ALBERTA SECURITIES COMMISSION

DECISION

Citation: Re CatalX CTS Ltd., 2024 ABASC 23 **Date: 20240209**

CatalX CTS Ltd. (operating as Catalyx) and Jae Ho Lee

Panel:	Tom Cotter Kari Horn
Representation:	Justin Dunphy Matthew Bobawsky for Commission Staff
	James W. Reid John-David D'Souza for CatalX CTS Ltd.
	Andrew Wilson, KC for Jae Ho Lee
Submissions Completed:	January 5, 2024
Decision:	February 9, 2024

TABLE OF CONTENTS

I. OVERVIEW

[1] On December 21, 2023, we issued an Interim Order (the **Interim Order**, cited as *Re CatalX CTS Ltd.*, 2023 ABASC 167) against CatalX CTS Ltd. operating as Catalyx (**Catalyx**) and Jae Ho Lee (**Lee,** and together with Catalyx, the **Respondents**). The Interim Order was issued pursuant to ss. 33 and 198 of the *Securities Act* (Alberta) (the **Act**) and prohibited the Respondents from trading in or purchasing any securities or derivatives. The Interim Order was to expire on January 5, 2024 unless extended by the Alberta Securities Commission (the **ASC**).

[2] On January 3, 2024, staff (**Staff**) of the ASC issued a notice of hearing (the **Application**, cited as *Re CatalX CTS Ltd.*, 2024 ABASC 1) seeking to extend the Interim Order against the Respondents for a period of 12 months. The Application also sought an order that the evidence provided in support of it remain confidential and not be divulged except in accordance with s. 45 of the Act, a provision that was also included in the Interim Order.

[3] In the Application, Staff alleged that the Respondents had, on a *prima facie* basis, contravened section 93.2 of the Act by, in the case of Catalyx, failing to abide by a Pre-Registration Activities Undertaking given to the ASC on March 24, 2023 (the **PRU**), and in the case of Lee, authorizing, permitting, or acquiescing in Catalyx's contraventions. Staff sought an order extending the Interim Order in the public interest while Staff's investigation continues.

[4] We heard the Application on January 5, 2024 (the **Hearing**). The Application record was comprised of the following:

- the Application;
- materials from the Interim Order application heard December 21, 2023;
- Affidavit of Stuart Mills sworn January 2, 2024;
- Hearing transcripts, which included submissions of the parties and *viva voce* testimony from Stuart Mills; and
- an electronic exhibit.

[5] At the Hearing, Catalyx advised through counsel that it consented to an extension of the Interim Order being made on a public interest basis, but contested the allegations that Catalyx breached section 93.2 of the Act. Lee took no position on the Application. After hearing from the parties and considering the evidence and submissions of counsel, we granted the orders sought in a brief oral ruling with written reasons to follow. These are our reasons.

II. BACKGROUND

[6] The following facts are undisputed. Catalyx operated an internet-based platform for the trading of cryptocurrency (**crypto**) contracts that enabled clients to buy, sell, hold, deposit, and withdraw crypto assets. Catalyx was winding up and ceased its trading operations as of December 4, 2023.

[7] Catalyx entered into the PRU with the ASC as its principal regulator. Catalyx had applied to the ASC for registration as a restricted dealer and for exemptions from certain regulatory requirements. Catalyx undertook certain commitments and obligations in the PRU so that Catalyx

would be permitted to carry on business pending registration approval. Among other things, Catalyx undertook:

- that it had designated an individual as Chief Compliance Officer who was responsible for the maintenance and application of policies and procedures for assessing compliance by Catalyx and individuals acting on behalf of Catalyx, with securities legislation (PRU at para. 5(a));

- to promptly inform the ASC in writing of any material breach or failure of Catalyx's or its third party custodian's system of controls or supervision, and what steps had been taken by Catalyx to address each such breach or failure (PRU at para. 7(a));

- to establish, maintain and apply written policies and procedures that established a system of controls and supervision sufficient to provide reasonable assurance that Catalyx and each individual acting on its behalf complied with securities legislation (PRU, Schedule I at para. 2(a)); and

- that it was proficient and experienced in holding crypto assets and had established and would maintain and apply policies and procedures that managed and mitigated custodial risks, including but not limited to an effective system of controls and supervision to safeguard the crypto assets and a mechanism for the return of the crypto assets to clients in the event of Catalyx's bankruptcy or insolvency (PRU, Schedule I at para. 39)

(collectively, the **Undertakings**).

