IN THE MATTER OF THE *SECURITIES ACT*,
R.S.N.S. 1989, CHAPTER 418, AS AMENDED ("Act")

- AND –

IN THE MATTER OF KENNETH G. MACLEOD
AND CALVIN W. WADDEN

- AND -

IN THE MATTER OF AN INVESTIGATION IN RESPECT OF
KNOWLEDGE HOUSE INC.

- AND -

IN THE MATTER OF THE MOTIONS OF DANIEL F. POTTER,
KNOWLEDGE HOUSE INC., KENNETH G. MACLEOD
AND CALVIN W. WADDEN

DECISION dated April 17, 2012

Amended September 30, 2012:

Following the issuance of the Court of Appeal's decision in National Bank Financial Ltd. v. Nova Scotia (Securities Commission), 2012 NSCA 99, I have chosen to delete certain portions of this decision in light of continuing court orders and to protect settlement privilege.

BACKGROUND

1. Given the complexity of the proceeding before the Commission and the importance of the matter now before me, it is appropriate to set out the procedural history leading to my decision.

2. Despite the current confidentiality orders with respect to the Court proceedings, the parties before me included in their submissions a transcript of the in-camera hearing conducted by Justice Rosinski. I agreed to receive those confidential submissions on the matter now before me in order to allow those involved to fully argue their positions.

THE INVESTIGATION ORDERS

3. In 2003, the Commission authorized an investigation into the affairs of Knowledge House Inc. ("KHI") pursuant to section 27 of the *Securities Act*. The Commission issued an order dated February 4, 2003 appointing Scott Peacock, a member of Staff

of the Nova Scotia Securities Commission ("Staff"), to investigate the affairs of KHI "in accordance with all the powers, authorities and duties imposed on a person or persons so appointed by the Act".

4. An amended investigation order was issued April 23, 2003 appointing additional investigators again with all the powers, authorities and duties imposed on a person or persons so appointed by the Act.

SUPREME COURT APPLICATION AND APPEAL

5. In 2004, after the investigation was underway, Daniel Potter, a principal of KHI, applied to the Nova Scotia Supreme Court for *certiorari* to quash the Commission's investigation. Potter alleged that the investigators improperly obtained and used emails originally on KHI's email servers, some of which were subject to solicitor-client privilege. Potter's application was granted by the Supreme Court in an unreported decision.

6. The Commission appealed the decision to the Court of Appeal, which resulted in the decision of *Potter v. Nova Scotia (Securities Commission)*, 2006 NSCA 45. The Court of Appeal held that Potter's Supreme Court application was premature and that the Commission should have the opportunity to consider and address Potter's complaints. The court required that Potter direct his concerns to the Commission in the first instance rather than to the court by way of judicial review. Potter's application was stayed and the matter was sent back to the Commission for hearing.

NOTICE OF HEARING AND STAFF ALLEGATIONS

7. Subsequent to the Court of Appeal's decision, the Commission issued a Notice of Hearing dated May 19, 2006 attaching Staff's Statement of Allegations. Staff alleges that Potter and other former insiders of KHI (namely Kenneth MacLeod, Calvin Wadden and Raymond Courtney) violated certain sections of the *Securities Act* and acted in a manner contrary to the public interest.

8. Courtney entered into a settlement agreement with Staff, which was approved by order of the Commission on November 4, 2010. By Notice of Discontinuance dated May 16, 2011, Staff discontinued its allegations against Potter in light of criminal charges being filed against Potter on or about March 28, 2011. The criminal charges arise from similar facts underlying the Statement of Allegations.

9. As it stands now, Wadden and MacLeod are the remaining respondents to the Statement of Allegations. However, in view of the Court of Appeal repeatedly directing Potter to take his complaints regarding Staff's investigation to the Commission for adjudication, I allowed him to have standing in this proceeding with respect to his motion (described below).

THE MOTIONS

10. Following the issuance of the Notice of Hearing and Statement of Allegations, Potter and KHI filed a Motion (the "Potter Motion") on June 30, 2006 seeking an order revoking or varying the investigation orders and removing the investigators named therein along with any Staff and other persons involved in the investigation. Potter and KHI also sought to prohibit the use of any findings of the investigation in any amended or new investigation or any other proceeding. Potter and KHI sought an order for the return to Potter of material filed by the Commission and an order for the return of all CDs containing email documents from the KHI email server.

11. The Potter Motion is based on alleged improprieties on the part of Staff in taking possession and reviewing email documents on a KHI email server that was supplied to the Commission by counsel for National Bank Financial Limited ("NBFL") without consent or warrant. In the motion, Potter alleges that Staff:

    (a) Misinterpreted and exceeded the jurisdiction under the *Securities Act* in obtaining documents without consent or warrant;

    (b) Committed the tort of trespass;

    (c) Violated sections 7 and 8 of the *Charter*;

    (d) Breached certain sections of the *Securities Act*;

    (e) Committed theft and/or the tort of conversion;

    (f) Breached solicitor-client privilege;

    (g) Breached legal and ethical duties requiring them to have the issue of solicitor-client privilege determined;

    (h) Exhibited bias or reasonable apprehension of bias;

    (i) Conducted the investigation in a manifestly unfair manner, which brings the administration of justice into disrepute; and

    (j) Committed such other errors of jurisdiction, law, procedural fairness and natural justice as may appear.

12. On July 6, 2006 Wadden and MacLeod filed a Notice of Motion (the "Wadden Motion") seeking an order revoking or varying the investigation order, removing the investigators named therein and prohibiting the use of the fruits of the investigation. The order was sought on the basis that Staff:

    (a) Interpreted the *Securities Act* incorrectly and exceeded their jurisdiction under the *Act* in obtaining certain documents;

(b) Permitted an illegal search and seizure contrary to the common law and section 8 of the *Charter*;

(c) Created an appearance of bias against Wadden and MacLeod as being unduly influenced by NBFL by accepting the email accounts of Wadden and MacLeod from the solicitor for NBFL, which Staff and other investigators knew or ought to have known were obtained illegally;

(d) Violated section 29F of the *Securities Act*, which specifically sets out a procedure for dealing with claims of solicitor-client privilege; and

(e) Refused to follow an order of the Nova Scotia Court of Appeal, and may be in contempt of that order and must be barred from proceeding.

