

# **INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA**

**IN THE MATTER OF:**

**THE RULES OF THE INVESTMENT INDUSTRY REGULATORY  
ORGANIZATION OF CANADA (IIROC)**

**AND**

**PATRICK WILLIAM McLAUGHLIN**

**AND**

**ANDREW MICHAEL McMANUS**

## **SETTLEMENT AGREEMENT**

### **I. INTRODUCTION**

1. IIROC Enforcement Staff (“Staff”) and the Respondents, Patrick William McLaughlin (“McLaughlin”) and Andrew Michael McManus (“McManus”) consent and agree to the settlement of this matter by way of this agreement (the “Settlement Agreement”).
2. The Enforcement Department of IIROC has conducted an investigation (“the Investigation”) into the conduct of McLaughlin and McManus.
3. The Investigation discloses matters for which the Respondents may be disciplined by a hearing panel appointed pursuant to IIROC Transitional Rule No.1, Schedule C.1, Part C (the “Hearing Panel”).

### **II. JOINT SETTLEMENT RECOMMENDATION**

4. Staff and the Respondents jointly recommend that the Hearing Panel accept this Settlement Agreement.
5. The Respondents admit to the following contraventions of IIROC Dealer Member Rules, Guidelines, Regulations or Policies:

McLaughlin:

- a) Between December 2010 and January 2011, McLaughlin, as registered representative, failed in his role as gatekeeper to the capital markets in that he failed to ask any or sufficient questions surrounding the transfer of certain securities amongst his clients, thereby acting contrary to IIROC Dealer Member Rule 29.1.

McManus:

- b) Between December 2010 and January 2011, McManus, as branch manager and supervisor of McLaughlin, failed in his role as gatekeeper to the capital markets in that he failed to ask any or sufficient questions of McLaughlin surrounding the transfer of certain securities amongst McLaughlin's clients, thereby acting contrary to IIROC Dealer Member Rule 29.1.

6. Staff and the Respondents agree to the following terms of settlement:

McLaughlin:

- a) a \$20,000 fine; and
- b) a 30 day suspension in all registration capacities.

McManus:

- a) a \$20,000 fine.

7. The Respondents agree to pay costs to IIROC as follows:

McLaughlin:

- a) the sum of \$5,000.

McManus:

- a) the sum of \$5,000.

### **III. STATEMENT OF FACTS**

#### **(i) Acknowledgment**

8. Staff and the Respondent agree with the facts set out in this Section III and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

**(ii) Factual Background**

**Overview**

9. On February 1, 2011, BMO Nesbitt Burns (“BMO”) filed a gatekeeper report with IIROC regarding a private distribution of shares of Karnalyte Resources Inc. (“Karnalyte”), a junior potash mining company with its head office in Okotoks, Alberta.
10. Specifically, BMO identified that seven related clients (the "giftors") had transferred, ostensibly without consideration, a total of 279,658 shares of Karnalyte (“the share transfers”) to sixty-two other BMO account holders (the "giftees") during the periods of December 22-24, 2010 and January 11-12, 2011. The market value of the share transfers was slightly in excess of \$2.4 million.
11. McLaughlin was the Registered Representative of record for all of the giftors and giftees and is employed at BMO's Calgary Westmount branch (the “Westmount Branch”). McManus is the Branch Manager at the Westmount Branch.
12. The gifted shares were initially purchased by the giftors in a 2009 private placement (the “2009 Private Placement”). McLaughlin was aware of the details of the 2009 Private Placement and played an active role in assisting Karnalyte to raise capital.
13. All seven giftors are relatives of RP, the CEO of Karnalyte. There is no obvious relationship, in the sense of shared surnames or otherwise, between the vast majority of the giftors and the giftees. The sixty-two transfers ought to have raised questions as to the nature and purpose of the transactions.
14. The giftors appear to have purchased shares in the 2009 Private Placement on behalf of other clients of McLaughlin who did not qualify for any available prospectus exemptions. The giftors then executed a "Change in Beneficial Ownership Form" (“CBO Form”) to effect the transfers. The CBO Form stipulates that the transfers "were not made upon the existence or expectation of any consideration". The CBO Forms were approved by McManus.
15. On January 13, 2011, the compliance department of BMO commenced an internal investigation into the share transfers. When asked as to the motivation for the giftors’ transfer of the Karnalyte shares, McLaughlin advised BMO compliance that he “did not know” and that the transfers were “initiated by the clients”. McManus did not ask any or sufficient questions when approving the CBO Forms although he did understand at the time of the transfers that the giftors were all related to the principals of Karnalyte.

