IN THE MATTER OF THE SECURITIES ACT
R.S.O. 1990, c. S.5, AS AMENDED

– AND –

IN THE MATTER OF
LYDIA DIAMOND EXPLORATION OF CANADA LTD., JURGEN PRINZ VON ANHALT AND EMILIA PRINCESS VON ANHALT

Hearing:	**June 28, July 3-5, September 18-20, October 10-11, 15-16 and November 4, 2002**		
Panel:	**Paul M. Moore, Q.C.**	**-**	**Vice-Chair (Chair of the Panel)**
	M. Theresa McLeod	**-**	**Commissioner**
	H. Lorne Morphy, Q.C.	**-**	**Commissioner**
Counsel:	**Matthew Britton**	**-**	**For the Staff of the Ontario Securities Commission**
	Nigel Campbell **Robert Brush**	**-**	**For Lydia Diamond Exploration of Canada Ltd.**
	Joseph Groia **Alistair Crawley** **Kevin Richard**	**-**	**For Jurgen Prinz von Anhalt and Emilia Princess von Anhalt**

REASONS

I. The Proceeding

[1] This proceeding was a hearing pursuant to sections 127(1) and 127.1 of the *Securities Act*, R.S.O., 1990, c. S.5 (the Act), in the matter of Lydia Diamond Exploration of Canada Ltd. (Lydia), Jurgen Prinz von Anhalt (the Prinz), and Emilia Princess von Anhalt (the Princess), under a notice of hearing dated April 1, 2002, and the related statement of allegations of staff of the Commission.

[2] During the course of the hearing we heard from the following witnesses: Stephanie Collins, a

forensic accountant with staff, Fran Harvie, a self-styled psychic consultant, Allan Cheskes, a partner with Mintz & Partners, the auditor of Lydia (the auditors), Dr. Hamish McGregor, a senior associate geologist with Watts, Griffis and McOuat, the Princess, and Alexander Sennecke, an independent director of Lydia.

[3] We made an order under sections 127 and 127.1 on November 19, 2002, which we have attached as Appendix I. We made a further order under section 144 on December 13, 2002, which we have attached as Appendix II.

[4] On May 16, 2001, Lydia Consolidated Diamond Mines Ltd. (Old Lydia) and Acadia Mineral Limited (Acadia) amalgamated to form Lydia. In these reasons, "Lydia" refers to Old Lydia or the amalgamated company, depending on the time frame.

[5] The following are our reasons.

II. The Allegations

[6] Staff alleged that:

(1) Lydia and the von Anhalts traded in securities of Lydia while unregistered and without an applicable exemption from the registration requirement of the Act;

(2) Lydia and the von Anhalts distributed securities of Lydia without a prospectus and without an applicable exemption from the prospectus requirement of the Act;

(3) Lydia misled staff;

(4) Lydia paid undisclosed commissions to Harvie for the sale of Lydia shares;

(5) The von Anhalts used investor funds other than exclusively for proper corporate purposes; and

(6) The von Anhalts, as directors of Lydia, authorized, permitted or acquiesced in the contraventions of the Act by Lydia.

III. Response of the Respondents to the Allegations

[7] Counsel for the von Anhalts argued that:

(1) The respondents relied on the private company exemptions from the registration and prospectus requirements of the Act. The private company exemptions require that there not be more than a certain number of "shareholders". The word "shareholder" in this context means a registered shareholder and does not include investors for whom shares were held in trust by Harvie.

(2) Even if "shareholder" does include investors for whom shares were held in trust, the respondents believed, based on legal advice, that it did not. Therefore, even if the respondents breached the registration or prospectus requirements of the Act, the breaches were technical only. As such, a section 127 order against them would not be in the public interest.

(3) The von Anhalts were, in the beginning, unsophisticated in legal, business and accounting matters and have since obtained valuable experience.

(4) Lydia relied on its lawyers in providing information to staff. If staff were misled, it was not the respondents who misled them.

(5) The financial statements of Lydia have been audited. The Commission should give great weight to this fact in deciding whether investor funds were used for proper corporate purposes.

(6) Only funds expended by the von Anhalts for proper corporate purposes have been reflected in the financial statements as expenses of Lydia. Funds of Lydia expended for their own personal purposes by the von Anhalts have been properly reflected in the financial statements through the shareholders loan account as deductions in the appropriate periods from amounts owed by Lydia to the von Anhalts at the time of the expenditures.

(7) No shareholders of Lydia have been harmed.

(8) An order under section 127 cease-trading Lydia would harm the shareholders of Lydia, the very persons the Commission purports to protect.

(9) The von Anhalts are important to the on-going prospects of Lydia. An order preventing them from acting as officers and directors of Lydia would be harmful to the shareholders of Lydia.

[8] Counsel for Lydia argued that:

(1) Lydia is a viable corporation with a viable exploration program.

(2) Lydia is now well managed by its committee of independent directors. It is not necessary to remove the von Anhalts from the board of directors and management of Lydia. To do that would be to remove the driving force behind Lydia and cause the shareholders more harm than good.

IV. Facts

1. Chronology

[9] The following is a chronology of important events:

1988	• The Princess comes to Canada as a student.
February 13, 1994	• The von Anhalts meet in Nassau, Bahamas.
April 1, 1994	• The von Anhalts marry in Nassau.
August 4, 1994	• The von Anhalts visit Canada on their way to take up residence in Italy. They remain in Canada.
September 1, 1994	• The von Anhalts move to Indian River, near Peterborough, Ontario.
November, 1994	• The von Anhalts begin staking property around Wolf Lake (the Wolf Lake property), near Peterborough.
November 24, 1994	• The birth of Lydia von Anhalt, daughter of the von Anhalts.
November 26, 1994 to December 16, 1994	• First intense period of exploration for gold by the von Anhalts on the Wolf Lake property.
February 10, 1995	• Incorporation of Old Lydia.
February 10 to end of June, 1995	• Second intense period of exploration for gold by the von Anhalts on the Wolf Lake property.
May 31, 1995	• First fiscal year-end of Lydia. Financial statements for that year, issued in 2000, show total operating cash outflows for the year of $188,702 including $108,902 of travel and financing expenses, $24,641 of office, general and other expenses and $55,159 of mining exploration.
	• At year-end, Lydia owes to the von Anhalts $188,600, according to the shareholders loan account constructed in 2000.
1996	• Some time during the year, Lydia first retains MacLeod Dixon LLP (MacLeod Dixon) as lawyers for Lydia.

May/June, 1996	• Lydia discovers kimberlite indicator minerals in gold digging samplings from the Wolf Lake property. • The Prinz decides the focus of exploration for Lydia should change from gold to diamonds.
May 31, 1996	• Second fiscal year-end. Financial statements for that year, issued in 2000, show total operating cash outflows for that year of $176,189, including $52,183 of travel and financing expenses, $20,922 of office, general and other expenses and $103,083 of mining exploration. • At year-end, Lydia owes to the von Anhalts $364,789, according to the shareholders loan account constructed in 2000.
Mid-July, 1996	• Shares sold to Clark Brown and Izhak Fixler as first investor shareholders.
May 31, 1997	• Third fiscal year-end. Financial statements for that year, issued in 2000, show total operating cash outflows of $186,726, including financing and travel expenses of $20,303, office, general and other expenses of $24,503, and mining exploration expenses of $188,399 (of which $46,481 was non-cash). • During the year, third-party investors provide cash funds of $149,545. • During the year, distributions to the von Anhalts total $196,026. • At year-end, Lydia owes to the von Anhalts $401,970, according to the shareholders loan account constructed in 2000.
August, 1997	• Budget for exploration set at $1,000,000.
December, 1997 to May 1998	• The von Anhalts spend six months in Florida waiting to receive $1,000,000 in funding from a German investor consortium. The funds are not forthcoming.
May 31, 1998	• Fourth fiscal year-end. Financial statements for that year, issued in 2000, show total operating cash outflows of $48,919, including office, general and other expenses of $33,089, financing and travel expenses of $570, and mining exploration of $17,760 (of which $2,500 was non-cash).

	• During the year, third-party investors provide cash funds of $57,634.
	• During the year, distributions to the von Anhalts total $57,634.
	• At year-end, Lydia owes to the von Anhalts $393,255, according to the shareholders loan account constructed in 2000.
	• As at year-end, Mintz & Partners require a reduction of $60,045 in the shareholders loan account to reverse the personal portion of rent, accommodation and travel expenses and to reflect cash received from investors.
	• During the year, the Princess reports her discovery in 1996 of a 9.346 carat diamond in gold digging samplings discovered while walking around the Wolf Lake property.
Late summer, 1998	• Harvie and the von Anhalts are introduced by Fixler at Harvie's home. According to Harvie, a psychic consultation between Harvie and the Princess occurs.
	• Harvie subsequently visits the Wolf Lake property with the von Anhalts and later develops a friendship with them.
September 11, 1998	• Harvie buys shares of Lydia and requests permission of the von Anhalts to allow her friends to invest.
	• Number of Lydia shareholders likely less than 50 at this point in time.
November 24, 1998	• Birthday party dinner with Harvie, the von Anhalts, and Chuck Higgins of MacLeod Dixon.
December, 1998	• Mintz & Partners retained as auditors of Lydia.
March, 1999	• Werb retained as bookkeeper of Lydia.
May 31, 1999	• Fifth fiscal year-end. Financial statements for that year, issued in 2000, show total operating cash outflows of $72,746, including $30,123 of office, general and other expenses, $655 of financing and travel expenses, and $63,411 of mining expenditures (of which $21,443 was non-cash).
	• During the year, third-party investors provide cash funds totalling

	$109,500.
	• At year-end, Lydia owes to the von Anhalts $360,001, according to the shareholders loan account constructed in 2000.
	• During the year, Mintz & Partners require a net reduction to the shareholders loan account of $33,254 to reflect the personal portion of rent, travel and other expenses.
January, 2000	• The von Anhalts, who had been visiting Palm Beach, return, meet with Harvie, and receive an envelope with $100,000 of subscription cheques from investors who purchased shares through Harvie.
	• The von Anhalts become concerned over the number of shareholders.
January 16, 2000	• Information meeting at "Jackson's Touch of Class" restaurant between the Princess and investors solicited by Harvie.
February, 2000	• According to the Princess, the von Anhalts meet with MacLeod Dixon to discuss what to do about the number of shareholders. According to the Princess, this was the first discussion with MacLeod Dixon about a reverse take-over by way of amalgamation with a reporting issuer as a possible solution. Acadia later identified as an amalgamation prospect.
March 9, 2000	• Staff receives e-mail complaint about distributions of Lydia shares.
May 31, 2000	• The sixth fiscal year-end. Financial statements for that year show total operating cash outflows of $549,073, including $340,946 of office, general and other expenses, and $232,020 of mining expenditures (of which $18,000 was non-cash).
	• During the year, third-party investors provide net cash funds of $1,046,478.
	• At year-end, the shareholders loan account reduced to zero, as a result of extensive adjustments (the 2000 adjustments) required by Mintz & Partners, totalling $364,929, to reverse personal expenses and cash received from investors.
June 1, 2000 and February	• The board of directors of Lydia, comprising the Prince and the

