

ALBERTA SECURITIES COMMISSION

ORDER

Citation: Johnson, Re, 2007 ABASC 28

Date: 20070117

Docket: E/03067

Jerry Russell Johnson

Panel: James A. Millard, QC
Karen A. Prentice, QC

Appearing: Laurie Schrader
For Commission Staff

Date of Hearing: 5 January, 2007

Date of Decision: 17 January, 2007

I. Background

[1] This matter originated in a notice of hearing (the Notice of Hearing) issued by staff (Staff) of the Alberta Securities Commission (the Commission) on November 9, 2006. In the Notice of Hearing, Staff alleged that Jerry Russell Johnson (Johnson) breached Alberta securities laws by engaging in an illegal distribution of securities to Alberta residents, making prohibited representations, contravening the terms and conditions of his registration as a "salesperson", and acting as an "advisor" when not registered to do so, all of which amounted to conduct contrary to the public interest.

[2] Staff sought a number of orders against Johnson under sections 198, 199 and 202 of the *Securities Act*, R.S.A. 2000, c. S-4 (the Act).

[3] On December 29, 2006, a "Statement of Agreed Facts" was entered into between the Respondent and the Commission (the Agreement), which is attached as Appendix "A" hereto.

[4] In the Agreement, Johnson made admissions of fact respecting the allegations in the Notice of Hearing and acknowledged that he had breached Alberta securities laws. The Agreement also set out the parties' joint submission as to appropriate sanctions in this matter.

[5] The hearing was conducted on January 5, 2007. Counsel for Staff made written and oral submissions and entered the Agreement into evidence. Johnson did not appear and no witnesses were called.

[6] This order evidences the Commission's decision in this matter, as delivered orally at the conclusion of the hearing.

II. Findings of Fact

[7] The Panel accepts the agreed upon facts set out in the Agreement. We also accept the admissions made by Johnson in the Agreement.

III. Orders

[8] We find it is in the public interest to remove Johnson permanently from the Alberta capital market in any capacity in which he could affect the investing public, including acting as an officer or director of any issuer. We also find it is in the public interest to impose on him a significant administrative penalty.

[9] We therefore order, with effect as of the hearing date:

- (i) under subsection 198(1)(b) of the Act, that Johnson be permanently prohibited from trading in or purchasing any securities;

- (ii) under subsection 198(1)(c) of the Act, that Johnson be permanently denied the use of any of the exemptions contained in the Alberta securities laws;
- (iii) under subsections 198(1)(d) and (e) of the Act, that Johnson immediately resign any and all positions that he holds as a director or officer of any issuer and he be permanently prohibited from becoming or acting as a director or officer or as both a director and an officer of any issuer;
- (iv) under subsection 199(1) of the Act, that Johnson pay to the Commission an administrative penalty in the amount of \$100,000; and
- (v) under subsections 202(1) and (2) of the Act, that Johnson pay \$10,000 toward the costs of the hearing and investigation.

[9] This proceeding is now concluded.

January 17, 2007.

For the Commission:

"Original Signed By"

James A. Millard, QC, Member

"Original Signed By"

Karen A. Prentice, QC, Member

APPENDIX "A"

E/03067

ALBERTA SECURITIES COMMISSION

IN THE MATTER OF the *Securities Act*
R.S.A. 2000, c. S-4 ("Act")

-and-

JERRY RUSSELL JOHNSON (the "Respondent")

STATEMENT OF AGREED FACTS

The Staff (Staff) of the Alberta Securities Commission (Commission) and the Respondent, Jerry Russell Johnson (Johnson) hereby admit the following facts for the purpose of this Hearing.

Introduction

- 1 A Notice of Hearing issued on November 9, 2006, seeks the imposition upon Johnson of various orders under s. 198(1) of the Act, pursuant to s. 198(1.1) of the *Act*.
- 2 Staff and Johnson have agreed upon the following facts to be presented to the Commission at the hearing of this matter and have agreed to present a joint submission of the appropriate sanction based upon those facts. Both Staff and Johnson recognize that the joint submission on sanction is not binding on the panel that hears this matter.
- 3 Terms used herein have the same meaning as provided in the Alberta securities laws.

Circumstances

- 4 Johnson is a 56-year-old resident of Lethbridge, Alberta. Johnson was registered as a securities salesperson from approximately 1980 to June 15, 2005, and has been employed as a futures broker by various Members of the Investment Dealers Association (IDA).

Previous Misconduct

5 In August 2000, Johnson's employment as a salesperson was terminated for borrowing in excess of \$340,000 from clients without his dealer employer's knowledge or authorization. The IDA disciplined Johnson for this conduct in a settlement agreement in November 2003.