13. It is clear that Potter, Wadden and MacLeod allege very serious improprieties on the part of Staff in conducting the investigation. I set out the substance of the Potter and Wadden Motions (collectively, the "Motions") at some length because the discovery examinations that gave rise to the current matter before me were authorized to address the issues raised in the Motions as well as the Statement of Allegations, as explained below.

14. I have repeatedly declined to make rulings based on the allegations of the parties rather than on the basis of evidence.

15. The question of whether the Motions should be heard at the same time as, or in advance of, the Statement of Allegations was the subject of my decision dated June 18, 2010. I declined to hear the Motions and allegations separately for the reasons set out in that decision. The hearing of the Motions and Staff's allegations is scheduled to commence October 1, 2012.

DISCLOSURE AND DISCOVERIES

16. In a decision dated December 11, 2006, Daren Baxter (who was the Commissioner seized of the matter at the time) ordered disclosure and authorized the discovery examination of Peacock and other investigators. Staff disclosure was ultimately completed to the satisfaction of Potter, Wadden and MacLeod in July 2009. The discoveries were to follow.

17. Commissioner Baxter ordered that the scope of the discovery examination would be limited to evidence directly relevant to the applications (i.e. the Motions) and was not to evolve into a "fishing expedition" on topics beyond how Staff came to have possession of the KHI email documents and what Staff did with the documents.

18. The scope of the discoveries was expanded by my order dated November 13, 2009. All parties consented to the form of the order. Paragraph 3 of the order states:

> The scope of the discovery examination is to be conducted pursuant to this order is as described by Commissioner Baxter in his December 11, 2006 decision together with the full scope of discovery regarding

> all materials provided on July 10, 2009 and July 29, 2009 in relation to the pending Motions of Mr. Potter, Knowledge House Inc., Calvin Wadden and Kenneth MacLeod and any issues identified in the Notice of Hearing in this matter.
>
> [Emphasis added]

19. The discovery examinations may address the allegations in the Motions and the Statement of Allegations.

20. Discoveries were commenced on April 6, 2010. I have been informed that the first investigator discovered was Brian Connell-Tombs. I now know that in course of the discovery of Connell-Tombs, counsel for Wadden and MacLeod asked the witness why Commission proceedings were not commenced against NBFL. Specifically, Connell-Tombs was asked:

> The documents indicate that after an extensive multi-year investigation it was the opinion of yourself and Mr. Peacock that National Bank Financial should be charged. They weren't, can you tell me what you know about why they weren't charged?

21. Counsel for Staff objected to the question on the basis that the question was irrelevant and hearsay and a potential violation of Nova Scotia securities law. The discovery process came to a halt.

22. Counsel appeared before me on April 7, 2010. They sought determination on how the parties should proceed given Counsel for Staff's objections to the question. The parties agreed to put the following discovery question before me for consideration of whether any objection to it is well founded:

> Do you have any knowledge/information as to why the decision was made to not bring enforcement proceedings against particular subjects of the investigation with respect to whom you had recommended there was sufficient evidence to support a violation?

23. On the basis of the limited information and evidence before me at that time, I ruled that the question was objectionable on the ground that it called for irrelevant information and hearsay. Counsel for Staff would not say what securities law would be breached by answering the question and told me that even specifying the securities law at issue would violate it. Counsel for Staff suggested that the matter could be determined at an in-camera hearing, excluding other counsel. I declined to do so and the basis of Staff's securities law objection was not revealed at that time.

24. I asked the parties to resume discoveries and proceed as far as possible. I directed that objections on the basis of relevancy be noted, but that the witness should answer the question. After my ruling, the discoveries reached an impasse as counsel for Staff continued to object on the basis that answering the question would violate undisclosed securities law and the witness was not permitted to answer. I referred the determination of the objection to the impugned question to the Nova Scotia Supreme Court for determination.

REFERENCE TO THE SUPREME COURT AND THE APPEAL

25. Justice Rosinski heard the matter referred to the Supreme Court. His Lordship agreed to hear the basis of Staff's objection in-camera, where he heard argument and evidence from Peacock. The other parties were excluded. After hearing Staff's rationale for objecting to the question, Justice Rosinski provided NBFL and its management employee Eric Hicks the opportunity to make written submissions on the issue before him. Justice Rosinski received submissions from NBFL and Hicks before rendering his decision on June 16, 2011.

26. His Lordship determined that, as a matter of law, the investigators would not violate Nova Scotia securities law by answering the impugned question and anticipated follow up questions. Justice Rosinski supplemented his public, written reasons with (*Nova Scotia (Securities Commission) v. Potter*, 2011 NSSC 239) a sealed decision addressing the basis of Staff's objection.

27. Staff appealed the decision. NBFL and Hicks were granted appellant status. Justice Bryson, writing for the court, allowed the appeal and remitted the matter to me for determination: *Nova Scotia (Securities Commission) v. Potter*, 2012 NSCA 12. The Court of Appeal determined that concerns about disclosure, privilege or related evidentiary procedural questions are to be decided by the Commission.

MATTER REMITTED TO THE COMMISSION

28. My counsel did not participate in the Supreme Court or Court of Appeal proceedings. I was not provided with a copy of Justice Rosinski's sealed decision until counsel revealed it to me in their submissions in this matter. As such, when the Court of Appeal remitted the matter to me for determination, I did not know the basis of Staff's objection.

29. A pre-hearing conference was convened on February 16, 2012 to determine the procedure to implement the Court of Appeal's decision and consider Staff's objection.

30. The question of NBFL and Hicks' standing was raised at the pre-hearing conference. I declined to grant them standing at that time as I had no information regarding the nature of NBFL and Hicks' involvement in the matter. I ordered that Staff provide written submissions setting out the factual and legal basis for its objection to the question posed to the investigator on discovery. The submissions were to be confidential, but Potter, Wadden and MacLeod would be provided an opportunity to respond.