2001	Princess, reverses many of the 2000 adjustments. New credits totalling $20,224 are recorded in the shareholders loan account on June 1, 2000. Additional credits of $130,974 are recorded in February 2001.
July 30, 2000 to May 10, 2001	• The von Anhalts sell 3,718,435 Lydia shares held by them.
August 3 and 4, 2000	• Audit reports signed by Mintz & Partners on the financial statements of Lydia for fiscal years 1995, 1996, 1997, 1998, 1999 and 2000.
August 4, 2000	• Lydia issues Joint Management Information Circular (the Information Circular) in connection with the amalgamation with Acadia. The Information Circular includes the audited financial statements of Lydia for the three years ending May 31, 1998, 1999 and 2000.
August 29, 2000	• Shareholder meeting approving amalgamation agreement between Old Lydia and Acadia.
October 3, 2000	• Staff send a letter (the October 3 letter) to the von Anhalts inquiring as to the number of Lydia investors.
October 13, 2000	• Mr. Do of MacLeod Dixon replies (the October 13 reply) to the October 3 letter.
October 19, 2000	• Staff send a letter (the October 19 letter) to Do stating that the number of Lydia investors may have exceeded 50.
November 1, 2000	• Mr. Helfand of MacLeod Dixon replies (the November 1 reply) to the October 19 letter.
May 1, 2001	• Quebec Securities Commission grants an exemption, subject to conditions, permitting amalgamation to be consummated.
May 16, 2001	• Old Lydia and Acadia amalgamate to form Lydia.
January 4, 2002	• Staff notifies Lydia of its intention to proceed with its investigation.
April 1, 2002	• Notice of hearing issued.
May 15, 2002	• At the urging of the independent directors, Heinke Martens made

a director and appointed co-chief executive officer with the Princess.

2. The Company

[10] Old Lydia was incorporated under the Ontario *Business Corporations Act*, R.S.O., 1990, c. B.16 (the OBCA) as a private company.

[11] The articles of incorporation of Old Lydia contained the following restrictions:

> No shares of the corporation shall be transferred without either:
>
> > (a) the express consent of a majority of the directors of the corporation expressed by a resolution passed by the board of directors or by an instrument or instruments in writing signed by all of the directors; or
> >
> > (b) the express consent of a majority of the shareholders expressed by a resolution passed by such shareholders or by an instrument or instruments in writing signed by such shareholders.
>
> It shall be a condition of the articles:
>
> > (a) that the number of shareholders of the corporation, exclusive of persons who are in its employment and exclusive of persons who, having been formerly in the employment of the corporation, were while in that employment, and had continued after the termination of that employment to be shareholders of the corporation, is limited to not more than fifty, two or more persons who are the joint registered owners of one or more shares being counted a sole shareholder;
> >
> > (b) that any invitation to the public to subscribe for securities of the corporation is prohibited;

[12] Lydia, from the time it was formed by amalgamation, was a reporting issuer in Ontario.

3. Governance of Lydia

[13] The amalgamation required exemptive relief from the Quebec Securities Commission. A condition of the exemptive relief was that:

> (1) Harvie agree to transfer shares of Old Lydia held by her to the beneficial shareholders of the shares; and
>
> (2) Lydia be managed exclusively by three independent directors until the end of the investigation by the Ontario Securities Commission.

[14] Since the amalgamation, various persons, including Sennecke, have served as independent directors of Lydia; and until the sudden death of one of the directors during the time of the hearing before us, Lydia has had at least three independent directors who have operated as a committee (the independent committee).

[15] Before the amalgamation, the Prinz was the chairman, chief executive officer and a director of Lydia and the Princess was the president, chief operating officer and a director. After the amalgamation, the Prinz has been the chairman and a director, and the Princess has been the president, chief executive officer and a director.

[16] On May 15, 2002, at the urging of the independent committee, Heinke Martens was made a director and appointed co-chief executive officer with the Princess.

[17] Despite the establishment of the independent committee, the Princess has been involved in the continuing operation and affairs of Lydia.

4. Books and Records

[18] Until 1999, Lydia kept none of the corporate records required under the OBCA, including no register of shareholders, no transfer record of shareholders, and no minutes of shareholder and director meetings. Indeed, we heard evidence that there were never any meetings of directors or shareholders before 1999.

[19] Before 1999, Lydia kept no books of account. It had no general ledger, no accounts to record assets or liabilities or income and expenses. It had no bank accounts and no credit card accounts. It had no process or procedures for budgeting, approving expenses, or for issuing shares.

[20] Starting in 1999, Lydia, at the suggestion of Cheskes, retained Michael Werb, as bookkeeper, to construct financial accounts and books for Lydia for all periods from the date of incorporation of Old Lydia up to the current time. Werb worked closely in this endeavour with Mintz & Partners, who were retained as the auditors of Lydia at the end of 1998. Mintz & Partners prepared the financial statements of Lydia for all periods up to May 31, 2000 from the financial accounts constructed by Werb.

[21] According to the Princess and Cheskes, Werb had a reputation for being careful, thorough and

meticulous.

[22] Under the direction of Cheskes, Werb started collecting information regarding the expenses incurred on behalf of Lydia from receipts kept in boxes, and orally from the von Anhalts.

[23] At the same time, Lydia's lawyers were trying to put together a shareholder list and to determine the company's share capital.

[24] Among the accounts constructed by Werb was the shareholders loan account. The shareholders loan account did not exist for most of the time that the von Anhalts were expending funds for Lydia. When Werb was faced with the situation, properly he constructed the shareholders loan account. The account was an explanation for what had happened, not a justification for what had already taken place. The von Anhalts were never aware at any particular moment of how much money Lydia owed them.

[25] Werb recorded in the shareholders loan account as credits to the von Anhalts, moneys they claimed were expended out of their own funds for corporate purposes of Lydia, and as debits to the von Anhalts, moneys of Lydia expended by the von Anhalts for their own purposes.

[26] No written agreements were ever entered into between Lydia and the von Anhalts to provide for loans by the von Anhalts to Lydia, or advances by Lydia to the von Anhalts, or to document the credits and debits eventually reflected by Werb in the shareholders loan account. However, the von Anhalts advised Lydia's directors, and note 7 to the financial statements for the year ended December 31, 2001 reflected, that the von Anhalts had agreed not to demand payment of moneys owed by Lydia to them before June 30, 2003.

[27] Several expenditures by the von Anhalts in 1994, and in 1995 before February 10, 1995, the date of incorporation of Old Lydia, were reflected in the shareholders loan account as corporate expenditures of Lydia. There was no pre-incorporation contract with respect to such expenditures. The evidence we heard did not justify in any way the charging against Lydia of these expenditures as proper corporate expenses. The expenditures were incurred by the von Anhalts in 1994 before the von Anhalts had even thought of acquiring the Wolf Lake property.

[28] Lydia had no corporate bank or credit card accounts until after Mintz & Partners became involved. Before that, and even after, in some instances, funds received from investors were deposited and commingled in personal bank accounts of the von Anhalts or spent directly by the von Anhalts.

[29] Lydia has never generated funds from operations. All of its funds have either come from investors or were funds expended on its behalf by the von Anhalts. All funds applied to reimburse the von Anhalts for moneys expended by them on behalf of Lydia, or otherwise paid to them, came from investors.

5. Shares

[30] On February 10, 1995, the day of incorporation of Old Lydia, 10 shares were issued to the von

Anhalts. The next day Old Lydia issued 50 million shares to the von Anhalts.

[31] From and including 1996, up to the time of the amalgamation of Lydia, the von Anhalts caused Lydia to issue shares to approximately 50 individuals, not including Harvie. One of the first investor shareholders was Fixler who ran a local gas bar and restaurant. They had become acquainted with him and had discussed their search for diamonds on their trips to and from Lydia's exploration property. In addition, Lydia issued shares to Harvie in her own right and shares to be held by her "in trust" for 341 other investors.

[32] The von Anhalts sold to investors, before and after the amalgamation, shares of Lydia originally issued to them. The von Anhalts were not registered to trade and Lydia did not file a prospectus under the Act with respect to such trades.

[33] There were no agreements between Harvie and Lydia, nor between Harvie and any investor for whom she held shares in trust, regarding the establishment of any trust or its terms.

[34] In the latter half of 2000, the Princess asked Harvie to sign, and Harvie did sign, subscription agreements between Harvie and Lydia for the shares previously issued to Harvie in trust for others. The agreements were all in the same form, were signed at the same time, and were backdated to the various dates the shares were sold. They contained a representation by Harvie that she was acquiring the shares as principal for her own account. The Princess admitted that she knew at the time that this representation by Harvie in the subscription agreements was untrue.

[35] At the time of the hearing, Lydia had outstanding approximately 60 million shares of which approximately 79% were held by the von Anhalts. The balance were held by approximately 2,600 other shareholders.

[36] The shares of Lydia are not listed on any exchange, and do not trade on a recognized market.

6. Correspondence with Staff

[37] As part of its investigation, which resulted in the issuance of the notice of hearing in this matter, staff asked Lydia for information about its accounts, its shareholders and its investors.

[38] On October 3, 2000, staff sent the October 3 letter to the Prinz and the Princess suggesting that they consult their legal counsel and requiring them to provide, among other information, "[t]he total number of Lydia investors" and "[t]he names, addresses and phone numbers of all individuals and/or companies who are or have been investors of Lydia."

[39] On October 13, 2000, Do replied to the October 3 letter as follows:

> We are counsel to Lydia. We write, on behalf of Lydia to respond to your letter of October 3, 2000 requesting information in respect of said company. Please find enclosed the responses of Lydia to your information request, which responses we have been instructed to

forward to your attention.