16. The BMO internal investigation concluded that McLaughlin “*failed to complete the appropriate due diligence prior to submitting the transfer requests for approval*”. He was fined \$20,000 and also required to attend the compliance training component of its rookie training program. McManus was fined \$20,000 and required to complete the Chief Compliance Officer course offered by CSI.

### **The Respondents**

17. McLaughlin began work at BMO in January 2008 as a Registered Representative. He was hired by an established RR at BMO, an individual named Julius Brinkman (“Brinkman”), to work as his Associate Registered Representative.
18. Prior to his employment with BMO, McLaughlin was employed by CIBC World Markets from November 1997 to April 2007. He became a registered representative in 2006. Prior to becoming registered, he had worked as an assistant on a team and followed instructions as to who to call and what to advise based on the senior IA’s direction. He did not have clients of his own and did not receive formal training.
19. Subsequent to his employment with CIBC World Markets, McLaughlin was then employed by ATB Investor Services for a brief period of time in the Wealth and Estate Planning area.
20. McManus was the Branch Manager for the Westmount Branch and was responsible, amongst other things, for supervising McLaughlin’s activities. McManus started his career with Greenline Investor Services Inc. in 1993 before transferring to BMO in 1996. He became a Registered Representative in March 2003. He was registered as an Assistant Branch Manager beginning in June 2009 and was promoted and registered as a Branch Manager and Supervisor effective November 1, 2010.

### **Karnalyte and the Private Placements**

21. Karnalyte is a junior potash mining company with its head office in Okotoks, Alberta.
22. RP is the CEO and a director of Karnalyte. His brother, SP, resides in Kenora, Ontario and was instrumental in Karnalyte’s efforts to raise capital. SP was one of the main giftors in the transfers which occurred between December 22 and 24, 2010 and again between January 11 and 12, 2011. Various relatives of SP and RP comprise the other giftors.
23. In April 2008, Karnalyte closed an initial private placement of 5,000,000 shares at \$1.00 each. McLaughlin participated in this initial private placement in his personal account.
24. In early 2009, Karnalyte continued with its efforts to raise capital by way of private placement. BMO, and in particular Brinkman and McLaughlin, were engaged to facilitate the raising of capital.

25. On June 26, 2009, McLaughlin's assistant, on behalf of Brinkman sent an e-mail to McLaughlin and others regarding the 2009 Private Placement. That e-mail set out the specific "rules for qualification, as dictated by the security [sic] regulators in each province for the purchase of private shares in this Karnalyte offering".
26. The June 26, 2009 e-mail then went on to describe three groups of potential investors ("Group 1" – Ontario investors; "Group 2" – Canadian residents, other than Ontario; and "Group 3" – financially accredited investors). This e-mail detailed the specific criteria by which an investor would qualify for one of the groups eligible to invest in Karnalyte.
27. Accordingly, McLaughlin knew, or ought to have known, that potential investors needed to meet certain criteria to qualify for the 2009 Private Placement.
28. Throughout 2009, McLaughlin participated in efforts to help Karnalyte raise capital. He was in contact with SP regarding potential investors in the 2009 Private Placement on a regular basis. He attended a "road show" with SP in Winnipeg and Kenora to meet with potential investors. McLaughlin had discussions with potential investors and went through a qualification process with them by which he could determine whether they met the criteria for investing directly in the 2009 Private Placement.
29. Through his involvement in the qualification process, McLaughlin was aware that some potential investors did not qualify for direct investment in the 2009 Private Placement.
30. The 2009 Private Placement closed on August 12, 2009. A total of 2,037,600 shares were distributed at a price of \$5.00 each. McLaughlin participated in the offering in his personal accounts.