31. Staff subsequently brought a motion for determination of whether it is in the public interest to order that NBFL and Hicks have standing in the determination of the matter remitted to me by the Court of Appeal. An in-camera hearing was convened on March 8, 2012 to consider the standing of NBFL and Hicks. After hearing from counsel, I allowed NBFL and Hicks to make written submissions on the matter referred to me by the Court of Appeal, but did not give them standing beyond that.

THE BASIS OF STAFF'S OBJECTION

32. I have now received submissions from the parties and NBFL on the basis of Staff's objection to the impugned question. Staff objects to the impugned question because the reason no enforcement proceedings were brought against NFBL is that Staff entered into a settlement agreement with NBFL and Hicks along with a subsequent agreement on May 30, 2005 to hold the settlement agreement in escrow. It is not clear to me whether one settlement agreement pertains to both NBFL and Hicks, or whether there are two separate settlement agreements. In the interest of simplicity, I will refer to the agreement or agreements as the "settlement agreement" throughout. It is clear, however, from reading the escrow agreement, that it followed the settlement agreement.

33. By agreement between counsel for NBFL and Peacock, the settlement agreement has not followed the usual procedure for approval by the Commission. Rather, it has been held in escrow for nearly seven years. Staff maintains that revealing the terms – or even the existence – of the settlement agreement will violate Rule 10 of the Commission's General Rules of Practice and Procedure (the "Rules").

34. I set out below my decision regarding the validity of Staff's objection to the impugned discovery question and other issues arising from the matter remitted to me by the Court of Appeal.

ISSUES

35. The Court of Appeal in remitting this matter to me has suggested that I decide:

    (a) The procedure by which to consider Staff's objection;

    (b) Whether the impugned question may be asked and answered;

    (c) Whether the existence of evidence thereby revealed and/or its content should be disclosed and if so, when and to whom; and

    (d) Whether confidentiality orders or undertakings should be made and the terms thereof.

36. I accept these as appropriate matters for consideration flowing from the Court of Appeal remitting this matter back to me for determination.

37. The procedure to consider Staff's objection has been established. The parties have provided written submissions, as have NBFL and Hicks. In the course of receiving those submissions, I have been provided with a transcript of the in-camera hearing before Justice Rosinski, a copy of Justice Rosinski's sealed decision and other documents. I have reviewed the filed submissions and materials.

38. The central issue is whether the impugned discovery question may be asked and answered. Staff maintains that the question may not be answered for the following reasons:

    (a) Relevance: Staff argues that questions about why proceedings were not commenced against other individuals calls for irrelevant information or evidence.

    (b) Collateral Purpose: Staff objects to disclosure of information on the basis that it is intended to be used by a party for a collateral purpose.

    (c) Potential Violation of the Securities Act: Staff argues that disclosing a settlement agreement prior to it being approved by the Commission violates Nova Scotia Securities law.

39. NBFL and Hicks argue that the impugned discovery question should not be answered for the same reasons. I will address these three objections in turn. Also at issue is whether the escrow agreement prevents the investigators from answering the impugned question.

40. I will then address the question of whether and to whom such evidence should be disclosed. I also will address what if any confidentiality orders or undertakings should be made.

OBJECTIONS TO ANSWERING THE IMPUGNED QUESTION

RELEVANCE

41. At the April 7, 2010 hearing, I ruled that the impugned question called for irrelevant information. That determination was made on the basis of the limited information and evidence available to me at the time. In light of the evidence and more fulsome submissions now before me, I intend to revisit the question of relevance.

42. I am not bound by the rules of evidence in this proceeding. Rule 14.1 states:

> The Commission should not be bound by rules of evidence. The primary test for the admission of evidence is its relevance to the allegations in the Statement of Allegations.

43. In the present proceeding, relevance must also be determined not only based on the allegations in the Statement of Allegations, but also based on the allegations in the Motions.

44. Although I directed the parties to proceed with discovery examinations under the procedure in the *Civil Procedure Rules (1972)*, for the reasons set out below, I believe the impugned question calls for relevant evidence under the old "semblance

of relevancy" test or the "trial relevancy" standard under the current Civil Procedure Rules.

45. I do not consider myself bound by my previous determination regarding the relevance of the impugned question as new information originally provided in the proceeding before Justice Rosinski and the Court of Appeal has come before me. In *Johnson v. Mill*, 2011 NSSC 66, Justice Hood states at para 20:

> The "semblance of relevancy" test is no longer applicable. I must assess whether a judge presiding at the trial of this action would find the information relevant or irrelevant. At this early stage of the proceeding, commenced less than one year ago, I conclude that the assessment of trial relevancy can only be based on the pleadings. At later stages of proceedings, there may be other information available to a Chambers Judge to assist in assessing trial relevancy. On this motion for production of documents relevancy must be based on the allegations in the Statement of Claim on the assumption that they can be established.
>
> [Emphasis added]

46. In *Saturley v. CIBC World Markets Inc.,* 2011 NSSC 4, Justice Moir states at paras 46-47:

> This examination of the legislative history, the recent jurisprudence, and the text of Rule 14.01 leads to the following conclusions:
>
> - The semblance of relevancy test for disclosure and discovery has been abolished.
>
> - The underlying reasoning, that it is too difficult to assess relevancy before trial, has been replaced by a requirement that judges do just that. Chambers judges are required to assess relevancy from the vantage of a trial, as best as it can be constructed.
>
> - The determination of relevancy for disclosure of relevant documents, discovery of relevant evidence, or discovery of information likely to lead to relevant evidence must be made according to the meaning of relevance in evidence law generally. The Rule does not permit a watered-down version.
>
> - Just as at trial, the determination is made on the pleadings and evidence known to the judge when the ruling is made.
>
> In my opinion, these conclusions follow from, and are enlightened by, the principle that disclosure of relevant, rather than irrelevant, information is fundamental to justice and the recognition that an overly broad requirement worked injustices in the past.