[40] Among the responses enclosed with the October 13 reply were these statements:

> In respect of the promotion and sale of Lydia's shares stock certificates, Lydia has relied on the private company exemption from the prospectus and registration requirements of the *Securities Act*. Lydia has no more than 50 shareholders, exclusive of current and former employees and has marketed its stock certificates only to acquaintances in the community.
>
> The total number of Lydia investors is 52.

[41] Among the responses enclosed with the October 13 reply, there was also a list of 56 persons, with addresses and phone numbers, identified as current or past shareholders, under the heading "The names, addresses and phone numbers of all individuals and/or companies who are or have been investors of Lydia".

[42] The Princess testified that she did not review the October 13 reply in advance of it being sent, but that she reviewed it afterwards.

[43] On October 19, 2000, staff sent a letter to the attention of Do stating:

> It has come to the attention of Commission staff that the number of investors may have significantly exceeded the 52 investors you have provided in your list to staff and therefore rendering the private company exemption 35(2)10 of the *Securities Act* (Ontario) inapplicable.

[44] On November 1, 2000, Helfand replied to the October 19 letter stating, among other things:

> The Company is now aware that one of its shareholders, Fran Harvey, has also purchased common shares on behalf of third parties (the "Third Parties") despite having signed subscription agreements stating that she was purchasing such shares for her own account. When such information came to the attention of the Company, it did not understand that the purchase of Lydia shares by Ms. Harvey in trust for Third Parties may have taken it outside the ambit of the Private Company Exemptions…
>
> After receipt of your correspondence dated October 3, 2000, the Company was advised by counsel that the purchase of common shares by Ms. Harvey on behalf of Third Parties may have occurred without the benefit of exemptions from the registration and prospectus requirements available under the Act.

[45] This passage from the November 1 reply suggested that Harvie sold shares to third parties without the knowledge of Lydia. The evidence established, however, that Harvie sold to third parties with the full knowledge of the von Anhalts. The suggestion that Harvie sold Lydia shares to third parties without the company's knowledge was, therefore, misleading to staff.

[46] The Princess testified that she did review a draft of the November 1 reply before it was sent and was aware that its contents were not accurate. However, she permitted the letter to be sent.

[47] The information contained in the October 13 and November 1 replies was clearly false. The Princess knew that the letters contained false information and that they had been sent on behalf of Lydia.

[48] Even assuming that she did not know about the October 13 reply until after it was sent, she did not take any steps to rectify the situation when, according to her testimony, she learned of the letter once it had been sent. Her conduct was designed to mislead staff.

[49] Counsel for the von Anhalts argued that if anyone misled staff, it was due to the lawyers, and that, at worst, the von Anhalts merely acquiesced in the lawyers' conduct. That in itself, however, would have amounted to misleading staff.

7. The von Anhalts

[50] When the Princess met the Prinz, she was a landed immigrant of Canada. She later became a Canadian citizen. When they met, the Prinz held a German passport, but now holds a passport of the Dominican Republic.

[51] The Prinz had never been to Canada until August 4, 1994, when the von Anhalts came for a visit. The Princess was pregnant at the time. They did not intend at the time to make Canada their home.

[52] The Princess testified that because of complications in her pregnancy in Canada, she was unable to fly. Therefore, the von Anhalts could not go to Italy to take up residence in the house that they had rented. The Princess also testified, however, that she did fly to Bermuda after August 4, 1994 and before the birth of her child.

[53] The Princess testified that when she and the Prinz started Lydia, they were relatively unsophisticated persons with respect to legal, business and financial matters, but that they had learned much about these matters over the years. However, we heard evidence that the Prinz had been president of his own property development company in the Bahamas and had had several business relationships in the past. A Harold Gray, an attorney-at-law in the United States, wrote a "To Whom It May Concern" letter dated September 1, 1993 in which he stated, with reference to the Prinz, "he has an engaging personality with an ability to comprehend, understand and analyze business opportunities". Another "To Whom It May Concern" letter from another business colleague referred to the fact that the Prinz had "business savvy".

8. The Wolf Lake Property

[54] The Prinz regularly read the Report on Business and realised that, in the Princess' words, "gold and diamond exploration was… the flavour of the mining industry" at the time.

[55] The Princess testified that while staying in Toronto in 1994, the von Anhalts saw an advertisement in the newspaper for a house in Indian River, 22 kilometres east of Peterborough. They arranged to rent it because it was situated in an ideal small-town setting.

[56] The von Anhalts moved into the Indian River house at the beginning of September, 1994.

[57] When the landlord of the Indian River house asked the Prinz what he did, he replied that he was retired but also mentioned that they were interested in mining. Upon hearing this, the landlord mentioned the Eldorado gold mine nearby.

[58] The von Anhalts had heard that the mine was for sale, which turned out to be untrue, but they discovered that the property next to the Craig mine was for sale. The von Anhalts acquired rights to mine this property (the Wolf Lake property) and subsequently began staking it in the three weeks preceding November 24, 1994. They intended to explore for gold.

[59] The von Anhalts' daughter was born on November 24, 1994.

[60] The Princess testified that two days after the birth of her daughter, she drove on bumpy roads to visit the Wolf Lake property, leaving her infant child in the car, with an attendant, for hours at a time.

[61] The Princess testified that the von Anhalts worked particularly intensely on the property for a three-week stretch from November 26, 1994, to December 16, 1994, and again for a five-month period from February to June 1995. She said that the work was long and exhausting and that the von Anhalts "bucked each other up". She testified that they rented a backhoe and the Princess learned how to operate it in order to cut expenses. At the same time, they learned all they could about mining, including reading the *Mining Act* over dinner each night and into the evening. Whenever the Princess suggested that they give up exploring for gold, the Prinz was determined to continue. He was a very persuasive person and the Princess yielded to his determination.

[62] Under cross-examination, the Princess admitted that during these same time periods, the von Anhalts had travelled to Palm Beach and Europe, including Amsterdam, Madrid, Majorca and Zurich, spending much of their time out of the country.

[63] Despite the fact that Old Lydia was incorporated to explore for gold, the von Anhalts chose a name for the company incorporating the word "diamond". The Princess testified that the various names the von Anhalts applied for that included "gold" were not available. Besides, she testified, they just liked the sound of "diamond". We were surprised at the choice of the corporation's name employing the word "diamond" instead of "gold".

[64] The Princess testified that in May or June, 1996, Lydia discovered kimberlite indicator minerals in gold digging samplings, and the von Anhalts changed their search from gold to diamonds.

[65] The Princess testified that in 1996, she found a nine-carat diamond among the gold digging samplings, although this fact was kept secret and was not disclosed until 1998. In Lydia's 2001 Annual Report, in the "Exploration Review" section, under the sub-heading "1998", it was stated, in reference to this diamond:

> A fourth diamond is discovered in a till sample. Duncan Parker of Harold Weinstein Ltd. (Gemmological Laboratory) later describes it as an octahedron of 9.346 carats.

The 2001 Annual Report also stated under the heading "1994":

> Jurgen and Emilia von Anhalt investigate the area around Eldorado, site of Canada's first gold mine, and stake claims surrounding Wolf Lake. Initially their interest is gold. Later, kimberlite indicator minerals (KIMs) identified in drilling samples turn their attention to diamonds.

[66] In 1997, the von Anhalts prepared an exploration plan for the property with a budget of approximately $1 million. The Princess testified that from this time, the von Anhalts started seeking money from investors locally and outside the country.

9. Fran Harvie

[67] Harvie held herself out as a psychic consultant.

[68] In September of 1998, Harvie became acquainted with the von Anhalts. She became very interested in what the von Anhalts were doing, visited the Wolf Lake Property, and used her alleged psychic powers to indicate where she thought diamonds might be located on the property.

[69] Harvie acquired shares of Lydia for herself and was granted permission by the von Anhalts to find investors for Lydia. Although Harvie testified that she never received commissions for selling shares of Lydia, she stated that she was reimbursed for expenses and received gifts from the von Anhalts. However, she agreed in the settlement agreement between her and staff that she had been paid commissions by the von Anhalts for selling shares in Lydia. Harvie was paid $95,000 in commissions. The fact that Lydia had paid commissions to Harvie was not disclosed to investors.

[70] She agreed with the Princess that shares issued to investors found by Harvie would be held in trust by her in order to limit the number of shareholders of Lydia.

[71] When investors were found by Harvie, she would sell them shares at prices previously set by the Princess, and would collect cheques from the investors. The Princess would subsequently meet with the investors to provide them with information about Lydia.

[72] When the von Anhalts returned from Palm Beach in mid-January 2000, they met with Harvie. Harvie presented them with an envelope containing approximately $100,000 of subscription cheques from investors. The Princess testified she was surprised and overwhelmed by the investors' interest.

[73] She arranged with Harvie to have an information session with the new investors. This was held at "Jackson's Touch of Class" restaurant in Whitby, Ontario. While most of the attendees at the meeting were investors, there may have been some who were not.

[74] As a result, by the end of 2000, Harvie held shares in trust for 341 investors and had raised close to $1 million, which she turned over to the von Anhalts.

[75] Harvie and the von Anhalts told almost everyone they met about the exploration project at Wolf Lake and their enthusiasm for it. As a result, persons interested in investing in Lydia were constantly approaching them.

[76] The Princess testified that she kept a list of investors' names, as did Harvie. There was evidence, however, that in order to complete Lydia's shareholder record, Harvie's help was required.

V. Considerations in Determining the Facts

1. Allegation of Misuse of Funds

[77] Counsel for the von Anhalts moved at the commencement of the hearing to strike the allegation that the moneys from the sale of Lydia shares had not been used exclusively for diamond exploration on the Wolf Lake property. The grounds for the motion were that the respondents had not been provided with particulars. Our rule of practice concerning motions was not complied with. We refused to waive the rule and did not hear the motion.

[78] Staff clarified early on at the hearing that the thrust of the allegation was that moneys received by the von Anhalts were not used exclusively for proper corporate purposes.

[79] The evidence established that during the investigation and pre-hearing phase, on numerous occasions, staff sought information as to the source, amount and use of investor funds and that they had not been provided with full answers to their inquiries. Furthermore, it became evident that during the construction of the general ledger and the shareholders loan account that questions as to the use of funds and the allowability of claims for the credit of expenses were matters of concern among the bookkeeper, the auditors and the von Anhalts.

[80] We had no reason to believe that staff failed to provide all relevant documents and information in their possession relating to this allegation, including analyses of corporate and personal bank accounts that established commingling of moneys received from investors with the von Anhalts' own funds, and the payment of personal expenses out of corporate funds, including those in corporate bank accounts.