6 On June 15, 2005, Johnson's employment as a salesperson with another dealer was terminated, again for having unauthorized personal financial dealings with clients. As a result of that conduct, the IDA suspended Johnson's registration and approval effective the same date, and on October 21, 2005, following a hearing, expelled Johnson from its membership.

Sales of Securities and Use of Funds

7 From approximately February 2004 to April 2006, Johnson entered into 135 loan or investment agreements (Loan Agreements) with various Alberta residents, mainly from the Lethbridge area, some of whom were long-term clients (Investors). During this period, and pursuant to the Loan Agreements, Johnson collected approximately \$2.5 million from 35 Investors in exchange for a promised return on investment of approximately 4% to 10% per month.

8 The Loan Agreements were drafted by Johnson and were essentially the same as those used by him in the activities for which the IDA previously sanctioned him. Johnson did not keep, or provide to Investors, any records or receipts of amounts borrowed or payments made, other than the Loan Agreements themselves. In addition, there was no segregation of the borrowed funds from his personal funds; they were all co-mingled.

9 Many Investors knew Johnson from church and from his activities in the investment community and Johnson has indicated that most Investors entered into the Loan Agreements based on their trust in Johnson, and he provided no other security for the investments.

10 Many Investors made more than one investment through the Loan Agreements, and in many cases the amounts invested were substantial. Johnson admits he collected about \$1 million from one family alone. Further, Johnson admits that some of the Loan Agreements were made with persons investing on behalf of third parties not actually party to the Loan Agreements. In addition, Johnson was paying at least two Investors commissions or finder's fees for referrals and at least two Investors borrowed money (from lines of credit secured by their homes) in order to loan money to Johnson.

11 While soliciting funds, Johnson was either vague or silent in his discussions with Investors about what he intended to do with the money and how he would provide Investors with a return. Johnson admits the majority of the borrowed funds were

invested by him in an Internet-based offshore entity called Fast Market Ltd. (FM), that claimed to be a high-yield investment program promising returns of up to \$2.5% per day.

12 Johnson states his intention was to pay back the loans and interest to Investors with income generated from the investment in FM, as well as from some other small investments. None of these investments generated sufficient income, or any income at all, and Johnson used newly borrowed funds to honour repayment schedules in previous Loan Agreements. He also used some of the funds to pay his personal bills and expenses, including his mortgage, insurance, multiple vehicles, and approximately \$36,000 to support his son's career.

13 Johnson admits that the Investors were not aware he was making payments to them using money borrowed from other Investors, and they were not aware of Johnson's investment, on their behalf, in FM and use of their funds for his personal expenses. Johnson admits he did not obtain any general or specific trading instructions from any of the Investors for the use of the borrowed funds.

14 Of the approximately \$2.5 million paid to Johnson by the Investors, only \$1,502,562.74 has been returned. Once Johnson stopped making payments to Investors, many of them contacted him because they were concerned about the status of the money they had invested with him. Johnson reassured all such Investors that money was coming and had just been delayed. Johnson has indicated that while he did receive some payments from FM totalling approximately \$240,000 USD, he has not received any payments from FM since November 2005. Eventually, some Investors made complaints to the Commission.

15 Johnson states the money left unaccounted for, about \$1 million, is either still with FM or has already been used for his living expenses, as described in paragraph 12.

16 Staff's investigation to date indicates there is no reliable evidence showing that FM is, or was, a legitimate or viable company and Staff's understanding is that FM has ceased to operate. Johnson states that he still believes FM will be revived and that he intends to use any funds recovered from FM to pay back Investors.

Activities after Suspension and Expulsion from IDA

17 Johnson completed 25 Loan Agreements, accepting \$750,500 from 14 Investors, after his suspension by the IDA. Seven of those 25 Loan Agreements, representing \$190,000, were completed after Johnson's expulsion from the IDA. In addition, Johnson collected approximately \$105,000 in January 2006 from two other Investors and used the funds for personal expenses and to make payments to prior Investors.

18 Johnson admits that he collected money and signed Loan Agreements with Investors, often with long-term repayment schedules, after his suspension and expulsion, and even after he was aware of Staff's investigation of his activities.

