SIPA Sentinel

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SIPA has a mission:

- to aid public awareness of how the investment industry operates;
- to provide guidance to those who have a complaint about investments with a bank, broker, financial advisor, or other seller of financial products;
- and to advocate improvement of industry regulation and enforcement.

Small Investor Protection Association - A voice for the small investor

The **SIPA Sentinel** offers articles and re-prints with opinions SIPA may not share.

IN THIS ISSUE

TWO ELDERLY INVESTORS ROBBED BY INDUSTRY

Paul Marck reported in the Edmonton Journal on April 12th that Glenn Murray Greyeyes, a mutual fund dealer with Dundee Private Investors at the time, misappropriated investors' savings. He persuaded two clients, both now 83, to lend him funds totaling at least $423,000. He sporadically repaid only small amounts and bounced cheques before stopping payments entirely.

Paul writes that William Donegan, enforcement counsel for the MFDA, told a three-member panel that Greyeyes admitted his misconduct during an investigation into his activities. Lawyer Thomas Lloyd, acting for Greyeyes, said his client does not contest allegations involving the two clients. Donegan said Greyeyes's conduct was reprehensible, taking advantage of unsophisticated and vulnerable clients.

Paul also reported that during the course of deliberations, it was also disclosed that Greyeyes preyed on other clients.

B.C. Court of Appeal increases investor's damage award

James Langton writes in the Investment Executive April 11th, 2006 that the B.C. appellate court has allowed an investor's appeal, bumping up the damage award it received against its former broker. In the original case, a married couple and their company each sued their former broker and his firm, Midland Walwyn Capital Inc. claiming damages for losses in their investment accounts, alleging breach of contract, negligence, and breach of fiduciary duty. The trial judge dismissed the claims regarding the individual accounts, but found that the broker and the firm had been negligent in failing to meet industry standards concerning the corporate account and awarded damages in the amount of $65,500. The plaintiffs appealed. And the broker and the firm also cross-appealed.

The appeal court ruled that the appeal is allowed, and it recalculated the amount of damages the plaintiff should receive. "I would allow the appeal and adjust the award by adding $168,500, for a total of $234,000, for the losses in the September 1996 to the September 1997 period, calculated on the actual performance of the investments rather than an assumed performance," noted Justice Ian Donald.

Class actions are becoming more prevalent in Canada. It is only a few years ago that they were relatively unknown in Canada although they were happening in the United States. The following article by Dimitri Lascaris outlines how class actions work and the benefits for investors of participating in a class action. Mr. Lascaris has kindly contributed this article to the Sentinel, and we hope it will help members to have a better understanding. Visit SIPA's webpage on Class Actions at www.sipa.ca.

Securities Class Actions -- At Last a Helping Hand for the Small Investor

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Canada's Capital Markets: The "Wild West"

In December 2004, David Dodge, the Governor of the Bank of Canada, was quoted by the financial press as having described Canada's capital markets as "the wild west of lax securities regulation".[2] Mr. Dodge was also said to have complained that Canada's image made it more difficult for Canadian companies to raise money abroad.

The real victims of lax securities regulation, however, are not the companies that seek to raise capital abroad. Rather, the real victims are the investors who entrust their capital to corporations that have operated for far too long in a permissive environment. Rules are only as effective as the penalties that must be paid for violating them. If there are no penalties, or if the penalties are small in relation to the profits that can be earned by violating the rules, then the rules will never be effective to protect those for whose benefit they were adopted.

Effective January 1, 2006, a new law came into force in Ontario that was designed to give our securities laws real teeth. That law is contained in the new Part XXIII.1 of the Ontario *Securities Act*. The effect of the law is to make it far easier to prosecute ***class actions*** against corporations that fail to respect the fundamental principle of modern securities law: the principle of full and timely disclosure of all material facts.

What is a Class Action?

A class action is a lawsuit brought by one or more plaintiffs on behalf of themselves and other persons who are similarly situated. These other persons are called the "class members", and the plaintiff who represents them is called the "representative plaintiff". Not every lawsuit can be prosecuted as a class action. After a proposed class action lawsuit is commenced, the representative plaintiff must make a motion to the Court

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[1] A. Dimitri Lascaris is a class actions lawyer whose practice is concentrated in securities law. He is currently acting for representative plaintiffs in six securities class actions being prosecuted against Canadian public companies and certain of their senior officers and directors. Siskind, Cromarty, Ivey & Dowler LLP ("Siskinds") is an Ontario law firm with offices in London, Toronto and Windsor and an affiliate law firm in Quebec City (Siskinds Desmeules). Siskinds has one of the largest class actions departments in Canada, and has successfully resolved over 50 class actions.

