems that Mr. Brighten confused the 25% rule, which related to sales, with the 100,000 rule, which related to approvals.

¶ 147 Mr. Garrod’s rule or instruction concerning 100,000 shares, although it was initially misunderstood, did not relate to sales, as alleged in the Particulars, but to approvals, and the evidence is that it was complied with in the sense in which it was propounded by Mr. Garrod and that Mr. Brighten in fact noted, on each approval, the status of cumulative approvals to date. It is also worth noting that Mr. Garrod signed off on each approval.

¶ 148 The evidence, accordingly, does not in our opinion substantiate the charge made against Mr. Brighten in this respect in the Notice of Hearing. In the circumstances we do not find it necessary to deal with the questions whether IIROC has a legitimate interest in the enforcement by a Member against its employees of its internal policies, directions or instructions; and if it does, what the extent of that interest may be.

## **L. OVERALL CONCLUSION CONCERNING THE ALLEGATIONS AGAINST MR. BRIGHTEN**

¶ 149 It follows from the specific conclusions that we have reached in respect of the particular complaints of inadequate supervision of Ms. Zosiak by Mr. Brighten that in our opinion IIROC has not made out its case against him as set out in Count 3 which must, accordingly, be dismissed.

October 26 , 2012

Leon Getz

Barb Fraser

Brian Field

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