19 Johnson admits that:

19.1 all of the Loan Agreements were securities, as defined in the *Act*;

19.2 the sale of these securities to the Investors represented trades in securities under the *Act*;

19.3 as trades in securities of an issuer (Johnson) that had not been previously issued, Johnson's trades to the Investors were distributions under the *Act*;

19.4 at no time was he issued a receipt for a preliminary or final prospectus for the distribution of the Loan Agreements and he did not file any forms of exempt distribution with the Commission;

19.5 until June 15, 2005, he was registered as a salesperson which permitted him to trade for clients only in futures, but at no time was he registered as an advisor or portfolio manager; and

19.6 particularly for all Loan Agreements signed on or after June 15, 2005, there were no exemptions from the registration requirements under the *Act* applicable to the trades of these securities.

20 As a result, Johnson admits that:

20.1 all of his trades with Investors were in breach of section 110 of the *Act* as distributions of securities of an issuer without a prospectus or appropriate exemption;

20.2 all of his trades with Investors on or after June 15, 2005 were also in breach of section 75(1)(a) of the *Act*;

20.3 for all of his trades with Investors, he acted as an "advisor" and engaged in unauthorized discretionary trading when he was not registered to do so, in breach of subsection 75(1)(b) of the *Act*, specifically by:

20.3.1 holding his activities out as an "investment process" by which he would invest money for the Investors and provide them with a return;

20.3.2 engaging in the business of advising the Investors with respect to their investments in securities; and

20.3.3 not obtaining any general or specific trading instructions for the money invested or loaned to him.

21 Particularly in relation to all Loan Agreements signed prior to June 15, 2005, Johnson admits he acted contrary to the terms and conditions of his registration as a salesperson, and specifically subsections 2.1, 2.3, 2.5 and 2.8 and subsection 3.2 of ASC Policy 3.1, and consequently was in breach of subsection 75(2) of the *Act*. The particulars of Johnson's conduct are as follows:

21.1 the investments in FM were not appropriate for any of the Investors, nor in keeping with their investment objectives, resulting in aggregate losses to Investors of approximately \$1 million;

21.2 he failed to make his client's interests the foremost consideration in all business dealings;

21.3 he failed to follow the "Know Your Client Rule";

21.4 the manner of his solicitation of funds from Investors and the conduct of his business throughout the period was not such as to merit public respect and confidence;

21.5 he failed to conduct his personal business affairs in a responsible manner so as to reflect credit on the securities industry; and

21.6 he failed to avoid unethical practices, as he engaged in personal financial dealings with clients without the knowledge or authorization of his employer.

22 In addition, Johnson admits his failure to properly inform the Investors of what he would do with the funds and how he would provide them with the promised return amounted to misrepresentations or omissions which induced Investors to enter into the Loan Agreements, contrary to what was then subsection 92(3)(c) [now subsection 92(4.1), of the *Act*].

23 Finally, Johnson admits that his breaches of the *Act*, his failure to abide by the code of conduct and ethical practices of registrants in ASC Policy 3.1, and his failure to learn from and comply with the previous sanctions levied against him by the IDA, constitutes conduct that was contrary to the public interest.

Other Relevant Circumstances

24 The Commission received complaints from several Investors and other members of the public with respect to the sale of the Loan Agreements by Johnson, which resulted in Staff's investigation.

25 The Commission has not previously sanctioned Johnson; however, the IDA has twice sanctioned him for similar misconduct, as discussed in paragraphs 5 and 6.

26 Johnson previously declared bankruptcy in April 2002. At that time, he declared over \$1 million in liabilities, about \$880,000 of which was unsecured, against minimal non-exempt assets. Some of the unsecured creditors were clients of Johnson's at the time. Johnson was discharged from bankruptcy on November 29, 2004.

27 Johnson cooperated with Staff's investigation of these matters and this Agreement has saved the Commission the time and expense associated with a contested hearing under the *Act*.

Sanction

28 Based on this Agreement and the facts herein, Staff and Johnson jointly propose that he:

28.1 be permanently prohibited from trading in and purchasing securities;

28.2 be permanently denied the use of any exemptions in the Alberta securities laws;

28.3 immediately resign any and all positions as a director and officer of any issuer and be permanently prohibited from becoming or acting as a director or officer, or as both a director and officer, of any issuer;

28.4 be ordered to pay to the Commission an administrative penalty of \$100,000; and

28.5 be ordered to pay to the Commission \$10,000 towards the costs of the investigation.

Administration

29 Johnson acknowledges that he has received the Notice of Hearing, that he has been informed of the hearing date and that he waives his right to a hearing.

30 Johnson acknowledges that he has sought independent legal advice and that he has voluntarily made the admissions contained herein, which admissions are made for the purposes of this proceeding, and any other securities regulatory proceedings, and for no other purpose.