### **Karnalyte is Listed on the TSX**

31. On December 14, 2010, Karnalyte was listed for trading on the TSX.
32. In the time frame leading up to Karnalyte's TSX listing, McLaughlin received communications from SP indicating that certain individuals would need accounts opened. McLaughlin opened accounts for these individuals, who ultimately became giftees.
33. Also in the timeframe leading up to Karnalyte's TSX listing, McLaughlin received periodic e-mails from clients referencing shares in Karnalyte that were being held for them by SP, or for which they had paid SP several months ago. These clients did not qualify for the 2009 Private Placement and ultimately became giftees pursuant to the December 2010 or January 2011 transfers.

### **The Transfers and Processing of the CBO Forms**

34. The transfers were accomplished in two separate batches. The first involved 31 CBO Forms which were processed between December 22 and 24, 2010; the second involved a further 31 CBO Forms which were processed between January 10 and 11, 2011.
35. The giftors were all clients of McLaughlin. The giftees were all clients of McLaughlin. Attached as Appendix "A" is a summary of the gifted shares which were transferred pursuant to the CBO Forms. The giftors are all relatives of RP and SP.
36. The giftors made large purchases of Karnalyte shares in the 2008 and 2009 Private Placements at a price of \$1.00 or \$5.00 respectively. The December 2010 Karnalyte IPO was priced at \$8.60. Notwithstanding the immediate increase in value of the Karnalyte shares, the giftors transferred the shares they had purchased in the 2008 or 2009 Private Placement by way of the CBO Forms. In many cases, the "gifts" carried out by the giftors constituted the vast majority (if not all) of the shares originally purchased. Additionally, two of the giftors purchased Karnalyte shares in the December 2010 IPO at a price of \$8.60 while having transferred shares to giftees at \$5.00 at or about the same time. These transactions make little or no economic sense and warranted further investigation by McLaughlin.
37. Given his:
  - (i) involvement in the Karnalyte private placements;
  - (ii) communications with SP;
  - (iii) knowledge of e-mail communications from various giftee clients; and
  - (iv) the unusual circumstance of clients "gifting" shares which had just experienced a windfall price increase and some giftors transferring shares at \$5.00 while purchasing IPO shares at \$8.60,

McLaughlin knew or ought to have known that SP was purchasing shares on behalf of investors who did not qualify under available prospectus exemptions. McLaughlin knew or ought to have known that the share transfers were not gifts and that there was consideration involved. McLaughlin ought to have asked questions to satisfy himself that the transfers were made in accordance with all applicable securities regulations.

### **Relationship of McLaughlin to Karnalyte Principals**

38. On March 9, 2010, Brinkman resigned from BMO to join Karnalyte as its VP, Investor Relations. On or about this date, McLaughlin purchased Brinkman's book of client accounts and took over as RR for all of Brinkman's existing clients.
39. The families of RP and SP are significant clients and are worth approximately \$150 million to McLaughlin's book.

### **Internal Investigation by BMO**

40. BMO conducted an internal investigation relating to this matter. In early February, 2011, senior representatives from BMO's Compliance Department travelled to Calgary to interview the Respondents and other individuals.
41. McLaughlin advised the senior compliance representatives that he was aware of the share transfers before they occurred. He also told them that he knew, before the fact, that SP had purchased shares on behalf of giftees and that the share transfers were not gifts.
42. McManus advised the senior compliance representatives that he did not make any inquiry regarding the share transfers.
43. At the conclusion of the internal investigation, McLaughlin and McManus were disciplined.
44. McLaughlin was:
  - (i) fined \$20,000; and
  - (ii) required to attend the Compliance Training component of BMO's internal IA Rookie Training conference.
45. McManus was:
  - (i) fined \$20,000; and
  - (ii) required to complete the Chief Compliance Officer course offered through the Canadian Securities Institute.

### **Mitigating Factors**

46. Neither McLaughlin nor McManus have any prior disciplinary history.
47. Although it is not possible to calculate potential client losses, (many giftees still hold Karnalyte shares, other giftees have purchased shares at different cost bases and at different times), Staff acknowledges that no clients have registered complaints regarding losses due to purchases of Karnalyte shares. Over the last year, Karnalyte shares have traded in the \$1.00 - \$1.50 per share range. As at January 1, 2015, Karnalyte shares traded at \$0.85 per share.

### **Conclusion**

48. There were sufficient red flags regarding the two large batches of transfers of Karnalyte shares that further inquiries were warranted to ensure that the proposed transfers were not designed to circumvent any securities laws.