[8] As of September 30, 2023, Catalyx reported that it held an aggregate value $12,896,380 of crypto assets on behalf of its clients.

[9] On December 21, 2023, counsel for Catalyx wrote to the ASC (the **Miller Thomson Letter**) to advise that:

- In early- to mid-December, Catalyx's Chief Executive Officer (**CEO**), Hyuk Jae Park, and the Board of Directors became aware that Catalyx had ceased allowing its clients to withdraw crypto assets from their accounts and ceased paying employees.

- Catalyx's Chief Financial Officer (**CFO**), Lee, was the only individual that held the keys or otherwise had access to the digital wallets and accounts that held the crypto assets. In addition, Lee was the only person with access to the bank accounts that were used to pay employees and fund operations.

- On December 12, 2023, the CEO requested from Lee the login information for the accounts and access to the digital wallets.

- On December 14, 2023, Catalyx's counsel requested from Lee's counsel the login information for the accounts and access to the digital wallets.

- On December 19, 2023, Catalyx's counsel made another urgent demand to Lee's counsel for the login information.

- Staff of Catalyx were able to see that all the balances of customer funds in Catalyx digital wallets had been withdrawn or transferred out of the accounts.

- Catalyx was retaining Deloitte LLP to conduct an investigation into the transactions that took place and was seeking to have Deloitte LLP court-appointed as receiver and manager of Catalyx.

[10] On December 21, 2023, Lee's counsel wrote to Catalyx's counsel (the **Lee Letter**) to advise that:

- Lee was not the only person who had access to Catalyx's digital wallets or accounts.

- Multiple employees had or have access to Catalyx's trading history.

- Bittrex, an entity that acted as a third-party custodian for Catalyx's digital assets, suspended Catalyx's trading accounts and, as of December 21, 2023, there was approximately US$69,000 worth of digital assets remaining in the accounts.

- The login information for the trading accounts required two factor authentication and a verification code from Lee would be required to access the accounts.

[11] The Lee Letter included Catalyx's operating bank account information, which as of December 11, 2023, held a balance of $46,075.69.

[12] On December 28, 2023, Catalyx issued a news release announcing a recently discovered security breach on its trading platform in connection with the holding of crypto assets on behalf of its clients, which it said may have involved an employee and resulted in the loss of a portion of the crypto assets held by Catalyx on behalf of its clients.

[13] At the time of the Hearing, there was no explanation for the apparent disappearance of more than $12,800,000 from Catalyx's trading account.

III. LAW

[14] Section 33 of the Act authorizes an ASC panel to issue an interim order for preventative and protective measures under s. 198 of the Act where it finds that the length of time required to conduct an enforcement hearing and render a decision could be prejudicial to the public interest. While an interim order is an extraordinary remedy and should not be granted lightly, it is an important tool that allows the ASC to protect Alberta investors and the capital market where circumstances warrant. As described in *Re Workum and Hennig*, 2008 ABASC 719 (at para. 130),

interim orders are not sanctions, but are ". . . interim protective measures to forestall the continuation of *prima facie* improprieties while an investigation and hearing proceed".