[2] "Dodge says Canada needs to fix its Wild West Image", Bloomberg.com, December 9, 2004.

asking the Court to authorize the representative plaintiff to sue on behalf of the class members. That motion is called the "certification motion". In Ontario, in order for a proposed class action to be "certified" as a class action, five requirements must be satisfied:

(1) the statement of claim must disclose a cause of action;
(2) there must be an identifiable class of two or more persons that would be represented by the representative plaintiff;
(3) the claims of the class members must raise common issues;
(4) a class action must be the preferable procedure for the resolution of those common issues; and
(5) there must be a representative plaintiff who
    (a) would fairly and adequately represent the interests of the class;
    (b) has produced a plan that sets out a workable method of advancing the lawsuit and of notifying the class members of the lawsuit; and
    (c) does not have, with respect to the common issues, an interest in conflict with the interests of the other class members.[3]

In Ontario, if the Court finds that these criteria are satisfied, then each class member is automatically bound by the outcome of the lawsuit (win or lose) unless the class member elects to be excluded from the lawsuit, or "opts out". If there is a settlement, or if a judgment is entered in favour of the class, then only class members who have not opted out will be entitled to receive compensation from the class action. In order to receive that compensation, those class members are generally required to submit a claim form to a claims administrator selected by the Court.

Why do Investors need Class Actions?

One of the fundamental purposes of class actions is to enhance access to the Courts. Pursing an individual lawsuit against a public company can be extremely expensive. Apart from having to pay a lawyer who might charge several hundred dollars per hour, the plaintiff will often be required to hire one or more scientific, accounting or economic experts. The plaintiff will also have to bear document reproduction costs, court filing fees and process server fees, among other expenses.

Most investors simply cannot afford to bear these expenses alone, especially after having sustained a loss on their investment. Moreover, if the plaintiff's investment was small, and the potential upside of winning the lawsuit is therefore limited, it would make no economic sense for a plaintiff to expose herself to the risk of having to bear these expenses.

From the perspective of an unscrupulous company or corporate manager, the individual investor's economic dilemma creates profitable opportunities. If a corporate manager stands to earn millions by withholding the truth from investors, and if he knows that the vast majority of the investors who sustain losses will not have the means or the economic incentive to sue to recover their losses, then withholding the truth becomes an attractive proposition.

[3] Ontario *Class Proceedings Act, 1992*, s. 5.

Class actions are an effective mechanism for resolving the investor's economic dilemma. By pooling the claims of all investors who have suffered losses as a result of corporate misrepresentations, the costs of the litigation can be spread across hundreds or even thousands of individual investors.

Moreover, because the total pool of damages in a securities class action is often quite large, it becomes economical for the law firm representing the class to fund the litigation and to prosecute the litigation on a contingency basis. This means that the law firm recovers its expenses and is paid for its efforts *only if* the class members receive compensation. In that event, the law firm representing the class will usually receive a percentage of the total compensation paid to the class members. In Canada, that percentage is generally less than 25%.

What are the Duties of a Representative Plaintiff?

In order for a securities class action to happen, at least one member of the class must step up to the plate and assume the duties of a representative plaintiff. Without a representative plaintiff, there can be no class action.

Although the idea of acting as a representative of many aggrieved investors might sound daunting, the duties of a representative plaintiff are not unduly burdensome. The basic duty of every representative plaintiff is to act in the best interests of the class members. This means that the representative plaintiff must remain reasonably informed about the progress of the lawsuit. This can generally be accomplished by obtaining periodic briefings from class counsel about the case. The representative plaintiff must also exercise her best judgment when class counsel seek instructions. For example, if the defendants offer a compromise in settlement of the class members' claims, the representative plaintiff should weigh the offer carefully, in consultation with class counsel, in order to satisfy herself that the settlement is fair and reasonable to the class as a whole.

Generally, the representative plaintiff spends little if any time in court. A representative plaintiff will generally be required to submit a brief sworn statement to the Court in support of the certification motion. Unless the case goes to trial, however, which rarely occurs in class actions, it is unlikely that the representative will be required to testify in public.

A Securities Class Action in Action: *CCWIPP v. Royal Group Technologies, Ltd.*

Royal Group Technologies, Ltd. ("RYG") is a building products and services company. Its stock is listed for trading on the Toronto Stock Exchange and the New York Stock Exchange. On October 2004, RYG announced that it and various of its insiders, including its former Chairman, Vic De Zen, were the subject of criminal and regulatory investigations by the RCMP and the Ontario Securities Commission. Those investigations related to various undisclosed "related party transactions" between the company, on the one hand, and Mr. De Zen and other RYG insiders, on the other. Related party transactions are required by Canadian law to be promptly disclosed to investors, because they give rise to opportunities for abusive self-dealing by corporate insiders.