49. McLaughlin, as Registered Representative of record for the giftor and giftee accounts knew, or ought to have known, that the proposed transfers raised questions warranting further enquiries. In failing to make any enquiries, he failed in his role as gatekeeper to the capital markets.
50. McManus, as Branch Manager, knew or ought to have known, that the proposed transfers raised questions warranting further enquiries. In failing to make any enquiries, he failed in his role as gatekeeper to the capital markets.

#### **IV. TERMS OF SETTLEMENT**

51. This settlement is agreed upon in accordance with IIROC Dealer Member Rules 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member Rules of Practice and Procedure.
52. The Settlement Agreement is subject to acceptance by the Hearing Panel.
53. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.
54. The Settlement Agreement will be presented to the Hearing Panel at a hearing (“the Settlement Hearing”) for approval. Following the conclusion of the Settlement Hearing, the Hearing Panel may either accept or reject the Settlement Agreement.
55. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives his/her/its right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.
56. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondent may enter into another settlement agreement; or Staff may proceed to a disciplinary hearing in relation to the matters disclosed in the Investigation.
57. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
58. Staff and the Respondent agree that if the Hearing Panel accepts the Settlement Agreement, they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement.
59. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.
60. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

**AGREED TO** by the Respondent Patrick William McLaughlin at the City of "Calgary" in the Province of

"7th", this "April" day of "April", 20"15".

**"Witness"**

**"Patrick William McLaughlin"**

**AGREED TO** by the Respondent Andrew Michael McManus at the City of "Calgary" in the Province of "Alberta"

this \_\_\_\_\_ day of "Apr 07 2015 , 20\_\_\_\_\_.

**"Witness"**

**"Andrew Michael McManus"**

**AGREED TO** by Staff at the City of "Toronto" in the Province of "Ontario",

this "1st" day of "April" , 20"15".

**"Witness"**

**"Andrew P. Werbowski"**

Senior Enforcement Counsel on behalf of  
Staff of the Investment Industry Regulatory  
Organization of Canada

**APPENDIX “A”**

<b>Transferor A/C &amp; Client Name</b>	<b>Transferee A/C &amp; Client Name</b>	<b>Transfer QTY</b>	<b>Transfer Date</b>
***_**264 --- KR and / or PG	***_**390 --- E and / or I D	1210	Dec 24/10
***_**264 --- KR and / or PG	***_**340 --- N McP	1100	Dec 22/10
***_**264 --- KR and / or PG	***_**555 --- J and / or J L	8800	Dec 22/10
***_**264 --- KR and / or PG	***_**327 --- J H	1100	Dec 22/10
***_**264 --- KR and / or PG	***_**443 --- R K	2200	Dec 22/10
***_**264 --- KR and / or PG	***_**366 --- B and / or R W	3520	Dec 24/10
***_**264 --- KR and / or PG	***_**371 --- J and / or R K	4620	Dec 24/10
***_**264 --- KR and / or PG	***_**362 --- L R and J-M V	1100	Dec 24/10
***_**264 --- KR and / or PG	***_**447 --- L B	4400	Dec 24/10
		<b>28,050</b>	
***_**257 --- NR and / or GR	***_**342 --- D R	2200	Dec 22/10
***_**257 --- NR and / or GR	***_**352 --- M K G	2200	Dec 22/10
***_**257 --- NR and / or GR	***_**451 --- D V	12100	Dec 22/10
***_**257 --- NR and / or GR	***_**264 --- K R and / or P G	4400	Dec 22/10
***_**257 --- NR and / or GR	***_**372 --- O and / or M A	1100	Dec 22/10
***_**257 --- NR and / or GR	***_**380 --- W and / or E O	4400	Dec 22/10
***_**257 --- NR and / or GR	***_**320 --- S and / or G B	1100	Dec 22/10
***_**257 --- NR and / or GR	***_**319 --- M R and / or F M	19988	Dec 22/10
***_**257 --- NR and / or GR	***_**310 --- C V	2200	Dec 22/10
***_**257 --- NR and / or GR	***_**452 --- R V and / or N P	12100	Dec 22/10
***_**257 --- NR and / or GR	***_**329 --- C N	1100	Dec 22/10
***_**257 --- NR and / or GR	***_**520 --- C V and / or M N	12100	Dec 22/10
***_**257 --- NR and / or GR	***_**388 --- V B	1100	Jan 12/11
		<b>76,088</b>	
***_**284 --- HoP	***_**353 --- A / B Z	2200	Dec 22/10
***_**284 --- HoP	***_**285 --- D / J DLT	2200	Dec 22/10
***_**284 --- HoP	***_**368 --- T / A S	22000	Dec 22/10
***_**284 --- HoP	***_**428 --- C / D N	5500	Dec 24/10
		<b>31,900</b>	
***_**263 --- HeP and / or EP	***_**446 --- G P	500	Dec 22/10
***_**263 --- HeP and / or EP	***_**381 --- G / F R	1000	Dec 22/10
***_**263 --- HeP and / or EP	***_**440 --- D Q	1700	Dec 22/10
***_**263 --- HeP and / or EP	***_**445 --- M N	500	Dec 22/10
		<b>3,700</b>	
***_**272 --- TP and / or CP	***_**450 --- P / T K	<b>2,000</b>	Jan 11/11
***_**277 --- SP and / or NP	***_**346 --- W D	2000	Jan 11/11
***_**277 --- SP and / or NP	***_**655 --- F G	4000	Jan 11/11
***_**277 --- SP and / or NP	***_**215 --- M / N F	4000	Jan 11/11
***_**277 --- SP and / or NP	***_**334 --- D / M D	2000	Jan 11/11
***_**277 --- SP and / or NP	***_**313 --- P / P O-B	2000	Jan 11/11
***_**277 --- SP and / or NP	***_**267 --- C R	5000	Jan 11/11