> In my opinion, these conclusions do not suggest a retreat from the broad or liberal approach to disclosure and discovery of relevant information that has prevailed in this province since 1972.
>
> [Emphasis added]

47. I must determine relevancy based on the information and evidence now before me.

48. I am in an unusual situation with respect to determining the relevance of the impugned question. As a result of the process to date, I know the answer to the impugned question, as do Potter, Wadden and MacLeod. No enforcement proceedings have been publically brought against NBFL and Hicks because they entered into the settlement agreement with Staff that has been held in escrow. The agreement has not been provided to the Commission's secretary for presentation to a settlement panel, even though it was executed nearly seven years ago. I expect that none of the signatories to the escrow agreement expected that it would cause the settlement agreement to be kept from the public for so long, but that has been the result.

49. "Settlement Agreement" is defined in Rule 1.1. A settlement agreement contains agreed facts, allegations admitted and acknowledged by the responding party and the terms of settlement. The current Rules came into effect on June 18, 2007 (after the NBFL and Hicks agreements were made). The previous General Rules of Practice and Procedure did not deal with settlement agreements. However, it is clear from approved settlement agreements from the same time period that settlement agreements contain an admission of violation of securities law and acting contrary to the public interest.

50. [Deleted]

51. Although the terms of the settlement agreement have not been revealed, it is clear from the evidence before me that the agreement contains admissions [deleted] on the part of NBFL and Hicks.

52. Staff, NBFL and Hicks maintain that the reason for Staff's decision not to bring enforcement proceedings against NBFL and Hicks is not relevant and therefore the question need not be answered. I disagree.

53. Potter alleges in his Motion that Staff manifestly exhibited actual bias or a reasonably apprehensible bias and otherwise failed to conduct the investigation in a fair and impartial manner in accordance with the principles of natural justice. Wadden and MacLeod, in their Motion, allege that Staff, by their actions in the investigation, created an appearance of bias against Wadden and MacLeod as being unduly influenced by NBFL.

54. The question with respect to why Staff decided not to proceed against NBFL after its investigator recommended that it do so calls for information relevant to the allegations of bias in the Motions. Moreover, I (and Potter, Wadden and MacLeod) now know that enforcement proceedings were not brought against NBFL and Hicks

because Staff entered into the settlement agreement with NBFL and Hicks but agreed to hold the agreement in escrow until the final disposition of all regulatory proceedings relating to KHI. These circumstances could not have been anticipated at the time of my previous relevance consideration because the Rules contemplate that any settlement agreement be presented to a settlement panel for approval, not held in escrow for years pending resolution of the entire related proceeding.

55. Furthermore, the existence of a settlement agreement **[deleted]** is potentially relevant to the allegations against Wadden and MacLeod in the amended Statement of Allegations of Staff dated May 16, 2011. The existence of a settlement agreement between Staff and other targets of the investigation is relevant to determining the extent of Wadden and MacLeod's alleged wrongdoing.

56. On the basis of the information and evidence now before me, I have determined that the impugned question calls for relevant information and should be answered.

COLLATERAL PURPOSE

57. It is clear from the submissions and evidence before me that Wadden and MacLeod wish to use the settlement agreement in the ongoing civil litigation. Staff has referred me to Civil Procedure Rule 14.03:

> 14.03 (1) Nothing in Part 5 diminishes the application of the implied undertaking not to use information disclosed or discovered in a proceeding for a purpose outside the proceeding, without the permission of a judge.
>
> (2) The implied undertaking extends to each of the following, unless a judge orders otherwise:
>
> (a) documentation used in administering a test, such as test documents supplied to and completed by a psychologist;
>
> (b) all notes and other records of an expert;
>
> (c) anything disclosed or produced for a settlement conference.

58. The parties are aware of this rule, but it is for the judge before whom any collaterally obtained evidence is proposed to be admitted to adjudicate the admissibility of such evidence. That does not render such evidence inadmissible before me.

VIOLATION OF SECURITIES LAW

59. Staff relies on Rule 10.6 for the position that parties to a settlement agreement are prohibited from making public both the existence and contents of the agreement prior to it being approved by the Commission. Staff maintains that part 8 of the Rules does not require Staff to disclose either the existence of or the contents of any settlement agreements that have not yet been approved by the Commission.

60. Part 8 of the Rules defines a process to which the parties must adhere regarding disclosure of relevant documents. Disclosure is required only where such disclosure would not otherwise violate the law. Rule 8.12 states:

> Notwithstanding anything contained in the Rules, no disclosure is required to be made:
>
> (a) which would contravene sub section 148(2) of the Act;
>
> (b) of information which is protected from disclosure by privilege;
>
> (c) of a fact or matter which is inadmissible by virtue of Nova Scotia Securities laws; or
>
> (d) of information which would not otherwise be disclosed by law.

61. Staff's position is that the terms of a settlement agreement are confidential until approved by the settlement panel and, as a result, a pending settlement agreement is excluded from disclosure pursuant to Rule 8.12.

62. Although Rule 10.6 requires that the terms of the settlement agreement be kept confidential until approved, it does not require that the existence of a settlement agreement be kept secret. In fact, the Rules contemplate and the practice in the Commission has been to make public the existence of a settlement agreement prior to approval via a public Notice of Hearing.

PROCEDURE FOR APPROVAL OF SETTLEMENT AGREEMENTS

63. The procedure for approving settlement agreements is specified in Part 10 of the current Rules:

> Part 10 - SETTLEMENTS
>
> Settlement Discussions
>
> 10.1 Settlement discussions may occur at any time, including prior to the issuance of a Notice of Hearing.
>
> Settlement Agreement
>
> 10.2 A settlement shall be evidenced by a Settlement Agreement between Staff and a Respondent or an Applicant and signed by these Parties.
>
> Commission Review and Approval of Settlement Agreement
>
> 10.3 A Settlement Agreement is subject to review and approval by a Settlement Panel.
>
> 10.4 The Secretary shall prepare a Notice of Hearing for a Settlement Hearing. The Notice of Hearing shall be served

upon the Parties to the Settlement Agreement. Copies of the Settlement Agreement will be forwarded to and distributed by the Secretary to the Settlement Panel in advance of the date set for the Settlement Hearing.

10.5 Based upon the Settlement Agreement and any submissions of the Parties, the Settlement Panel will determine whether the proposed settlement is appropriate and in the public interest, and, if so, approve the Settlement Agreement and issue any related order.