[15] On an application for an interim order under ss. 33 and 198, Staff must generally establish, on a *prima facie* basis, that Alberta securities laws have been contravened as alleged. A *prima facie* case arises where the available evidence supports the material parts of one or more of Staff's allegations and the evidence appears credible and reliable, having regard to all of the circumstances including its source, detail, and the presence or absence of any explanations or evidence that may contradict it (*Re Omega Securities Inc.*, 2017 ONSEC 42 at para. 25). However, an ASC panel is not required to find actual misconduct when considering whether there is a *prima facie* case. *Prima facie* means "at first sight" or "upon initial examination", and does not include a thorough examination and consideration of all the evidence as would be necessary in a merits hearing (*Magneson v. Alberta Securities Commission*, 2023 ABCA 348 at para. 54).

[16] Staff's extension application was brought under s. 33(4) of the Act. That section authorizes an ASC panel to extend an interim order prior to its expiration so long as (a) the person or company named in the order has been provided with an opportunity to be heard, and (b) the panel considers that the length of time required to conduct a hearing and render a decision could be prejudicial to the public interest.

IV. ANALYSIS

[17] Some of the requisite elements for an order under s. 33(4) of the Act were not in dispute. In particular, the Interim Order had not expired and the Respondents were provided with an opportunity to be heard. Our focus was therefore on whether there was a *prima facie* case that the Respondents had contravened the Act or engaged in conduct contrary to the public interest based on the allegations described in the Application.

A. *Prima Facie* Contravention of s. 93.2

[18] Staff alleged a *prima facie* breach of s. 93.2, which provides that "[a] person or company that gives a written undertaking to the [ASC] or the Executive Director shall comply with the undertaking." The contravention, Staff said, resulted from Catalyx failing to comply with the Undertakings. We will deal with each of the Undertakings in turn.

1. Role of Designated Chief Compliance Officer

[19] Catalyx undertook that it had designated an individual as Chief Compliance Officer who was responsible for the maintenance and application of policies and procedures for assessing compliance with securities legislation by Catalyx and individuals acting on its behalf. The Miller Thomson Letter referred to Peter Fang (**Fang**) as the named Chief Compliance Officer. We received no additional evidence about the responsibilities assigned to Fang, and were unable to reach any conclusion as to whether he maintained and applied policies and procedures as required.

[20] Counsel for Catalyx asserted that the company had a policies and procedures manual in place that had been reviewed by ASC market regulation staff, however Staff's witness disclaimed any knowledge of its existence. A document entitled "CatalX CTS Ltd. Policies and Procedures Manual" was given to Staff's witness on cross-examination, and he acknowledged the document's title and certain provisions in the document. We were satisfied that there was evidence of Catalyx

having in place a policies and procedures manual, but again there was no evidence of what Fang had done in maintaining and applying the manual for assessing compliance with securities legislation.

2. Promptly Reporting Material Breach

[21] Catalyx undertook that it would promptly inform the ASC of a material breach or failure of its system of controls or supervision. This undertaking stated expressly that the loss of any crypto assets impacting clients would be considered a material breach or failure requiring prompt reporting to the ASC.

[22] Staff argued that Catalyx ought to have reported the material breach or failure of its systems immediately upon becoming aware of any such failure, which, on the basis of the Miller Thomson Letter, would have been no later than December 14, 2023.

[23] By December 12, 2023, Catalyx understood that Lee was the only person with access to the crypto assets and asked Lee for the account information since employees were not getting paid and customers were not able to make withdrawals from their accounts. On December 14, 2023, Catalyx's counsel wrote to Lee's counsel:

> We understand that recently, CatalX has ceased allowing the withdrawals of deposits made by its customers. We understand that this is at least in part due to there being a shortfall in the crypto currency deposited with CatalX and held by CatalX on behalf of its customers.