Transferor A/C & Client Name	Transferee A/C & Client Name	Transfer QTY	Transfer Date
***--**277 – SP and / or NP	***--**007 --- J L	4000	Jan 11/11
***--**277 – SP and / or NP	***--**357 --- Z / A M	6000	Jan 11/11
***--**277 – SP and / or NP	***--**318 --- J T	2000	Jan 11/11
***--**277 – SP and / or NP	***--**246 --- E R N	2000	Jan 11/11
***--**277 – SP and / or NP	***--**382 --- B N	1000	Jan 11/11
***--**277 – SP and / or NP	***--**258 --- R W	6000	Jan 11/11
***--**277 – SP and / or NP	***--**393 --- J H	13000	Jan 11/11
***--**277 – SP and / or NP	***--**340 --- R P	3000	Jan 11/11
***--**277 – SP and / or NP	***--**338 --- R B	2500	Jan 11/11
***--**277 – SP and / or NP	***--**606 --- J B	18000	Jan 11/11
***--**277 – SP and / or NP	***--**391 --- A / C R	10000	Jan 11/11
***--**277 – SP and / or NP	***--**232 --- A P	1000	Jan 11/11
***--**277 – SP and / or NP	***--**457 --- D / J	1000	Jan 11/11
***--**277 – SP and / or NP	***--**375 --- J / J O	5000	Jan 11/11
***--**277 – SP and / or NP	***--**316 --- L / K L	5000	Jan 11/11
***--**277 – SP and / or NP	***--**343 --- E B	1200	Jan 11/11
***--**277 – SP and / or NP	***--**292 --- M / K B	5000	Jan 11/11
***--**277 – SP and / or NP	***--**259 --- G M	7000	Jan 11/11
***--**277 – SP and / or NP	***--**358 --- J D	2000	Jan 11/11
***--**277 – SP and / or NP	***--**685 --- C D	1500	Jan 11/11
***--**277 – SP and / or NP	***--**490 --- R F	3920	Jan 11/11
***--**277 – SP and / or NP	***--**293 --- M / J C	5000	Jan 11/11
***--**277 – SP and / or NP	***--**265 --- K / D F	5000	Jan 11/11
		<b>129,120</b>	
***--**266 - DP and / or EK	***--**256 T / M P	6600	Dec 23/10
***--**266 - DP and / or EK	***--**336 J / V Z	2200	Dec 23/10
		<b>8,800</b>	
	TOTAL	<b>279,658</b>	

**ACCEPTED** at the City of "Calgary" in the Province of "Alberta" ,  
this "28" day of "April" , 20"15" , by the following Hearing Panel:

Per: "Eric Spink, QC"

Panel Chair

Per: "Donald W Milligan"

Panel Member

Per: "John H. Wells"

Panel Member