[81] As the hearing progressed, it was clear that the respondents were in no way prejudiced as they

had asserted they would be.

2. Balance of Probability

[82] In determining whether staff had proved its allegations, we applied the standard of a reasonable balance of probability based on clear and convincing proof from cogent evidence.

3. Onus

[83] Staff had the onus of establishing the facts to substantiate its allegations. However, the respondents had the onus of proving the facts necessary to establish that they had the benefit of the private company exemption they claimed, once staff established that shares were issued without a prospectus and without Lydia being registered as provided under the Act.

[84] In *R. v. Buck River Resources Ltd. et al*. (1984), 25 B.L.R. 209 (Alta. P.C.) (*Buck River*), Marshall J. makes clear, at 222, that the burden of proof is upon the accused to bring himself or herself within the exemption:

> Furthermore, the exception sections therein, deeming sales to be "not to the public" appear to have been rather narrowly construed against the salesman trying to bring himself within the exception, notwithstanding the general rule of interpretation of penal statutes in favour of the accused, and, of course, it is to be remembered that we are dealing with an exception here, not the general provisions of the statute.

4. The Princess

[85] The picture painted by the Princess during her examination-in-chief, of her and her husband, working from morning until night on the Wolf Lake property seven days a week, for periods of up to five months at a stretch, working a backhoe by day, and studying the *Mining Act* by night, changed in cross-examination, when it was admitted that they had spent extended periods of time out of the country.

[86] The Princess testified that she did not know about the limit on the number of shareholders contained in the articles of Old Lydia, because she never had read the articles of incorporation of Old Lydia. Nor, she testified, had she received or sought any advice with respect to the terms and conditions of the articles from the lawyer who acted on the incorporation of Old Lydia. She claimed that she had been unaware of the need for Lydia to comply with the private company restrictions in its articles and the Act.

[87] However, at another time she testified that when Harvie asked her in 1998 if Harvie's friends might buy shares, the Princess for some reason felt the need to consult Higgins, which she did at her daughter's birthday party. Higgins, she testified, came up with the idea of Harvie's holding shares "in trust".

[88] However, over a year later, when Harvie presented her with cheques for $100,000 from investors in January, 2000, she for some reason became worried about the number of shareholders notwithstanding the trust arrangement, and sought the advice of Higgins for a solution. She testified that Higgins suggested that a reverse take-over by way of amalgamation, such as that which ultimately occurred with Acadia, was a possible solution to the problem of having a limit of 50 on the number of shareholders.

[89] Her testimony of not reading the articles of incorporation of Old Lydia, of not receiving advice from her lawyer at the time of incorporation on the terms and provisions governing Lydia, and of being ignorant of the private company exemption limitations and the need to limit the number of shareholders to 50, was inconsistent with her testimony that she sought advice, after meeting Harvie in 1998, concerning the 50 shareholder limit, and received it from Higgins at a birthday party for her daughter. Furthermore, her testimony that she became concerned about the number of investors to whom Harvie had sold shares was inconsistent with her testimony that she had received legal advice that having Harvie hold shares in trust would circumvent the 50-shareholder limit.

[90] The Princess's testimony contained many inconsistencies. In the end we gave little credence to anything she said that was not otherwise substantiated.

5. Harvie

[91] Before the hearing started, Harvie entered into a settlement agreement with the Commission in which she agreed as to a number of facts. However, her testimony in this case was inconsistent with some of the facts she agreed to in the settlement agreement.

[92] Harvie signed backdated subscription agreements, stating that she was purchasing shares of Lydia as principal, because she was asked to do so by the Princess. She did so even though this statement contradicted the fact that Harvie had purchased the shares for investors and was holding them "in trust".

[93] Harvie's testimony at first appeared to contradict the Princess' testimony that Lydia agreed to pay, and did pay, Harvie a 10% commission for selling shares of Lydia. However, Harvie later admitted that she was compensated for all her work in phoning and speaking to potential investors.

[94] Where Harvie's testimony related to her psychic powers, her version of events varied from the Princess'. We preferred Harvie's version of her first meeting with the Princess and the Prinz, and their first visit together to the Wolf Lake property.

[95] Staff never alleged or attempted to establish in evidence that the von Anhalts or Lydia relied on Harvie, or her purported psychic powers, in carrying out their exploration activities.

[96] We accepted the Princess' assertion that Lydia did not rely on Harvie's alleged powers in Lydia's search for diamonds. However, we concluded that the Princess did allow, if not encourage, Harvie to exercise her talents as a psychic as part of the Princess' endeavour to interest potential investors in Lydia.

6. Cheskes

[97] Cheskes was the partner at the auditing firm responsible for Lydia. Cheskes testified that he assisted Werb in constructing the books and accounts of Lydia and that Mintz & Partners prepared and audited the financial statements of Lydia based on these books and accounts.

[98] All six years were audited at the same time. Cheskes testified that the audits of the first two years of Lydia were very limited. The financial statements for these two years were not included in the Information Circular accompanying the notice of meeting to approve the amalgamation. However, the amount accumulated in the shareholders loan account for those years affected the balances in the financial statements for later periods.

[99] The auditors issued their audit reports on the financial statements on August 3 and 4, 2000, concurrent with the issuance of the Information Circular.

[100] Because of the degree of involvement the auditors had in preparing the financial statements and in assisting Lydia and Werb in the construction of the underlying books and accounts of Lydia, we were not prepared to give the financial statements the deference that counsel for the respondents suggested that we should "because they were audited." Nor were we satisfied that the auditors did the necessary testing and verification of reasonableness, purpose and purport of expenditures that were appropriate in the circumstances. For instance, Werb and Cheskes accepted without further investigation the descriptions and reasons for expenses given by the Princess even where they related to the period before the incorporation of Old Lydia.

[101] Counsel for the respondents argued in their written submission that staff had alleged during the hearing that the audit lacked integrity and that this allegation was not contained in the statement of allegations. This, however, was not an allegation before us. The auditors were not a party to the proceedings. It was not an allegation, but a legitimate submission of staff, based on the evidence, that went to the question of the degree that we, or anyone else, should rely on the audited financial statements as establishing that investor funds had been expended for proper corporate purposes.

[102] The respondents claimed that all of the von Anhalts' personal use of corporate funds was accounted for by the shareholders loan account. It was the respondents who raised as a defence that Lydia's books had been audited and that the auditors would testify that the von Anhalts did not misuse corporate funds. When the respondents raised this defence, staff quite properly challenged the integrity of the audit and proved that it lacked integrity.

[103] When Collins had looked at the shareholders loan account, she questioned whether many of the entries were incurred as expenses for Lydia. She did not receive answers to her questions. As mentioned previously, the respondents simply claimed that Lydia's books had been audited. The respondents claimed that Cheskes would testify and prove that the von Anhalts had not misused corporate funds. When he did testify, however, it was revealed that many of the expenses claimed to have been incurred for Lydia had not been carefully audited. For example, many of the considerable travel expenses had not been independently verified.

7. Werb

[104] Exhibit 24 was Werb's memo to file regarding Lydia expenses. Counsel for the respondents stated that they never intended to use Exhibit 24 in evidence and at first tried to keep it out of testimony. To forestall any suspicion that there might be something in it they wanted to hide, counsel for Lydia eventually waived privilege, if any, concerning the document and consented to its introduction into evidence.

[105] Exhibit 24 was evidence to which we gave a lot of weight, due to its circumstantial probability of trustworthiness. We knew from the evidence of the Princess that the purposes given to Werb and Cheskes for the expenses incurred from June 1, 1994 to mid-October of 1994 were false, because the idea of having a corporation, such as Lydia, and exploring for gold or diamonds, did not exist in the von Anhalts' mind at the time.

[106] For example, in the entry for June 8, 1994, Werb recorded the purpose as:

> Through a contact the Prinz von Anhalt's lawyer in the Bahamas they were introduced to Dr. Woody Stanley, PhD Geologist-Arruama, Brazil, information on diamond exploration and mining; visited his exploration property and discussed his interest in potential investing in Canada.

[107] The entry for July 1, 1994 states: "Introduction by the Honorary Consul of Panama in the Bahamas met with Iram Crespo, Panamanian lawyer – discussion possible funding."

[108] The Princess testified that the von Anhalts only commenced their mining exploration project in late September 1994. Thus, the purpose described in Werb's memo could not be accurate. The mining exploration project had not even been thought of yet.

[109] Counsel for the respondents argued that the only evidence we had on this document was the Princess', and she testified that there were mistakes in it. Counsel for the respondents had the memo. If there were mistakes in it, they could have taken them up with Werb. They could have called Werb to explain.

[110] We found Exhibit 24 reflected the fact of what the von Anhalts told Werb regarding many expenses, especially pre-incorporation expenses. The description of several expenses conflicted with the explanation the Princess gave in her testimony. We did not believe that Werb "got it wrong", or "made it up", in describing the expenses. We relied on the testimony of the Princess and Cheskes that Werb was meticulous and thorough.

[111] The evidence demonstrates that the von Anhalts led the bookkeeper and the auditors to believe that certain travel expenses were incurred in the course of Lydia's business. Indeed, when providing documentary support to Werb, the Princess provided a copy of a Dutch wire transfer dated July 6, 1994. On the transfer, the Princess noted for Werb's benefit "amount transferred *upon* the Prinz starting the staking process" (emphasis added). This was consistent with the von Anhalts' causing the

bookkeeper and auditors to believe that Lydia was a diamond exploration project as early as June 1994, and that travel expenses incurred in that period could be charged to the company.

[112] The Princess speaks at least four languages. She has spoken English extensively since at least 1988. Her English language abilities were quite good when she testified before us. And yet she testified that "upon" meant "before" in the description of the transfer of funds "upon" the commencement of staking. She advanced this explanation when it became starkly evident while she was testifying that at the time in question the Princess and the Prinz had not even become interested in mining, and certainly had not acquired the right to mine the Wolf Lake property.

[113] We believed that if Werb had been told the true reason for the travel, he would not have booked the expense. Cheskes confirmed this. The travel expenses were booked on the basis that the von Anhalts "were meeting with geologists, people in the diamond mining industry, and potential investors." We found that the auditors would not have allowed the travel expenses if they had been aware of their true nature.