10.6 Unless the Settlement Panel otherwise determines, the Settlement Agreement shall not be made public prior to its approval by the Settlement Panel. Upon approval by the Settlement Panel, the Settlement Agreement shall become a public document.

In Camera Settlement Hearing

10.7 Unless the Settlement Agreement expressly provides otherwise, such portion of the Settlement Hearing during which the Settlement Agreement is under review by the Settlement Panel shall not be open to the public without the prior leave of the Settlement Panel.

10.8 Upon a Settlement Panel making a determination to approve a Settlement Agreement, a Settlement Hearing may be open to the public by the Settlement Panel during the delivery of the Settlement Panel's reasons for approval.

Where Settlement Agreement Not Approved

10.9 If the Settlement Panel does not approve the Settlement Agreement, reasons will be provided at the request of a Party to the Settlement Agreement, in oral or written form at the discretion of the Settlement Panel. The Settlement Agreement and the reasons for not approving the Settlement Agreement shall not normally be made public where the Settlement Hearing is in camera unless the Settlement Panel otherwise determines.

10.10 Where a Settlement Agreement is not approved, a Party may proceed to the Hearing commenced by the Notice of Hearing. No settlement discussions, proposals or communications, written or otherwise, nor the content of the Settlement Agreement for which approval was not granted may be referred to in any way by a Party in the Hearing.

10.11 Failure to obtain approval of any Settlement Agreement does not preclude the Parties from completing a subsequent Settlement Agreement.

Constitution of Subsequent Hearing Panel

> 10.12 Where any Settlement Agreement is not approved, no member of the Settlement Panel will sit on a hearing panel at a subsequent Hearing of the issues, except with the prior consent of the Parties to the Settlement Agreement.

64. The procedure outlined in Rule 10.2 to 10.8 was the practice under the previous rules as well. This can be seen in the reasons for decision in the matter of *Bruce Elliott Clarke (*July 21, 2004). The Notice of Hearing was made public. At the subsequent hearing, the settlement panel granted a motion to proceed in-camera with members of the public excluded until a decision was made to approve or not approve the settlement agreement. Following submissions from the parties to the agreement, the panel determined that it was appropriate in the circumstances and in the public interest to approve the settlement agreement. Following which, the Commission indicated that the hearing was no longer in-camera and members of the public were readmitted to the hearing room.

65. The *Clarke* proceeding is but one example of the practice under the prior rules at about the time of the settlement agreements with NBFL and Hicks.

66. [Deleted]

67. Clearly, the usual process is to provide public notice of the existence of a settlement agreement, but not to reveal its terms until it is approved by the settlement panel.

PROCESS NOT FOLLOWED IN THIS INSTANCE

68. The process outlined above was not followed with respect to the settlement agreement between Staff, NBFL and Hicks. No Notices of Hearing were provided to the Commission secretary to issue nor was a settlement panel convened to approve or reject the agreement. Rather the existence of the settlement agreement has remained hidden from the public for nearly seven years.

69. Other individuals identified in the KHI investigation appear to have been dealt with in the usual course:

- Bruce Elliott Clarke was an employee and investment advisor of NBFL. His settlement agreement was fully executed on May 13, 2004. Notice of Hearing followed on June 6, 2004, a hearing was held on June 28, 2004 and the reasons for decision approving the settlement agreement were issued July 21, 2004.

- Steven Elliott Clarke was a salaried administrative employee of NBFL under the principle tutelage of Bruce Elliott Clarke. His settlement agreement was signed by Staff on October 7, 2005 and the Notice of Hearing was issued the same date (the settlement agreement was fully executed and dated October 20, 2005). The hearing

was held October 26, 2005 with an order of the same date approving the settlement agreement. The reasons for decision followed on November 2, 2005.

- R. Blois Colpitts is a lawyer and was a lead director of KHI. He entered into a settlement agreement dated March 21, 2006. The Notice of Hearing was dated the same date. The hearing was held on March 23, 2006 and the reasons for decision followed on April 4, 2006.

- Raymond G. Courtney was a director, officer and shareholder of KHI. He entered into a settlement agreement dated September 21, 2010. The Notice of Hearing followed on October 28, 2010 and the order approving the settlement agreement on November 4, 2010.

70. In the instances set out above, a settlement agreement was entered into, a Notice of Hearing for approval of the settlement agreement was made public, the hearing was followed by a decision and order of the Commission in a timely manner. After the settlement agreements were approved, they were made public.

THE ESCROW AGREEMENT

71. The settlement agreement did not follow the usual procedure because there was an escrow agreement confirmed by correspondence between counsel for NBFL and Hicks and Peacock dated May 30, 2005. The letter states:

> This letter is to confirm an agreement made on behalf of my clients, National Bank Financial Limited ("NBFL") and Eric Hicks ("Hicks") with the Nova Scotia Securities Commission ("NSSC"), Market Regulation Services Inc. (Market Regulation") and Investment Dealers Association of Canada ("IDA") whereby the Settlement Agreement will be held in escrow until such time as there is a final disposition of all regulatory proceedings relating to trading activity in the common shares of Knowledge House Incorporated ("KHI"). This will further confirm that Market Regulation and IDA will not initiate any regulatory proceedings against NBFL and/or Hicks relating to any of the matters which are the subject of my clients' Settlement Agreement with NSSC including the Statement of Allegations incorporated therein.

72. On its face, the escrow agreement is separate from the settlement agreement.

73. [Deleted]

THE ESCROW AGREEMENT IS NOT VALID

74. My conclusion is that the effect of the escrow agreement has been a failure to protect the public interest and potential deprivation of Wadden and MacLeod's right to make a full answer and defence to the allegations brought against them. I conclude that the escrow agreement is invalid and not permissible for reasons that I will set out below.