On December 19, 2023, Catalyx's counsel wrote to Lee's counsel:

> CatalX's Client Experience Manager and FINTRAC Compliance Officer, Lois Cusker, who can view the balances in the CatalX Wallets, advised today that in the past two to three weeks, all balances that were in the CatalX Wallets were withdrawn or transferred out of the accounts. Ms. Cusker has also advised of other suspicious transactions that need to be immediately reviewed.
>
> In this regard, CatalX is in the process of retaining Deloitte LLP to assist it with reviewing the accounts and records of the businesses. We hereby demand that Mr. Lee provide the following. . .
>
> . . .
>
> Finally, given Ms. Cusker's reporting of potentially improper transactions in the CatalX Wallets and CatalX Accounts, please advise Mr. Lee that he is to maintain all records and communications in his possession, including cell phone and other digital correspondences, for Deloitte LLP to conduct its investigation.
>
> Given the gravity of the situation, we require that all other requests in this letter be provided by no later than 4:00 pm (Calgary time) on December 21, 2023. Should we not get a positive response by this time, CatalX and Deloitte will need to take urgent steps to protect its assets and records, including by seeking relief from the Court.

Catalyx reported its circumstances and provided the foregoing letters to the ASC on December 21, 2023, which led to Staff seeking an immediate and urgent interim order that evening.

[24] Staff argued that at the latest, Catalyx was aware of a failure of its or its custodian's system of controls on December 14, 2023, and probably earlier when there were reported instances of customers unable to withdraw funds. As of December 14, 2023 there was an assertion from Catalyx's counsel that the customer complaints were attributable at least in part to there being a "shortfall" in the crypto assets held by Catalyx for customers. Staff contended that the undertaking to promptly inform the ASC in these circumstances should be construed as immediate notice.

[25] Counsel for Catalyx argued that prompt notice was given to the ASC after it had learned of customers being unable to make withdrawals and had made appropriate inquiries internally. They had no "concrete evidence", which was why they were engaging Deloitte LLP to locate the assets. Counsel for Lee did not make any submissions on this issue.

[26] We agree with Staff that the evidence establishes on a *prima facie* basis that this undertaking was breached by Catalyx. The undertaking deems the loss of "**any amount** of Crypto Assets" (emphasis added) to be a material breach or failure, thus requiring prompt notice to the ASC. On December 14, 2023, Catalyx asserted that there was a shortfall in customer crypto currency which was causally connected to the company disallowing the withdrawal of customer deposits. The company later determined that all balances of crypto assets in its wallets had been withdrawn or transferred in suspicious circumstances, which was reported to Lee's counsel on December 19, 2023. The ASC received notice of these events on December 21, 2023. In our view, notice given a full week after knowledge of a loss of crypto assets was not prompt.

[27] On February 22, 2023, the Canadian Securities Administrators published CSA Staff Notice 21-332 *Crypto Asset Trading Platforms: Pre-Registration Undertakings – Changes to Enhance Canadian Investor Protection* (**CSA Notice 21-332**). This followed the well-publicized insolvencies of several crypto asset trading platforms, including Voyager Digital, Celsius Network, the FTX group of companies, BlockFi, and Genesis Global. CSA Notice 21-332 stated that new investor protection measures were being added to the standard form PRU, central to which were "enhanced commitments in relation to the custody and segregation of crypto assets held on behalf of Canadian clients" (at p. 1). The Catalyx PRU included these new measures, and Catalyx could not have been in any doubt about the seriousness with which Canadian securities regulators were treating the safe custody of customer crypto assets. In light of that background, we agree with Staff that the undertaking to give prompt notice of a loss of crypto assets should be construed as nearly synonymous with immediate notice.

[28] Accordingly, we find that there was a *prima facie* breach of s. 93.2 of the Act by Catalyx in relation to the undertaking given in paragraph 7 of the PRU.

3. Policies and Procedures to Ensure Compliance with Securities Legislation

[29] Staff alleged that Catalyx breached its undertaking to establish, maintain and apply written policies and procedures that established a system of controls and supervision sufficient to provide reasonable assurance that it and each individual acting on its behalf complied with securities legislation. As mentioned, we were satisfied that Catalyx had a policies and procedures manual in place, however there was no evidence on what if anything was done to maintain and apply the policies and procedures. Staff did not make submissions about this alleged breach and, given our conclusions below, we did not find it necessary to consider this allegation.