8. Collins

[114] Collins' testimony made us seriously question the reliability of the financial statements of Lydia. We were satisfied, after considering all the evidence, including the memo by Werb, the Princess' explanation of the expenditures before incorporation of Old Lydia that were reflected as proper corporate expenses, and Cheskes' testimony, that many expenses charged against Lydia should not have been.

9. Need for a Review

[115] It was obvious that the von Anhalts had misled their bookkeeper and auditors.

[116] We concluded that a large amount of expenses included under travel and general expenses, in addition to those included in the pre-incorporation period, were for personal use.

[117] For example, the auditors initially disallowed but then reallowed 75% of the car rental expenses and 80 % of the living expenses for the von Anhalts while they were supposedly obliged to winter in Palm Beach to await financing from a German consortium.

[118] There was also evidence of extensive commingling of corporate and personal funds, even after the establishment of corporate bank accounts. Funds provided by investors were often deposited into the personal bank accounts of the von Anhalts.

[119] It became clear to us from the Princess' testimony that she completely misconceived the role of Werb, Mintz & Partners and Lydia. We were left with the impression that the Princess regarded the financial statements as the responsibility, in the first and last analysis, of the bookkeeper and the auditors. We were disturbed that the Princess accepted no responsibility that the von Anhalts, like any other officer or agent of a corporation, had a duty and responsibility to ensure that only claims that were for expenses properly and reasonably incurred by them for legitimate corporate purposes should

be submitted by them as expenses chargeable to Lydia.

[120] Furthermore, Sennecke testified that the independent directors of Lydia never requested that any further investigation be done concerning the audited financial statements based on questions raised by staff. This was explained in part by counsel for Lydia that Lydia had to concentrate its resources on getting through the hearing and that it was felt not to be appropriate for the independent directors to conduct what in effect would be a forensic audit of past financial periods.

[121] In light of the Princess' view of the role of Lydia, the bookkeeper and the auditors, the work actually done by Mintz & Partners as described by Cheskes, and the absence of a serious review of past financial periods by the independent directors, we had no confidence that the audited financial statements of Lydia should be relied on by the shareholders and others unless and until an independent review of them, as set out in condition 8 of the order we have made, takes place.

[122] Faced with the evidence we heard, we determined that it was in the public interest to require an independent review of the financial statements before they could be used again in connection with the issuance of securities of Lydia.

10. McGregor

[123] We refused to hear evidence as to whether Lydia currently had a viable exploration property. The issues before us did not include whether Lydia was a vibrant exploration company with a good exploration program and prospects. That might have been an issue if we were dealing with allegations that Lydia was not such a company. The issues before us were those outlined in paragraph 6 of these reasons.

[124] McGregor was not qualified by the respondents as an expert witness. He was called to establish that Lydia currently had a viable, reasonable or proper exploration program. Accordingly, we did not find McGregor's testimony all that relevant, although we considered it in determining the manner in which the independent committee operated and the influence and driving force that the von Anhalts had in Lydia.

11. Governance of Lydia

[125] We considered the impact of the condition that the Quebec Securities Commission imposed for approving the amalgamation and the manner in which the independent committee operated. We did not find it necessary to determine if the condition of the Quebec Securities Commission had been complied with. We accepted that Lydia made a real effort to attract qualified persons as independent directors and had some success in this endeavour. In the final analysis, however, we were satisfied that the von Anhalts remained the driving force and directing minds over every aspect of the business, affairs and operations of Lydia.

[126] We were satisfied that staff had proved its allegation that the von Anhalts, as directors of Lydia, authorized, permitted or acquiesced in Lydia's contraventions of the Act.

VI. Analysis

1. Private Company Exemption

A. Statutory Framework

[127] Section 25(1) of the Act provides:

> No person or company shall,
>
> > (a) trade in a security or act as an underwriter unless the person or company is registered as a dealer, or is registered as a salesperson or as a partner or as an officer of a registered dealer and is acting on behalf of a dealer…
>
> and the registration has been made in accordance with Ontario securities law and the person or company has received written notice of the registration from the Director and, where the registration is subject to terms and conditions, the person or company complies with such terms and conditions.

[128] Section 53(1) of the Act provides:

> No person or company shall trade in a security on his, her or its own account or on behalf of any other person or company where such trade would be a distribution of such security, unless a preliminary prospectus and a prospectus have been filed and receipts therefor obtained from the Director.

[129] The Act provides for several exemptions from the registration and prospectus requirements. Lydia relied on the private company exemption in section 35(2)10 of the Act.

[130] Section 35(2)10 of the Act provides:

> Subject to the regulations, registration is not required to trade in the following securities:
>
> 10. Securities of a private company where they are not offered for sale to the public.

[131] Section 73(1)(a) of the Act provides:

> Sections 53 and 62 do not apply to a distribution of securities,

> (a) referred to in subsection 35(2), excepting paragraphs 14 and 15 thereof.

[132] A private company is defined in the Act in section 1(1) as:

> a company in whose constating document,
>
> (a) the right to transfer its shares is restricted,
>
> (b) the number of its shareholders, exclusive of persons who are in its employment and exclusive of persons who, having been formerly in the employment of the company, were, while in that employment, and have continued after termination of that employment to be shareholders of the company, is limited to not more than fifty, two or more persons who are the joint registered owners of one or more shares being counted as one shareholder, and
>
> (c) any invitation to the public to subscribe for its securities is prohibited.

B. Who is the Public?

(i) The "Common Bonds" Test

[133] Counsel for staff referred us to the leading Canadian decision on whether shares are offered to the public: *R. v. Piepgrass*, [1959] 29 W.W.R. 218 (Alta. C.A.) (*Piepgrass*).

[134] In *Piepgrass*, MacDonald J.A. cited Viscount Sumner L.C.'s decision in *Nash v. Lynde*, [1929] A.C. 158, at 169:

> "The public", in the definition of s. 285, is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve; perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole.

[135] MacDonald J.A. stated at 227 of *Piepgrass*:

> It seems to me that the very essence of a private company envisages the idea that it is of private, domestic concern to the people interested in its formation or in later acquiring shares in it. It is one thing for an individual or group of individuals to disclose information to friends or associates, seeking support for a private company being formed or in existence, pointing out its attractions for investment or speculation as the case may be, but it is quite another thing for a private company to

> go out on the highways and byways seeking to sell securities of the company and particularly by high pressure methods, that is, by breaking down the sales resistance of potential purchasers and inducing them to purchase.

[136] And at 228:

> It is clear from the cases cited and from the authorities cited that it is impossible to define with any degree of precision what is meant by the term "offer for sale to the public." It follows that in each instance the court will be called upon to determine whether or not the sale of the securities of the private company transcended the ordinary sales of a private domestic concern to a person or persons having common bonds of interest or association. It is clear from the authorities that whether or not there was an offering to the public is a finding of fact.

[137] In *Piepgrass*, MacDonald J.A., at 228, upheld the trial judge's decision that there had been a solicitation of the public on the following basis:

> The accused in seeking subscriptions from people "had contacted the majority of them previously in other business episodes." The office of the company was in Calgary. Four of the five persons to whom the accused sold securities were in the Camrose district, a distance of some 200 miles from Calgary. Those persons were met individually on their farms by the accused. Each of those persons had a previous business dealing with the accused, each one, apparently, having purchased shares in another company from him. However, they were not in any sense friends or associates of the accused, or persons having common bonds of interest or association.
>
> The fifth person to whom the accused sold shares was Mr. Albert P. Bott, a railway station agent who lived at Westlock, a distance of about 260 miles from Calgary and about 100 miles from where the other persons lived to whom the accused sold shares. Mr. Bott was an absolute stranger to the accused.

[138] In *R. v. McKillop*, [1972] 1 O.R. 164, Greco Prov. Ct. J. stated at 168:

> In my opinion the sales made by the accused to the various named individuals were not of a strictly private nature. In other words shares were not available only to those particular people to the exclusion of all others. While it is true that the individuals who purchased the shares constituted a small number in proportion to all residents of this community, nevertheless, they were not a favoured few, so far as possessing knowledge of the availability of the shares was concerned.

> They were not, so to speak, in on a secret. To the contrary, information concerning the company and concerning the availability of shares from the accused was apparently of common knowledge, fairly widespread in the community, as witness one Dr. Shunock discussing it with individuals over lunch in a public restaurant. While it is true that the number of those who availed themselves of the opportunity to purchase the shares is not shown to be large, nevertheless the availability of the shares was known to the public generally. In my opinion the number of people involved is not the important criterion.

[139] In *Buck River*, the defendant was able to show that the sales of the shares concerned were not as a result of the defendant going "out on the highways and byways", but he was not able to establish that there were "common bonds of interest or association". Marshall Prov. J., stated at 220:

> … to suggest that the relationship of a rather loose association in the management or operation of a non-profit hockey club could, thereby, provide a reasonable opportunity to a purchaser, to assess the "integrity and character" of a fellow participant, as regards the worth of a speculative business venture that that participant was selling, is not reasonable.
>
> In a similar vein, although *Piepgrass* does not spell out that the "common bonds" must relate to the particular company or venture concerned, it appears that something approaching that should be implied. This is so because Macdonald J.A., in *Piepgrass*, concludes that the Act is a regulatory one, "designed to protect unwary purchasers."

[140] Marshall Prov. J., at 221 cited Greco, Prov. Ct. J.'s decision in *McKillop* with approval, noting that Greco had convicted because,

> the sales made by the accused to the various named individuals were not of strictly private nature. In other words, shares were not available only to those particular people to the exclusion of all others.

[141] A company is really nothing but its officers, directors or shareholders. Therefore, the common bonds of interest or association must be with one or more of such persons. Marshall stated at 223,

> Again, having in mind that the Act is regulatory legislation, and that the registration and prospectus filing requirements of the Act are for the purpose of protecting purchasers by insuring that they receive the maximum amount of legitimate information available, in order to fairly evaluate the company or venture, and that we are dealing with an exception to these proper requirements, then it seems to follow, reasonably, that such "bond" must be with such officer, director or

> shareholder who can provide much, if not all, of the information regarding the company or venture, that would otherwise be disclosed by persons properly registered as a dealer, or salesman of a dealer, in a prospectus, properly filed.

(ii) The "Need to Know" Test

[142] In the United States, the leading case on whether shares are offered to the public is *SEC v. Ralston Purina Co*., 346 U.S. 119 (1953) (*Ralston Purina*). In *Ralston Purina*, the defendant offered shares in the company to its employees from all facets of the company's operation. It was not restricted to senior executives who might have intimate knowledge of the company's affairs.