75. The purpose of the *Securities Act* is set out at section 1A:

> 1A (1) The purpose of this Act is to provide investors with protection from practices and activities that tend to undermine investor confidence in the fairness and efficiency of capital markets and, where it would not be inconsistent with an adequate level of investor protection, to foster the process of capital formation.
>
> (2) In pursuing the purpose of this Act, the Commission shall have regard to such factors as may be viewed by the Commission as appropriate in the circumstances, including any principles enunciated in the regulations. *1996, c. 32, s. 1.*

76. Appellate courts have emphasized the Commission's role in protecting the public interest. In *Nova Scotia (Securities Commission) v. Schrivier*, 2006 NSCA 1 at para 17, Justice Cromwell states:

> The purpose of the Act is to protect investors and foster the process of capital formation: s. 1A. As has been said many times, securities regulation with these objectives is a highly specialized activity. Lead responsibility for discharging this specialized function has been entrusted to the Commission: see, for example, *Pezim v. British Columbia*, [1994] 2 S.C.R. 557 at para. 60 and s. 5(1) of the Act. The Commission is given a broad mandate to determine and act in accordance with the public interest: see for example s. 134. It has not only an adjudicative role, but also a part in policy development, particularly through its extensive rule-making power: see s. 150. In short, the Act gives the Commission the central role in securities regulation under a complex and detailed statutory scheme.
>
> [Emphasis added]

77. In *Re Cartaway Resources Corp.*, 2004 SCC 26 Justice LeBel states at paras 46-47:

> Although courts are regularly called on to interpret and apply general questions of law and engage in statutory interpretation, courts have less expertise relative to securities commissions in determining what is in the public interest in the regulation of financial markets. The courts also have less expertise than securities commissions in interpreting their constituent statutes given the broad policy context within which securities commissions operate: National Corn *Growers Assn. v. Canada (Import Tribunal)*, [1990] 2 S.C.R. 1324, at p. 1336.

> A reviewing court must consider the general purpose of the statute and the particular provision under consideration with an eye to discerning the intent of the legislature: *Dr. Q*, *supra*, at para. 30. The adjudicative function of the Commission in enforcement proceedings under s. 162 would generally call for less deference. In the present case the Commission is called upon to adjudicate a bipolar dispute rather than exercise a pure policy decision. Nevertheless, the Commission also plays a principal role in policy development, in the management of a complex securities regulation scheme and in reconciling the interests of a number of different groups and in protecting the public: *Brosseau v. Alberta Securities Commission*, [1989] 1 S.C.R. 301, at pp. 313-14. This calls for some deference by the reviewing court: *Pezim*, *supra*, at p. 591 .
>
> [Emphasis added]

78. In *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 SCR 577 Justice Iacobucci states at para 59:

> It is important to note from the outset that the Act is regulatory in nature. In fact, it is part of a much larger framework which regulates the securities industry throughout Canada. Its primary goal is the protection of the investor but other goals include capital market efficiency and ensuring public confidence in the system: David L. Johnston, *Canadian Securities Regulation* (1977), at p. 1.
>
> [Emphasis added]

79. He goes on to say at para 68:

> As already mentioned, the primary goal of securities legislation is the protection of the investing public. The importance of that goal in assessing the decisions of securities commissions has been recognized by this Court in *Brosseau v. Alberta Securities Commission*, [1989] 1 S.C.R. 301 (*Brosseau*), where L'Heureux-Dubé J., writing for the Court, stated the following at p. 314:
>
> > Securities acts in general can be said to be aimed at regulating the market and protecting the general public. This role was recognized by this Court in *Gregory & Co. v. Quebec Securities Commission*, [1961] S.C.R. 584, where Fauteux J. observed at p. 588:
> >
> > > The paramount object of the Act is to ensure that persons who, in the province, carry on the business of trading in securities or acting as investment counsel, shall be honest and of good repute and, in this way, to protect the public, in

> the province or elsewhere, from being defrauded as a result of certain activities initiated in the province by persons therein carrying on such a business.
>
> This protective role, common to all securities commissions, gives a special character to such bodies which must be recognized when assessing the way in which their functions are carried out under their Acts.
>
> [Emphasis added]

80. Referring to section 144 of the British Columbia *Securities Act* (which is similar in substance to section 134 of the Nova Scotia Act) Iacobucci J states at para 71 "In reading these powerful provisions, it is clear that it was the Legislature's intention to give the Commission a very broad discretion to determine what is in the public's interest."

81. The above appellate court comments are made in the context of standard of review analysis; however, they clearly emphasize the Commission's duty is to apply the Act in accordance with the public interest and to maintain public confidence in the regulatory system.

82. It is also important to recall how this proceeding came to be before the Commission. After raising his complaints regarding the conduct of the investigation with the Commission, Potter sought relief from the Supreme Court and ultimately the Court of Appeal. The Court of Appeal and its decision in the *Potter v. Nova Scotia (Securities Commission)*, 2006 NSCA 45 accepted the Commission's submission that it has the statutory authority and the means to address Potter's complaints about the conduct of the investigation (see para 28 of the decision). At para 39:

> It is well-settled that securities commissions are entitled to a measure of judicial deference as they carry out their statutory duties in the public interest. They have the central and pre-eminent role in the field of securities regulation in the public interest and the courts have stressed the nature and importance of this role over and over again: see, e.g., *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 at 589, 593 and 595; *British Columbia Securities Commission v. Branch*, [1995] 2 S.C.R. 3 at para. 34.

83. At para 50:

> For all of these reasons, requiring Mr. Potter to go to the Commission in the first instance rather than to court by way of judicial review is the preferable course of action. It has the potential to provide Mr.

> Potter with effective redress for his complaint, respects the role and expertise of the Commission, is potentially less intrusive into the investigative process, relieves the court of the responsibility of making an initial and somewhat speculative assessment of the merits of his allegations and reduces the risk that confidential information will be released for no good reason.

84. There is no authority in the investigation orders, in the Act or the Rules for Staff to enter into an escrow agreement to withhold an executed settlement agreement from the usual procedure. If there is no authority for Staff to enter into these types of agreements, it must not be done (*Dunsmuir v. New Brunswick*, 2008 SCC 9 at para. 29).