4. Policies and Procedures to Mitigate Custodial Risks

[30] Catalyx undertook to maintain and apply policies and procedures that managed and mitigated custodial risks of clients' crypto assets, including but not limited to having an effective system of controls and supervision in place to safeguard the crypto assets.

[31] Catalyx reported to the ASC that, as at September 30, 2023, it held $12,896,380 in crypto assets on behalf of clients. Since reporting that value in early November 2023, Catalyx learned that the balance had been reduced to approximately US$69,000 through a number of withdrawals and transfers that occurred over the course of two to three weeks in early- to mid-December. Catalyx itself had no explanation for the disappearance of the funds and was retaining Deloitte LLP to investigate. According to Catalyx, it was unable to access the trading accounts because Lee was the only person with access.

[32] Lee did not give any evidence at the Hearing. The Lee Letter named the individuals who had signing authority or online banking access to the Catalyx bank accounts with Bank of Montreal and Servus Credit Union. However, while the Lee Letter denied that Lee had sole access to the trading accounts, it did not identify any other Catalyx employee or director who also had access. Even if another individual had access to the trading accounts, Lee held the two factor authorization key for the trading accounts, necessitating his cooperation for anyone else to access the accounts. Based on the information that was before us, Lee appeared to be the only Catalyx director or employee with true access to the trading accounts that held the clients' crypto assets.

[33] We were not provided with any policies or procedures that Catalyx had in place to manage or mitigate custodial risks. However, in light of the unexplained disappearance of almost all of the clients' crypto assets and the evidence before us, we are left with three possible inferences. Either:

(1) Catalyx had not put a system of controls in place to manage or mitigate custodial risks;

(2) the system of controls that Catalyx had in place was inadequate to manage or mitigate custodial risks; or

(3) there was a catastrophic failure to follow the polices or procedures that would have managed or mitigated custodial risks.

[34] All three possible inferences led us to conclude, on the face of the evidence before us, that Catalyx did not maintain or apply policies or procedures that managed and mitigated custodial risks of clients' crypto assets in accordance with the Undertakings. Therefore, the available evidence supported a finding that there was a *prima facie* breach of s. 93.2 of the Act by Catalyx in relation to the undertaking given in paragraph 39 of Schedule I of the PRU.

B. Authorize, Permit, or Acquiesce

[35] Section 198(1.2) of the Act gives an ASC panel authority to make orders against a director or officer of a company who authorizes, permits, or acquiesces in the contravention of Alberta securities laws or conduct contrary to the public interest. Staff argued that the evidence showed on

a *prima facie* basis that Lee authorized, permitted, or acquiesced in Catalyx's breach of s. 93.2 of the Act. We agree.

[36] In Re *Aurora*, 2011 ABASC 501, a panel of the ASC found that (at para. 199):

> [a]uthority over the acts of a corporation generally rests, ultimately with its directors and officers – who in consequence will bear responsibility for having approved or condoned (authorized, permitted or acquiesced in) those acts. (See also *Re Aitkens*, 2018 ABASC 27 at paras. 40-41.)

[37] Lee was both a director and officer of Catalyx. As CFO, he was responsible for the financial management of Catalyx, had signing authority on the company bank accounts, and through the two factor authorization, controlled Catalyx's access to the trading accounts. We conclude that Lee was in a position to explain where the clients' crypto assets were transferred. He should have knowledge of when, and for what purpose, the clients' assets were depleted in December 2023. However, the Lee Letter did not provide any particulars in that regard.

[38] At the Hearing, Lee's counsel pointed out that Lee did not sign the PRU. Regardless of whether he signed the PRU, by virtue of Lee's position as CFO and his access to the relevant accounts, we find on a *prima facie* basis that he authorized, permitted, or acquiesced in Catalyx's contraventions of s. 93.2 of the Act.