[143] The U.S. Supreme Court held that the share offering was an offering to the public. Accordingly, it did not qualify for the equivalent to the private company exemption in the *Securities Act of 1933*. The court held that the meaning of "the public" had to be interpreted in accordance with the purpose of the legislation. The *Securities Act of 1933* was intended to ensure that persons who purchased securities were provided with full disclosure. This could be satisfied by providing the potential purchaser with a prospectus that had been receipted by the regulatory authority. In order for the vendor of securities to be exempt from the prospectus requirement, it had to satisfy the court that the purchasers were persons who did not need to know the information a prospectus would provide since they already had that information or had access to such information.

[144] At 126-127, Clark J. stated:

> Keeping in mind the broadly remedial purposes of federal securities legislation, imposition of the burden of proof on an issuer who would plead the exemption seems to us fair and reasonable. *Schlemmer v. Buffalo, R. & P.R. Co.*, 205 U.S. 1, 10 (1907). Agreeing, the court below thought the burden met primarily because of the respondent's purpose in singling out its key employees for stock offerings. But once it is seen that the exemption question turns on the knowledge of the offerees, the issuer's motives, laudable though they may be, fade into irrelevance. The focus of the inquiry should be on the need of offerees for the protections afforded by registration. The employees here were not shown to have access to the kind of information which registration would disclose. The obvious opportunities for pressure and imposition make it advisable that they be entitled to compliance with s. 5.

[145] Both *Piepgrass* and *Ralston Purina* have been applied in Canada. In *R. v. Zitzerman* (1996), 11 C.C.L.S. 199 (Man. Prov. Ct.), four investors purchased trust certificates from the defendant. They had all known him for a long period of time, some as long as 40 years and two had hired him as their lawyer. He approached three of them to invest. The other had heard about his investments from a partner and approached the defendant about investing. The individual investors were connected to

the accused by their professional relationship, and not by any common bond or interest that would remove them from that relationship, so that they were not removed from being members of the public. They were persons in the category of "needing to know", so as to be entitled to the statutory protections.

[146] Aquila J. stated at 209:

> the purchasers were not friends or associates of the vendor, or persons having common bonds of interest or association, as outlined in the *R. v. Piepgrass* case, *supra*. In addition, I am convinced the witnesses were people who "need to know"; as set out in the U.S. Supreme Court decision of *Securities and Exchange Commission v. Ralston Purina Inc.*, *supra*.

[147] The prospectus requirements of our Act have the same basic objectives as similar provisions in the securities laws of the United States and other Canadian jurisdictions: to require that investors be provided with or have access to full, true and plain disclosure of the material facts about an issuer before making an investment decision. Accordingly, in our view, under the Act, the public is anyone who needs full disclosure. The private company exemption exempts those who, because of their close association with the issuer, do not require full disclosure. They already have it. Since the nature of the relationship between the purchaser and the issuer is solely within the knowledge of the issuer, and since the issuer claims the exemption, the onus is on the issuer to satisfy the finder of fact that the relationship between the purchaser and issuer is so close that disclosure is not required.

C. Who is a "shareholder"?

[148] The word "shareholder" used in the definition of "private company" is not defined in the Act. Nor was it defined in the articles of Old Lydia. Looking at the purpose of the Act, we do not believe that the word "shareholder" was intended to have a narrow technical meaning in this context.

[149] In our view, it includes persons shown in the register of the shareholders of a corporation required to be maintained by a corporation under corporate law. It also includes shareholders whose names are reflected in a book-based system such as that operated by Canadian Depository for Securities where names are maintained in the books of investment dealers.

[150] Depending on the particular facts, it may also include beneficial shareholders not shown as shareholders on any books or list of shareholders.

[151] In the case before the panel, it was clear that the only purpose for the "trust arrangement" by which Harvie held shares for investors was, on a technical basis, to circumvent the 50-shareholder limit in Old Lydia's articles and in the private company exemption in the Act. In fact, no shareholder register, or proper shareholder records, existed at the time the trust was created and technically, therefore, there were no registered shareholders at the time. In these circumstances, beneficial shareholders whose shares were held by Harvie should be counted in determining the number of shareholders of Lydia at the relevant time.

[152] We can conceive of situations in which the trustee of a trust and not the beneficiaries of the trust, should be counted as a shareholder for the purpose of section 35(2)10 of the Act, for example, where the beneficiaries of an estate hold shares of a private company. However, where a trust is created solely for the purpose of circumventing the provisions of the Act, we have no qualms in stating that it is the number of investors that is determinative of the number of shareholders.

D. Application to Facts

(i) Four Challenges

[153] Counsel for the respondents focussed on only one of the challenges of bringing themselves within the private company exemption to the registration and prospectus requirements of the Act, namely having fewer than 50 shareholders.

[154] Lydia had at least 398 shareholders after Harvie sold shares to investors.

[155] There are three additional challenges in relying on the exemption: i) there must not be any solicitation of the public regardless of the number of shareholders; ii) the onus of establishing the availability of the exemption rests with those relying on it; and iii) the provisions that are required to be contained in the articles of a corporation to qualify it as a private company under the Act must be implemented and not ignored.

[156] Failure to meet any one of the four challenges will result in the exemption not being available. The respondents failed to meet all four challenges in this case.

(ii) Solicitation of the Public

[157] Many of Lydia's first 50 shareholders did not have a particularly close relationship with the von Anhalts. These investors were a diverse group. Some were old friends and acquaintances of the von Anhalts. Others worked at the Wolf Lake property. Some were people who were just introduced to the von Anhalts. There was no evidence that these investors had actual knowledge about the company or access to that knowledge sufficient to make an informed investment decision. They were members of the public.

[158] None of the investors who purchased shares through Harvie had a close association to Lydia when they bought shares. As Helfand wrote in his November 1, 2000 reply to staff:

> [t]he meeting was organized on behalf of those persons for whom Ms. Harvie had purchased shares in trust, as such persons had not previously met any representatives of the company *and had little or no information regarding the exploration program being carried out on the Wolf Lake Property* (emphasis added).

[159] As such, none of these people had the information necessary to judge the character and integrity of the business of Lydia. They were members of the public.

[160] The opportunity to invest was not restricted to a particular class of people. Anyone who was interested could invest.

[161] The von Anhalts let it be known that they were interested in obtaining new investors. It was widely known in the community that they were exploring for diamonds. The von Anhalts allowed information to be circulated about the company.

[162] The Princess and Harvie suggested that they did not approach investors, but rather that investors approached them. What is important, however, is that both the Princess and Harvie attracted persons to approach them by publicly sharing their enthusiasm about the company. Information about the business and affairs of Lydia was not kept confidential, but rather was used to attract investors. Spreading information far and wide with the willingness to accept subscriptions was a solicitation. Taking potential investors to the exploration site also was a form of solicitation.

[163] The Princess admitted that Lydia let it be known to potential investors that Lydia was attempting to list its shares on the TSX. Lydia suggested that when its shares were listed their price would go up. Exhibit 11 was an e-mail dated March 9, 2000, from Debra L. Minion to the Commission's General Inquiries/Corporate Relations reporting that her husband had been offered Lydia shares:

> at 0.75 cents per share and the von Anhalt's say that once it goes on the Stock Exchange it would be listed at approximately $4.50 per share. (They say they have found coloured "fancy" diamonds.)

[164] This e-mail was hearsay evidence, but it was illustrative of the Princess' testimony that she had indicated to investors that Lydia intended to list on a stock exchange and that its share price would go up.

[165] The use of illegal sales tactics by an issuer suggests that an offer is being made to the public.

[166] Section 38(2) of the Act states:

> No person or company with the intention of effecting a trade in a security shall give an undertaking, written or oral, relating to the future value of the price of such security.

[167] Section 38(3) of the Act states:

> Subject to regulation no person or company with the intention of effecting a trade in a security shall, except with the written permission of the director, make any representation, written or oral, that such security will be listed on any stock exchange or quoted on any quotation and trade reporting system…

[168] The fact that Lydia used sales tactics prohibited by section 38 of the Act was further evidence

that Lydia was soliciting the public.

[169] Finally, the sheer number of shareholders suggested that the sale of Lydia shares was open to the public.

[170] In conclusion, we determined that Lydia had offered shares to the public and, therefore, the private company exemption was not available to the respondents, regardless of the number of its shareholders.

(iii) Breach of Old Lydia's Articles

[171] Counsel for the von Anhalts argued that the Act does not specifically require a private company to have fewer than 50 shareholders. It states that a private company is one that sets out in its articles a provision that limits its shareholder number to 50. Lydia's articles did this. If Lydia had, in fact, more than the permitted number of shareholders, this fact would not disqualify Lydia, he argued, from being a private company as defined, and entitled to the private company exemption.

[172] This technical argument ignores the fact that almost inevitably, and certainly in this case, where a company does not observe the limit on the number of shareholders set out in its articles, it will have offered its securities to the public.

(iv) Secondary Trades by the von Anhalts

[173] Section 72(3) of the Act provides:

> the first trade in previously issued securities of a company that has ceased to be a private company,… is a distribution except that where,
>
> a) the issuer of the securities is a reporting issuer and has been a reporting issuer for at least twelve months…
>
> then such first trade is a distribution only if it is a distribution as defined in clause (c) of the definition of "distribution" in subsection 1(1).

[174] A "distribution" is defined in paragraph 1(1)(c) as:

> a trade in previously issued securities of an issuer from the holdings of any person, company or combination of persons or companies holding a sufficient number of any securities of that issuer to affect materially the control of that issuer, but any holding of any person, company or combination of persons or companies holding more than 20% of the outstanding voting securities of an issuer shall, in the absence of any evidence to the contrary, be deemed to affect materially the control of that issuer.

[175] On February 11, 1995, Lydia issued approximately 50,000,000 shares to the von Anhalts. This constituted a "distribution" of shares as defined in the Act. This distribution was exempt from the registration and prospectus requirements pursuant to the private company exemption.

[176] Between July 30, 2000 and May 10, 2001, the von Anhalts sold approximately 3,718,435 shares each from their personal shareholdings for total consideration of approximately US$ 112,500 and C$ 338,525 each.

[177] Lydia was not a reporting issuer on May 10, 2001 when the last secondary trade of the von Anhalts' shares occurred. As a result, the secondary sales of the shares were distributions.

