

# ASC Panel Finds that Due Diligence Defence Does Not Apply to Fraud Allegations

February 23, 2018

On February 20, 2018, the Alberta Securities Commission (ASC) released its decision in *Re Aitkens*, 2018 ABASC 27. The ASC Panel found that the respondents, Aitkens, Stoney View Crossing and Harbour View Landing, had breached section 93(b) of the Alberta Securities Act (the "Act") by engaging "in a course of conduct that they knew or ought to have known perpetrated a fraud on Stoney View and Harbour View investors". The Panel also found that Aitkens, and certain other respondents, had made materially misleading omissions in offering memoranda. The Panel's decision did touch on some interesting legal issues, including the availability of a due diligence defence in the **securities law context**.

The ASC Staff had alleged that Aitkens, who was the directing mind of Stoney View Crossing and Harbour View Landing as well as other companies, had made misleading omissions in Stoney View Crossing and Harbour View Landing offering memoranda and had diverted most of the balance of the funds to other private companies he owned. The Panel alleged that Stoney View Crossing and Harbour View Landing had breached s. 93(b) of the Act by engaging "in a course of conduct that they knew or ought to have known perpetrated a fraud on Stoney View and Harbour View investors".

Aitkens had argued in part that he had not intended to commit fraud and he argued that he believed that he was entitled to use the money from projects which was not currently needed to assist other projects.

In reviewing the legal test for fraud, the Panel noted that it was not necessary for the Staff to show that a respondent specifically intended to be dishonest or cause financial loss to others. Rather, the Staff only had to establish a "prohibited" or dishonest act occurred that resulted in the deprivation of another and the person committing the act had subjective awareness of the prohibited act and such act placed another's economic interests at risk. In issuing its decision, the Panel noted that: "Aitkens knew or ought to have known that the transfers from [Stoney View] Crossing and the [Harbour View] Entities resulted in deprivation to others by placing their pecuniary interests at risk because he knew that such funds were ultimately being used for other projects and

purposes" and not for the purposes set out in the offering memoranda. Further, the Panel noted that "Aitkens' contention that he did not intend to commit fraud or to have investors lose their money was also irrelevant."

One of the interesting arguments raised by Aitkens (as well as one of the other respondents) was the defence of due diligence. Aitkens had argued that he relied on legal and accounting advice.

The ASC Panel acknowledged that there was an unfortunate lack of clarity in the law around the concept of due diligence (of which reliance on professional advice may be considered a subset) as a defence to allegations of securities regulatory misconduct. The ASC Panel did recognize that the concept of a due diligence defence could apply to securities administrative enforcement proceedings, such as strict liability offences (those offences that do not require proof of any particular "state of mind"). However, the ASC Panel found that allegations of misrepresentation and fraud did not give rise to a due diligence defence as those offences were not strict liability offences and required that **Staff prove the respondents requisite state of mind. Accordingly, to the extent that the** concepts of strict liability and the related due diligence defence apply in the securities law context, they were not relevant in this case. Further, the Staff had acknowledged the qualification of lawyers and accountants involved, but these professionals had insufficient knowledge of the facts and there was scant evidence regarding what advice was given to the respondents.

The Staff concluded that Aitkens Stoney View Crossing and Harbour View Landing perpetrated a fraud on investors when they caused these companies to misuse money raised from investors by diverting it to other entities with common ownership or management and he, along with a number of other respondents, had made materially misleading omissions in certain offering memoranda.

By

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