C. Public Interest Jurisdiction

[39] Catalyx consented to the extension of the Interim Order in the public interest. Staff submitted that we had the authority to extend the order under ss. 33(4) and 198 – even if we did not find a *prima facie* contravention of the Act – provided that we were satisfied it was in the public interest to do so. As noted, we have found *prima facie* breaches of s. 93.2 of the Act. Although it was not necessary in view of those findings, if we had not found those contraventions, we would have extended the Interim Order on the *prima facie* basis that the Respondents acted contrary to the public interest.

[40] The ASC has broad, discretionary powers to act protectively and preventively in the public interest, even in the absence of a contravention of Alberta securities laws. Our public interest jurisdiction is limited by the goals of securities legislation: protecting the investing public, capital market efficiency, and ensuring public confidence in the system (*Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37 at paras. 39-45).

[41] We considered the scope of the ASC's public interest jurisdiction in *Re PointNorth Capital Inc.*, 2017 ABASC 121 (at paras. 20-33). The public interest jurisdiction has been exercised by securities commissions absent a breach of the Act when impugned conduct was found to be abusive of investors and of the capital market (see *Perpetual Energy Inc.*, 2016 ABASC 2 at paras. 67-69), the market conduct engaged the animating principles of the Act (see *Point North* at paras. 26-33), or both (see *Re Daley*, 2021 ONSEC 27 at paras. 55-73). It may also be appropriate to exercise the public interest jurisdiction if a transaction is of a novel nature or involves a new principle (see *Re ARC Equity Management (Fund 4) Ltd.*, 2009 ABASC 390 at para. 66). In *Point North*, a panel found that "the appropriate test is 'clearly abusive' when securities laws articulate 'specific acts

which constitute misconduct'" (at para. 36). Because the public interest jurisdiction is broad and powerful, it must be exercised with caution and restraint.

[42] Regulation of crypto asset trading platforms is a relatively new part of securities regulation. While there is not yet a complete code in the Act that governs these market participants, enhanced pre-registration undertakings are intended to ensure that, among other things, crypto asset dealers are controlling custodial risks of managing clients' assets. The undertakings are aimed at ensuring investor assets are protected by proper systems of controls so that they will not be improperly diverted or lost. In our view, this foundational principle directly supports the ASC's public interest aim to protect investors and ensure confidence in the market.

[43] Catalyx operated a crypto asset trading platform that allowed investors to hold and trade crypto assets. In the PRU, Catalyx undertook to ensure that a system of controls was in place to address the risks of holding customers' crypto assets. Lee was the CFO of the company, appeared to control access to the trading accounts, and gave no explanation for the disappearance of virtually all customer assets. Catalyx was unable to account for the disappearance either. Clearly, the failure of Catalyx's system of controls and the consequent unexplained disappearance of investors' assets undermines confidence in the market and is antithetical to the principle of appropriately controlling and mitigating custodial risk, as set out in CSA Notice 21-332. We had no hesitation in concluding that Staff established a *prima facie* case that the Respondents' conduct was clearly abusive of investors and of the capital market.

[44] We therefore found, on a *prima facie* basis, that the conduct of the Respondents was contrary to the public interest. We exercised our discretion to issue a protective and preventative order and extend the Interim Order for a period of 12 months, and we would have done so even in the absence of a *prima facie* breach of s. 93.2 of the Act.

V. CONCLUSION

[45] Staff demonstrated on a *prima facie* basis that the Respondents contravened the Act. The Respondents had an opportunity to be heard. Staff have not issued a Notice of Hearing relating to the merits of this case and require time to complete their investigation. Given the nascent stage of Staff's investigation and the evidence adduced on the Application, we found that the length of time required to conduct a hearing and render a decision could be prejudicial to the public interest. In our view, it was in the public interest that we extend the Interim Order for 12 months.

February 9, 2024

For the Commission:

"original signed by"
Tom Cotter

"original signed by"
Kari Horn