In February 2006, the *Canadian Commercial Workers Industry Pension Plan* ("CCWIPP"), a former shareholder of RYG, commenced a proposed class action in the Ontario Superior Court of Justice against RYG and eight of RYG's current and former officers and directors, including Mr. De Zen. CCWIPP seeks to act on behalf of all persons who purchased RYG stock between February 26, 1998 and October 18, 2004 (the "Class Period"). This is the period during which RYG is alleged to have failed to disclose various related party transactions.

CCWIPP's objective is to obtain reasonable compensation for current and former RYG shareholders who suffered losses as a result of the defendants' alleged failure to disclose various related party transactions and other material information. If you purchased RYG shares during the Class Period and would like further information regarding the law suit, please visit the website of Siskinds, plaintiff's counsel, at www.siskinds.com. You can also obtain more information by calling 1-800-461-6166 (ext. 381).

The last issue of the Sentinel carried an article about income trusts. There are many products created by the investment industry that are deceiving the public. Another structured product is the Principal Protected Note (PPN). Many investors believe they will receive a high rate of return and the principal will be protected. Well, this sounds too good to be true, and many investors have already found out that this product does not perform as they expected. The following article is reprinted from the Canadian Business magazine. Jeff Sanford provides an outline but the regulators are failing to recognize that many investors are being deceived and are losing their savings with PPNs.

"Principal-protected notes are all the rage, but they aren't risk-free" is the headline of Jeff Sanford's article in Canadian Business Magazine's January issue. The article is about Portus Alternative Asset Management Inc. which failed and resulted in investors losing about $800 million. Jeff writes; "

"the Ontario Securities Commission has said a review of the hedge fund industry will include a look into the regulatory status of principal-protected notes (PPNs), a relatively new type of product that has allowed retail investors access to hedge funds like Portus. PPNs are fixed-income products that provide a guarantee of capital with the potential for higher returns by linking the performance to equity-type instruments. … But PPNs have also allowed retail investors access to hedge funds--which are normally restricted to accredited investors, usually defined in Ontario as those with more than $1 million in investable assets--by taking advantage of a loophole in securities legislation. In Canadian law, there exists an exemption in the definition of a security for certain "bank-debt" instruments, such as PPNs, which means they are not regulated by the securities commissions in this country. And that makes it possible to sell PPNs linked to hedge funds to retail investors. Critics point out this has resulted in the absurd situation where hedge funds--normally not sold to retail investors because of the speculative and unregulated nature of the hedge fund industry--have become easily accessible to exactly that group through a product that isn't even regulated as closely as your standard mutual fund. "The financial services industry has created this product to sell an

unregulated product to investors," says Stan Buell, president of the Small Investor Protection Association in Markham, Ont.
Another benefit (for the issuer) of the unique regulatory standing of PPNs is that, as exempt securities, they don't have to come with a prospectus, which, among other things, lays out the fee structure. According to Glorianne Stromberg, a former commissioner at the Ontario Securities Commission, that makes it very difficult for investors to figure out how much they're actually paying in fees on PPNs. ... "People just don't seem to grasp the ramifications; these products are designed to be sold, not bought," says Stromberg. "I don't see how advising clients to lock up their money for 10 years is a good idea. Not many people do that. I think most investors have forgotten the old saying, 'If it looks too good to be true, it probably is.'"
Investors need to be aware that the industry is generally three steps ahead of the regulators in developing new products. These products are developed to make money for the industry. Investors must be wary of any new issue or new innovative product and as Ms. Stromberg says ***"If it looks too good to be true, it probably is!"***

"FMF Capital saga far from over" is the headline for Barry Critchley's article in the National Post on May 10, 2006. Small investors who depended upon their Investment Advisors when they purchased income trusts have often been misled when they thought they were making a secure investment that provided an attractive rate of return. Critchley wrote;
"One year ago today, the world was told about Michigan-based Franklin Capital Group Ltd.'s initial public offering and that its operating subsidiary "is nearing conclusion of its regulatory and licensing process and should begin operations under its new name, FMF Capital, in June. In that same release, the world heard about Tom Little, a director in the financial-services group at BMO Nesbitt Burns, the lead manager of the $197.5-million offering. Little was quoted as saying the following: "Ultimately investors were attracted to FMF Capital's strong and predictable revenue and cash flow, a compelling strategy for future growth and a dynamic and committed management team with a proven track record of success." At 8 p.m. on Nov. 14, FMF Capital, after achieving the dubious distinction of never trading at the $10 issue price, said it would be suspending distributions on its common shares.
Naturally enough, that news didn't do wonders for FMF's trading price. The units fell to less than $1 and have stayed there ever since. "
While the FMF situation may not be typical it certainly illustrates the issue with business income trusts, and the need for investors to be wary of investing in products that are developed by industry and sold to retail investors without due regard for their needs. Unfortunately many of the investors in unit trusts are seniors who are unwilling to risk their capital in common shares, but seek safe investments so they will not lose their irreplaceable capital.
However, with the introduction of class action lawsuits in Canada there is hope that investors may get some of their money back. Critchley writes:

"FMF -- and all those who were involved with the underwriting -- have received two class-action lawsuits. The first was filed last December by Juroviesky and Ricci LLP, a U.S. law firm operating in Canada. It wants the matter to be addressed in the United States. In January, another class-action lawsuit was filed, this time with the Ontario Superior Court of Justice by the London, Ont.-based law firm of Siskind, Cromarty, Ivey & Dowler LLP. That class-action suit was filed on behalf of two investors. But the plan is for Siskinds' clients to act on behalf of a wider group of investors -- those who purchased FMF securities in the IPO and those who purchased FMF securities over the Toronto Stock Exchange from May 10, 2005 to Nov. 15, 2005. Later still, a class-action suit was filed in Quebec."

Small investors should be aware that many of the new products and IPOs may be highly risky as they have no performance history. Dr. John Bart of the Canadian Shareowner's Association once said he would not invest in anything without a ten year history. In light of what has been happening with income trust IPOs and the new products such as Principal Protected Notes, this seems like sound advice.

MORE ON INCOME TRUSTS – from Diane Urquhart (See Full Report on www.sipa.ca)

Sophisticated management at Teranet may have compromised the Ontario Government, simply by knowing the "tricks of the trade"!

Ontario's privatization experiment is shaping up to be a fiasco - managers get rich; government gets big payday; and the big losers will be unsophisticated investors (especially seniors) who still believe what the "experts" tell them.

Pension funds get left holding paper in this aggressively touted business income trust; the Ontario Securities Commission (and the Investment Dealers Association) stand by impotently; and the Federal Minister of Finance, Jim Flaherty, mumbles something vague about national securities regulation: current securities regu ation 'a waste'

The Ontario Government is expected to get a windfall gain from the Teranet Income Fund IPO, which is based on a formula that is more generous to the Ontario Government than what has been reported in the media to date. Further study of the preliminary prospectus and of the Ontario Termination Participation Agreement (OTPA) suggests that the Ontario Government windfall gain would be in the range of $416 to $673 million.

It is important to note that all of the anticipated cash proceeds from the Teranet IPO offering will be paid to management and the Ontario Government, while the existing shareowners get paper units only. The institutional owners include, Montreal Police Pension Plan, Caisse de Depot, CBC Pension Plan, McGill University Pension Plan, University of Guelph Pension Plan, HOOP, Sun Life Assurance of Canada, and a CIBC entity.

The Ontario Government may have been compromised by its prospects for both greater participation in the uplift of Teranet valuation and in its first dibs to the cash from the Teranet Income Fund IPO. The original Termination Agreement must be released so that the seniors and other small investors better understand the dynamics of this deal.

The minimum $167 million long term incentive payments granted to management over the past 21 months are $50 million more than the net income over the same 21 months. These minimum $167 million cash payments to management prior to the Teranet Income Fund IPO is stripping cash from the company that would have been better deployed in productive uses at the company, such as research, software development and new customer marketing expenses. The Teranet Income Fund IPO prospectus does not deduct any software expenses from the estimated distributable cash. Now both current shareholders and new unitholders post IPO have a business with substantial debt and limited cushions to weather a cyclical downturn or unforeseen calamities. Distributable cash and cash yield valuation methodologies have been strongly criticized by Accountability Research, Standard and Poors, the British Columbia Securities Commission in a recent investment warning and even the Canadian Accounting Standards Board in its recent Decision Summaries. I am concerned that the current Teranet owners, and especially Teranet management and the Ontario Government, are using deceptive means to raise the Teranet IPO valuation.

The preliminary prospectus omits substantial material information required to do a proper assessment of Teranet s value, such as the existence of the RealTrack lawsuit contesting Teranet s exclusive contract with the Ontario Government, the LTIP plan details, the future employee retention plan details, whether the trustees are getting past or future cash LTIP payments causing them to have a different interest than the unitholders, the Ontario Government Termination Agreement and management s assessment of future software value and the non-existence of royalty payments after the exclusive contract with the Ontario Government expires in 2017.

Is cash yield directly comparable to bond yield and dividend yield? Is saying so (or implying it) misrepresentation? Are acceptable standards of transparency and truth from vendors evidenced here?

Teranet managers have been quite astute - perhaps too astute - for some of their biggest and closest associates - including the Ontario Government. To plead ignorance of the law will be no defense - they have been alerted. Even the OSC has stayed away - a luxury they may not enjoy when seniors and other victims of this marketing slight of hand bear their long-term pain.

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