[178] In any event, even if Lydia had been a reporting issuer when the von Anhalts sold their shares, the secondary sale of shares would still have been a distribution pursuant to paragraph 1(1)(c) of the Act, as the von Anhalts held at the time a sufficient number of securities to affect materially the control of Lydia.

[179] As a consequence, the von Anhalts' sale of their previously issued shares was a distribution subject to registration and prospectus requirements of the Act. There was no evidence that the von Anhalts had available an exemption from the registration or prospectus requirements of the Act.

[180] Accordingly, staff's allegation that the von Anhalts distributed shares held by them while not registered to trade and without filing a prospectus had been proven.

2. Misleading Staff

[181] Counsel for the von Anhalts argued that staff had not been misled by the October 13 and November 1 replies because staff knew or must have known that there, in fact, were more than 50 investors. Counsel for staff responded that the evidence showed that staff was legitimately making inquiries to verify or confirm what they suspected. This was not done as an exercise in futility. It would have been that if staff had solid information at the time establishing to its satisfaction that there were in fact more than 50 investors.

[182] The statements in question were materially untrue. If we were to accept the argument of counsel for the von Anhalts, we would have to determine that it was not contrary to the public interest for persons to make false or misleading statements about material facts as long as the endeavours to mislead were not successful because of prior knowledge on the part of the Commission.

[183] The von Anhalts' conduct in providing misleading information to staff was particularly serious. In *Wilder et al v. Ontario Securities Commission* (2001), 53 O.R. (3d) 519 at 529 (C.A.), Sharpe J.A. stated:

> The OSC is charged with a statutory obligation to do its best to ensure that those involved in the securities industry provide fair and accurate information so that public confidence and the integrity of the capital markets is maintained. *It is difficult to imagine anything that could*

> *be more important to protecting the integrity of capital markets then ensuring that those involved in those markets, whether as direct participants or as advisers, provide full and accurate information to the OSC.* (emphasis added)

VII. Sanctions

1. Harm to Investors

[184] Counsel for the respondents argued that no one was harmed and that the case before us was not one of selling Kansas blue sky. We disagreed. The main purpose of the prospectus requirement of the Act is to ensure that investors receive full, true and plain disclosure of all material facts with respect to their investment. If investors do not receive the disclosure they are entitled to, there is harm to investors.

[185] Investors in Lydia did not receive information as to the use of the proceeds of their investment. The use of proceeds to pay down a shareholders loan from the von Anhalts to Lydia, even where legitimate, rather than to pay for new exploration, was never explained to investors.

[186] To the extent the shareholders loan account was based on expenses not incurred on behalf of Lydia, investors who thought they were investing their moneys to be used for exploration for diamonds suffered harm.

[187] There was no evidence that Lydia disclosed to investors who purchased shares through Harvie that she was being paid a sales commission. Lydia should have disclosed to investors that Harvie was being paid a commission by the company for selling shares.

2. Technical Violation

[188] Counsel for the von Anhalts submitted that the von Anhalts acted reasonably, if mistakenly, by relying on the fact that Lydia's lawyer had advised that they could keep their shareholder number under 50 by using a trust arrangement.

[189] While the term "technical violation" is not a defined legal term, it means a violation that is one of form rather than substance. See *Re Ontario Securities Commission and Electra Investments (Canada) Ltd*. (1984), 45 O.R. (2d) 246 (Sup Ct.).

[190] The violations in the case before this panel were not technical. They were not form over substance. They were substantive and they were wilful.

[191] The trust arrangement concocted by the respondents was solely an attempt to circumvent the registration and prospectus requirements of the Act.

3. Public Interest

[192] We are required to exercise our jurisdiction under sections 127 and 127.1 of the Act by making orders in the public interest, taking into account the purpose of the Act in section 1.1 and the principles set out in section 2.1.

[193] In *Re Mithras Management Ltd.* (1990), 13 O.S.C.B. 1600, the Commission stated at 1610-1611 that:

> 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 s. 118 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 doing so 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; we are not prescient, after all.

[194] This was endorsed by Iacobucci J. in *Committee for the Equal Treatment of Asbestos Minority Shareholders* v. *Ontario (Securities Commission)*, [2001] 2 S.C.R. 132.

[195] In *Re Belteco Holdings Inc.* (1998), 21 O.S.C.B. 7743 at 7746, the Commission set out a series of factors to consider when setting sanctions:

> [I]n determining both the nature of the sanctions to be imposed as well as the duration of such, we should consider 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; and whether or not the sanctions imposed may deter not only those involved in the case being considered, but any like-minded people from engaging in similar abuses of the capital markets.

[196] We took all these factors into consideration in issuing our order.

4. The Prinz

[197] We were satisfied from the Princess' testimony that she and the Prinz consulted extensively together, that she looked to him as the principal decision-maker on important matters and that he was fully implicated in her conduct.

[198] The Princess made it clear to us that the Prinz had a predominant influence over her with respect not only to their marriage but also every aspect of Lydia including its purpose, mission,

continuing direction and existence.

[199] The Princess testified that she obeyed her husband's wishes regarding Lydia, that he was a very determined person who often did not take no for an answer. She testified that it was he who decided to find a gold mine, he who decided to change the pursuit of Lydia from gold to diamonds, and he who decided to have Lydia pay Harvie a 10% commission. She reminded us that she was his fourth wife, that she had a prenuptial agreement with him, and that she did not know much about his previous business affairs or his financial circumstances.

[200] We concluded that they are very close, that her relationship with him in Lydia was very much a team effort, and that he had enormous influence with her.

[201] Until the amalgamation he was chief executive officer and a director of Lydia. After the amalgamation he continued as chairman of the board of Lydia. We had no reason to question that he knew everything important that occurred regarding Lydia and the Princess' involvement in these matters.

5. Seriousness of Conduct

[202] We did not believe that the von Anhalts recognized the seriousness of their conduct. They still believed that the only things they had done wrong were: commencing business with little understanding of the laws of the land; relying on others who have not done their job well or have given dishonest advice -- the bookkeeper, the auditors, the lawyers; and that their problems really stemmed from technical violations of the Act, at most, and from a scurrilous approach to an aspect of the case by staff. They still believed that their conduct should not result in real consequences to them because, in their view, no one suffered actual harm.

6. Consequences for the von Anhalts

[203] We were satisfied on clear and cogent facts, from the testimony of the Princess herself, that based on the von Anhalts' conduct in the past, it was likely they would continue to behave in character in the future, with little regard for good business practices and the requirements of securities law.

[204] In light of our findings, we determined that 15 years was the minimum period that the von Anhalts should not be able to act as directors or officers of any issuer.

[205] Staff suggested we consider barring the von Anhalts from the capital markets permanently. A permanent cease-trade would have been consonant with certain settlement agreements that have come before the Commission where there has been a suggestion of dishonesty and misrepresentations made to staff.

[206] We chose a 12-year cease-trade period as sufficient instead.

[207] We narrowed the cease-trading prohibition suggested by staff so it would apply only to securities of smaller and medium-sized issuers. We were satisfied that larger issuers with liquid

securities would remain uninfluenced by ownership of their securities by the von Anhalts.

[208] We determined that it would be in the public interest to allow the von Anhalts to divest themselves of their shares in Lydia to persons who would have full disclosure through a prospectus or else could protect themselves through due diligence in an exempt transaction. Accordingly, we allowed them flexibility to divest themselves of their ownership in Lydia with conditions, should they so choose.

7. Consequences for Lydia

[209] Lydia was tainted by the conduct of the von Anhalts. Lydia violated the prospectus and registration requirements of the Act. Lydia acted contrary to the public interest. Lydia's shareholders in addition to the von Anhalts have suffered the consequences of the von Anhalts' conduct.

[210] With respect to an appropriate order regarding Lydia, we were satisfied that prohibiting the von Anhalts from being officers, directors or paid consultants of Lydia was as far as we could properly go. We have no ability to order the von Anhalts to divest themselves of their interest in Lydia or their participation in matters properly belonging to the shareholders. However, it is in the public interest that Lydia not be permitted to access the capital markets unless the conditions we have provided in our order are met.

[211] Lydia now has approximately 2,600 shareholders. Counsel for Lydia submitted that any sanctions should not kill the company. Counsel for staff submitted that as long as the von Anhalts controlled Lydia, it would be difficult, if not impossible, to regard Lydia as separate from the von Anhalts. However, counsel for staff expressed the wish that this could be done.

[212] We have attempted to play the role of Solomon and divide the baby into Lydia and its investors on the one hand, and the von Anhalts on the other.

[213] The order that we have made does not affect trading in securities by any of Lydia's minority shareholders. Lydia's business and operations, including its exploration program, remain essentially unaffected by our decision. Although the Prinz and the Princess had to resign as directors, officers and employees of the company, all of Lydia's other directors and management were permitted to remain in place. Nothing in our decision prevents the Prinz and the Princess from playing a continuing role in the company as its controlling shareholders, and also as unpaid consultants for the company, provided that they comply with the terms of our order.

[214] Our order was designed to strike a balance between the interests of the respondents and the interests of the public. We did not believe it was necessary for general deterrence purposes to broaden or lengthen the periods of the order beyond what we considered necessary to achieve its protective and preventative purposes as regards Lydia and the von Anhalts.

VIII. Costs

[215] The notice of hearing stated that the Commission would consider whether it was in the public

interest to make an order pursuant to s. 127.1 of the Act for costs against the respondents. Counsel for staff informed us that the Commission's costs in relation to this hearing were $230,000 and requested an order that they be paid by the respondents.

[216] Counsel for staff advised that the amount of costs was determined using the methodology developed by AssetRisk on behalf of the Commission to calculate costs for the purpose of section 127.1. This methodology was used in determining costs in *Re Donnini* (2002), 25 O.S.C.B. 6225.

[217] We had no reason to believe that the amount of costs requested by counsel for staff was unreasonable, based on our experience and taking into account the effort expended on the case as evidenced by the exhibits and the other evidence.

[218] Counsel for the respondents did not demur concerning the amount of or request for costs, and we received no submission from them as to costs.

[219] The Princess testified that she accepted full responsibility regardless of the actions or advice of Lydia's lawyers, of Harvie, of Werb and of the auditors. Her counsel explained that her acceptance of full responsibility meant that she and not Lydia and the minority shareholders should be visited with the consequences of her actions.

[220] While both the von Anhalts and Lydia breached the Act and acted contrary to the public interest, we were of the view that it was in the public interest to have Lydia pay $25,000, the Princess pay $100,000, and the Prinz pay $100,000 of the Commission's costs.