85. The Rules require the secretary to prepare the Notice of Hearing for a Settlement Hearing (Rule 10.4). The settlement panel must review the agreement and determine whether it is in the public interest to approve it. The role of the Commission in reviewing settlement agreements is described in *Re Rankin* (2008), 31 OSCB 3303 at paras. 18-23:

> The role of the Commission in considering a proposed settlement agreement has been articulated in several cases. In *Re Koonar et al*. (2002), 25 O.S.C.B. 2691, the Commission stated:
>
> > The role of the panel in reviewing a settlement agreement is not to substitute the sanctions it would impose in a contested hearing for what is proposed in the settlement agreement, but rather to make sure the agreed sanctions are within acceptable parameters. (*Re Koonar et al.*, *supra* at 2692. See also Re *Melnyk* (2007), 30 O.S.C.B. 5253; *Re Pollitt* (2004), 27 O.S.C.B. 9643 at para. 33; and *Nortel Networks Corp.*, transcript of oral reasons of the Commission, May 22, 2007, p. 52.)
>
> In making that assessment in this case, we gave significant weight to the terms of the Settlement Agreement because those terms were reached as a result of negotiations between adversarial parties (Staff and the Respondent) and because a balancing of factors and interests has already taken place in reaching the agreement. The language of the Settlement Agreement was obviously very carefully negotiated by the parties. Our role in considering the settlement is not to renegotiate the terms of the Settlement Agreement or to suggest changes to the agreed facts, statements and sanctions set forth in the Settlement Agreement. Our role is simply to decide whether the Settlement Agreement as a whole, on the terms presented and agreed to, should be approved as being in the public interest (*Re Melnyk*, *supra* at para. 15).

In considering the sanctions to be imposed, the Commission has emphasized the following guiding principle:

> ... the role of this Commission is to protect the public interest by removing from the capital markets - wholly or partially, permanently or temporarily, as the circumstances may warrant - those whose conduct in the past leads us to conclude that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct; that is the role of the courts, particularly under section 118 [now 122] of the Act. We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient. In so doing, we must, of necessity, look to past conduct as a guide to what we believe a person's future conduct might reasonably be expected to be. ... (*Re Mithras Management Ltd.* (1990), 13 O.S.C.B. 1600 at 1610 and 1611.)

Further, the Commission must have regard to the specific circumstances of each case when determining the appropriate sanctions to be imposed on a respondent:

> We have a duty to consider what is in the public interest. To do that, we have to take into account what sanctions are appropriate to protect the integrity of the marketplace where illegal insider trading has been admitted.
>
> In doing this, we have to take into account circumstances that are appropriate to the particular respondents. This requires us to be satisfied that proposed sanctions are proportionately appropriate with respect to the circumstances facing the particular respondents. We should not just look at absolute values, e.g., what has been paid voluntarily in other settlements, or what has been found to be appropriate sanctions by way of cease trade order in other cases. (*Re M.C.J.C. Holdings and Michael Cowpland* (2002), O.S.C.B. 1133 at 1134.)

On the question of whether proposed sanctions are appropriate in the circumstances, the Commission has identified factors such as the following to be relevant:

- the seriousness of the allegations proved;
- the respondent's experience in the marketplace;
- the level of a respondent's activity in the marketplace;

- whether or not there has been a recognition of the seriousness of the improprieties;
- whether or not sanctions may deter not only those involved in the case being considered, but any like-minded people from engaging in similar conduct in the capital markets;
- any mitigating factors;
- the size of any profit (or loss avoided) from the illegal conduct;
- the size of any financial sanction or voluntary payment when considered with other factors;
- the effect any sanction might have on the livelihood of the respondent;
- the restraint any sanction might have on the ability of the respondent to participate without check in the capital markets;
- the reputation and prestige of the respondent;
- the financial consequences to a respondent of any sanction; and
- the remorse of the respondent.

(*Re Belteco Holdings* (1998), 21 O.S.C.B. 7743, at pp. 7746-7; *Re M.C.J.C. Holdings*, *supra* at 1136.)

We must weigh all of the relevant factors in determining whether the Settlement Agreement is in the public interest.

[Emphasis added]

86. It is the role of the settlement panel to determine whether the agreed-upon settlement is in the public interest. As set out above, there are many factors that the panel must consider in making that determination. The agreement to hold the settlement agreement with NBFL and Hicks in escrow for nearly seven years has prevented the settlement panel from carrying out its important role in protecting the public interest.

87. I can see no public interest in maintaining the escrow agreement. It has thwarted the established process for dealing with settlement agreements and has had the effect of keeping the settlement agreement confidential for a completely unreasonable length of time (see *Re Standard Trustco* (1992), 15 OSCB 143 in which a request for a further confidentiality order for an approved settlement agreement was denied as not being in the public interest).

88. It is clear from the above authorities that securities regulators have a broad mandate to protect the integrity of the public capital markets. Because of the complex and technical nature of the financial markets it is increasingly difficult to ensure that the public maintains confidence that the markets will be properly regulated and that those who misconduct themselves will be identified and sanctioned in a timely fashion. It is this public confidence that comes to the fore in the present matter as the existence of the escrow agreement – which has kept a settlement agreement secret for seven years – cannot possibly be viewed by a right thinking member of the public, the man on the Clapham omnibus or any other standard of reasonableness, as something that would inspire confidence in securities regulation in Nova Scotia. For these reasons I decline to maintain the escrow agreement.

89. In light of my finding that the escrow agreement is invalid, I believe it appropriate to order Staff to present the settlement agreement to the Commission secretary so that a Notice of Hearing may be issued and a settlement panel convened as contemplated by the Rules. It will be for the settlement panel to consider the settlement agreement and determine whether it is in the public interest to approve it. If the settlement agreement is approved, it will be made public. Until that time, however, its terms are protected by settlement privilege and the Rules.

90. The escrow agreement and continued secrecy surrounding the existence of the settlement agreement has prevented Potter, Wadden and MacLeod from obtaining relevant evidence in this proceeding. To maintain the integrity of the proceeding, the existence of the settlement agreement must be disclosed. Furthermore, in order to maintain public confidence in the Commission, the settlement agreement must be subjected to the usual process contemplated by the Rules, not continued to be held in escrow – especially in light of the ongoing proceeding before me, and the civil and criminal proceedings arising from the same facts.