DATED at Toronto this 18th day of March, 2003.

"Paul M. Moore" "Mary Theresa McLeod"

Paul M. Moore Mary Theresa McLeod

"H. Lorne Morphy"

H. Lorne Morphy

APPENDIX I

IN THE MATTER OF THE SECURITIES ACT
R.S.O. 1990, c.S.5, AS AMENDED

- AND –

IN THE MATTER OF
LYDIA DIAMOND EXPLORATION OF CANADA LTD.,
JURGEN VON ANHALT, EMILIA VON ANHALT

ORDER
(Sections 127 and 127.1)

WHEREAS on April 1, 2002, the Ontario Securities Commission (the Commission) issued a Notice of Hearing pursuant to sections 127 and 127.1 of the *Securities Act* (the *Act*) in respect of Lydia Diamond Exploration of Canada Ltd. (Lydia), Jurgen von Anhalt, and Emilia von Anhalt;

AND WHEREAS the Commission conducted a hearing into this matter on June 28, July 3-5, September 18-20, October 10-11 and 15-16, and November 4, 2002;

AND WHEREAS the Commission is satisfied that Lydia, Jurgen von Anhalt and Emilia von Anhalt have not complied with Ontario securities law and have not acted in the public interest;

AND WHEREAS the Commission is of the opinion that it is in the public interest to make this order;

IT IS ORDERED THAT:

Lydia

(1) Pursuant to clause 2 of subsection 127(1) of the *Act*, except as permitted in A, B and C below, trading in any securities of Lydia by Lydia cease for three years from the date of this order:

A. Lydia may issue securities to Jurgen von Anhalt, Emilia von Anhalt, any bank, trust company, loan company, insurance company, or any other entity with assets of at least $100 million, if condition (7) is met.

B. Lydia may issue securities under a prospectus that is filed and receipted under the *Act*, if conditions (7) and (8) are met.

C. Lydia may issue securities under an exemption from the prospectus requirements of the *Act*, if conditions (7), (8) and (9) are met.

(2) Pursuant to clause 6 of subsection 127(1) of the *Act*, Lydia is reprimanded.

Jurgen von Anhalt and Emilia von Anhalt

(3) Pursuant to clause 2 of subsection 127(1) of the *Act*, except as permitted in A and B below, trading by each of Jurgen von Anhalt and Emilia von Anhalt in any securities of any issuer - other than a government, an agency of a government, or a corporation with share capital in excess of $100 million at the time of acquisition of the security by Jurgen von Anhalt or Emilia von Anhalt - cease for 12 years from the date of this order:

A. Jurgen von Anhalt and Emilia von Anhalt may sell securities of Lydia under a prospectus that is filed and receipted under the *Act*, if conditions (7) and (8) are met.

B. Jurgen von Anhalt and Emilia von Anhalt may sell securities of Lydia under an exemption from the prospectus requirements of the *Act*, to a person:

1. who is acquiring all the securities of Lydia owned by Jurgen von Anhalt and Emilia von Anhalt, alone or together; or

2. who is acquiring securities of Lydia from Jurgen von Anhalt or Emilia von Anhalt, or both of them, for an aggregate purchase price of at least $500,000;

if condition (7) is met.

C. Notwithstanding the limitation in (3), Jurgen von Anhalt and Emilia von Anhalt may sell securities of any issuer, other than Lydia, held on the date of this order which are made within 60 days after this date.

(4) Pursuant to clause 7 of subsection 127(1) of the *Act*, each of Jurgen von Anhalt and Emilia von Anhalt resign all positions that he or she holds as a director or officer of any issuer.

(5) Pursuant to clause 8 of subsection 127(1) of the *Act*, each of Jurgen von Anhalt and Emilia von Anhalt is prohibited from becoming or acting as a director or officer of any issuer for 15 years from the date of this order.

(6) Pursuant to clause 6 of subsection 127(1) of the *Act*, each of Jurgen von Anhalt and Emilia von Anhalt is reprimanded.

Conditions

The following are the conditions referred to in this order:

(7) Condition (7):

From the day after this order to the time of a trade:

A. neither of Jurgen von Anhalt and Emilia von Anhalt:

1. is a director, officer, employee, agent or paid consultant of Lydia or of any associate or affiliate of Lydia or of any corporation, partnership, joint venturer or other entity that has a business relationship with Lydia or an associate or affiliate of Lydia;

2. acts as a director or officer of Lydia; or

3. attends directors meetings of Lydia;

B. a majority of the directors of Lydia are independent from Jurgen von Anhalt and Emilia von Anhalt; and,

C. the business and affairs of Lydia are managed, or the management thereof is supervised, exclusively by a committee of directors of Lydia all of whom are independent from Jurgen von Anhalt and Emilia von Anhalt.

(8) Condition (8):

A. Lydia has obtained a report of an independent forensic accountant not associated with Mintz & Partners containing recommendations for adjustments, if any, to the financial statements of Lydia for all completed fiscal years of Lydia. The report should address, but not be limited to, the following:

1. with respect to expenses incurred by Jurgen von Anhalt or Emilia von Anhalt and allowed as corporate expenses or reflected in the shareholders' advance (loan) or cash clearing account: the reasonableness of amounts of expenses claimed; the validity of expenses, or the portions thereof, allowed as being for proper corporate purposes; the satisfactory nature of documentation (or other independent verification) proving payment of the expenses to the suppliers;

2. with respect to investors' moneys paid for share subscriptions: the receipt by Lydia of such funds and the proper application by or for Lydia of such funds to proper obligations of Lydia;

3. the current balance of amounts owing, if any, by Jurgen von Anhalt and/or Emilia von Anhalt to Lydia or by Lydia to Jurgen von Anhalt and/or Emilia von Anhalt; and,

4. adjustments, if any, required to the financial statements of Lydia, to reflect properly the matters arising from the foregoing, including adjustments, if any, to the shareholders' advance (loan) or cash clearing account, the net income (deficit), and the assets accounts of Lydia for any fiscal period.

In this regard, items for examination by the forensic accountant should include, but not be limited to: (a) amounts recorded as travel and entertainment expenses of Lydia incurred by Jurgen von Anhalt and/or Emilia von Anhalt during the pre-incorporation period; (b) amounts recorded throughout as expenses of Lydia incurred by Jurgen von Anhalt and/or Emilia von Anhalt with respect to travel, accommodation and car rental; (c) the proportion of expenses, such as rent, incurred by Jurgen von Anhalt and/or Emilia von Anhalt which was attributed to business purposes; (d) charges to Lydia's bank accounts and visa accounts incurred by Jurgen von Anhalt and/or Emilia von Anhalt for non-business (personal) expenses; and (e) investors' subscription moneys, if any, not paid to or for the account of Lydia.

B. The directors of Lydia cause the financial statements to be restated, if required, in light of the report.

C. The report and any restated financial statements are filed with the Commission.

(9) Condition (9):

Any trade permitted by (1)C may only be made if, in addition to the requirements of the *Act* and Rule 45-501, before entering into an agreement of purchase and sale, Lydia causes to be delivered to the prospective purchaser an offering memorandum that:

A. contains sufficient information that the investor can form a reasoned decision with regard to its investment in Lydia;

B. attaches Lydia's audited financial statements for all fiscal years, as restated if required in light of the report of the independent forensic accountant;

C. is accompanied by each material change report of Lydia filed since the date

of the offering memorandum;

D. is accompanied by the interim financial statements for Lydia's most recently completed financial period for which Lydia prepares interim financial statements that are required to be filed; and

E. describes Lydia's corporate governance practices and the circumstances under which they were put in place in 2002, and any subsequent changes.

Costs

(10) Pursuant to section 127.1 of the *Act*, Lydia pay $25,000, Jurgen von Anhalt pay $100,000 and Emilia von Anhalt pay $100,000 of the costs of the Commission of, or related to, the hearing in this matter.

DATED at Toronto this 19th day of November, 2002.

"Paul M. Moore" "Mary Theresa McLeod"

"H. Lorne Morphy"

APPENDIX II

IN THE MATTER OF THE SECURITIES ACT
R.S.O. 1990, c.S.5, AS AMENDED

- AND –

IN THE MATTER OF
LYDIA DIAMOND EXPLORATION OF CANADA LTD.,
JURGEN VON ANHALT, EMILIA VON ANHALT

ORDER
(Section 144)

WHEREAS on November 19, 2002, the Ontario Securities Commission issued an order pursuant to sections 127 and 127.1 of the *Securities Act* in respect of Lydia Diamond Exploration of Canada Ltd. (Lydia), Jurgen von Anhalt, and Emilia von Anhalt;

AND WHEREAS on November 20, 2002, Lydia, Jurgen von Anhalt and Emilia von Anhalt filed a Notice of Appeal and a motion for a stay of the order pending the appeal;

AND WHEREAS the Honourable Mr. Justice McNeely heard the motion for a stay of the order on November 21, 2002 and he reserved his decision;

AND WHEREAS on November 22, 2002, Jurgen von Anhalt and Emilia von Anhalt requested the Commission to vary the order by changing the starting date of condition 7 from the day after the order to the day after the release of the decision on the motion for a stay of the order in the event the motion was dismissed;

AND WHEREAS the Commission did not deal with the request on the basis that it was premature;

AND WHEREAS on November 27, 2002, Justice McNeely dismissed the motion for a stay of the order;

AND WHEREAS on November 28, 2002, Jurgen von Anhalt and Emilia von Anhalt advised the Commission that Lydia, Jurgen von Anhalt and Emilia von Anhalt were then in compliance with the order except for the payment of costs;

AND WHEREAS on December 4, 2002, Lydia, Jurgen von Anhalt and Emilia von Anhalt applied to the Commission for an order pursuant to section 144(1) of the *Act* to vary the order by changing the starting date of condition 7 from the day after the order to November 28, 2002, and requested the

Commission not to require costs to be paid by Lydia, Jurgen von Anhalt and Emilia von Anhalt pending the disposition of the appeal;

AND WHEREAS the Commission consented to hear this application in writing;

AND WHEREAS the Commission is of the opinion that to make this order would not be prejudicial to the public interest;

IT IS ORDERED pursuant to section 144(1) of the *Act* that the original order of November 19, 2002, be varied by amending condition 7 by striking out the words "the day after this order" in the first line and substituting for them, "November 28, 2002".

DATED at Toronto this 13th day of December, 2002.

"Paul M. Moore" "Mary Theresa McLeod"

"H. Lorne Morphy"