91. I also wish to state that despite being urged to exercise my discretion and seek authority to constitute myself as a settlement panel for purposes of considering the settlement agreement under the *Act*, I decline to do so.

OTHER ISSUES

STANDING OF NBFL AND HICKS

92. Neither NBFL nor Hicks is a party to Commission proceeding before me. They provided submissions to Justice Rosinski and were added as Appellants in the appeal proceeding. I granted NBFL and Hicks limited standing in the Commission proceeding to make submissions on the matter remitted to me by the Court of Appeal. I have received those submissions and considered them.

93. NBFL and Hicks' standing is no longer required in the Commission proceeding before me. Staff, Potter, MacLeod or Wadden may deem it within their interest to require Hicks or another representative of NBFL to attend at the hearing of this matter as a witness.

94. I also wish to say that in Mr. Potter's submissions before me he has made a number of serious allegations with respect to alleged impropriety on the part of Staff and National Bank Financial Limited. I wish to make it clear that these remarks have in no way influenced my decision and I consider them intemperate as they are not supported by any evidentiary foundation. In addition, I observe that an evidentiary foundation cannot be established by referring to evidence created by a party such as their own blog and such references have not been helpful to me in determining the proper procedural course in this matter.

PROCEDURE FOR DISCOVERY EXAMINATIONS

95. The discovery examinations should be re-convened as soon as is practical as the hearing on this matter is scheduled to commence October 1, 2012. I reiterate my request that in the event that a party objects to the relevance of a question, that the objection be noted and the question answered.

96. As set out above, the impugned question must be answered, but the terms of the settlement agreement are protected by settlement privilege and the Rules until it is approved by settlement panel. Likewise, questions about settlement negotiations are privileged. However, the investigators will answer any questions regarding how they came to obtain the KHI email servers.

CONCLUSION AND ORDER

97. I order as follows:

    (a) I direct that the impugned discovery question be answered.

    (b) Subsequent questions may not deal with the contents of the settlement agreement unless and until it has been approved by settlement panel. Care must be taken to respect the settlement privilege that attaches to the terms of the agreement at this stage.

    (c) I direct that the settlement agreement be presented to the secretary of the Commission forthwith for compliance with Rule 10.4.

98. This decision shall remain confidential for 30 days from the date of issuance. If no appeal is taken pursuant to section 26.1 of the *Securities Act* within that time, the decision shall be made public in the ordinary course.

99. Finally, I am aware from the materials that have been placed before me that one or more parties may consider an appeal necessary from the decision I have made. Because of this possibility I direct that all parties in this matter keep the existence of a settlement agreement strictly confidential until such time as it is made public through the normal settlement panel approval process. In the event that the settlement panel process does not transpire as I direct, confidentiality shall be maintained until such time as a Court directs that reference may be made to the settlement agreement under discussion here.

DATED at Halifax, Nova Scotia, this 17th day of April, 2012.

"D. W. Gruchy"

Commissioner David W. Gruchy

NOVA SCOTIA

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April 24, 2012

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Dear Counsel:

Re: Knowledge House Inc. – Outstanding Procedural Items

I have been informed by my counsel that Staff has a concern with Mr. Dunlop's communication to Commission Secretary Shirley Lee on April 23, 2012.

I have been given a copy of Mr. Dunlop's communication to the Secretary as well as a copy of Staff's request that that communication be withdrawn due to the direction in paragraph 99 in my decision of April 17, 2012 (the "Decision").

I have also been provided with a copy of Mr. Potter's communication to my counsel on the same date. Mr. Potter indicates his intention to provide a copy of the Decision to another individual at the Securities Commission.

April 24, 2012

It was my intent to accord all parties an opportunity to consider their options before the matter before me becomes public. I consider the effect of paragraphs 97 to 99 of the Decision to be clear, but I amplify the meaning as follows:

1. Staff shall provide the specified settlement agreement to the Secretary of the Commission forthwith. At the expiry of the statutory appeal period, the Secretary shall prepare a Notice of Hearing for a Settlement Hearing in accordance with Rule 10.4.

2. The existence and terms of the settlement agreement shall be kept confidential until the expiration of the statutory appeal period, except for its provision to the Secretary as set out above.

In the circumstances I direct that Mr. Dunlop withdraw his communication to the Secretary and that the existence of the settlement agreement be kept confidential as contemplated by in the Decision. I will ask the Secretary to delete Mr. Dunlop's email from the record of this proceeding. Furthermore, I direct that Mr. Potter may not provide a copy of the Decision to anyone, in accordance with paragraph 98.

It was my intention to have the Decision and the existence of the settlement agreement kept confidential until the expiry of the statutory appeal period, at which time the Decision (and therefore the existence of the settlement agreement) will be made public in the ordinary course. If any party appeals the Decision, they may seek leave of the Court of Appeal to continue the confidentiality after the statutory appeal period if they so wish.

Please consider this letter to be an addendum to my Decision.

Yours very truly,

"D.W. Gruchy"

David W. Gruchy

DWG/slc

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May 16, 2012

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Dear Counsel:

Re: Knowledge House Inc.
Second Addendum to Decision of April 17, 2012

At the request and on agreement of the parties, I issue this addendum to my decision of April 17, 2012 and previous addendum of April 24, 2012 (collectively, the "Decision").

In light of the Notice of Appeal (Tribunal) of the Decision filed by National Bank Financial Limited ("NBFL"), and NBFL's motion before the Court of Appeal for a publication ban, order sealing the Court record and *in camera* hearing of the appeal and motion to stay the execution of the Decision, I defer the execution of the Decision until the Court of Appeal has ruled on NBFL's motions.

May 16, 2012

The confidentiality direction at paragraph 99 of the Decision shall remain in force for the same time period with the exception that the Decision may be provided to those necessary to commence an appeal under section 26 of the *Securities Act*.

Yours very truly,

"D.W. Gruchy"

David W. Gruchy
DWG/ab
cc: James Hodgson
cc: Edward Gores, Q.C.
cc: Sheldon Choo
cc: Sean MacDonald