



**IN THE MATTER OF
FIRST CLASS CRYPTO INC., JOHNATHAN
HARRIS, MITCHELL CARNIE AND NEILL KLOSS**

STATEMENT OF ALLEGATIONS
(Subsection 127(1) and Section 127.1
of the *Securities Act*, RSO 1990, c S.5)

A. OVERVIEW

1. Between December 2017 and May 2018, First Class Crypto Inc. (**FCCI**) and its principals Johnathan Harris, Mitchell Carnie and Neill Kloss encouraged Ontarians to invest approximately \$365,000 into their business. Investors were led to believe that FCCI would use their funds to purchase computing hardware that mines crypto assets (known as “mining rigs”). Investors were told that their original investment with FCCI was guaranteed and that they could earn significant monthly returns from the company’s crypto asset mining activities.
2. However, investors were not told that FCCI’s principals had no experience in crypto asset mining, no business plan and no ability to protect, much less guarantee, investments and returns. This did not stop the Respondents from soliciting and accepting investments from members of the public. The Respondents lacked the skills, knowledge and experience needed to manage investor funds and purchase mining rigs. While the Respondents attempted to find mining rigs, investor funds were being held in crypto assets that were rapidly decreasing in value. The Respondents also failed to maintain even basic documentation regarding FCCI's operations, which hindered FCCI’s ability to pay the promised monthly returns and track repayments to investors. When FCCI was finally shut down in June 2018, a substantial amount of investor funds had been lost.
3. Although new and innovative crypto asset products can seem appealing, investors should be cautious when promised risk-free investments. The Respondents raised funds from the public without being registered as dealers and without disclosing the risks of the investments in a prospectus. The importance of protecting investor interests by complying with registration and

prospectus requirements and maintaining accurate and complete books and records is heightened when operating in the crypto asset sector.

B. FACTS

(a) Solicitation of Investors

4. FCCI is an Ontario company that was purportedly in the business of crypto asset mining. Harris and Carnie are founding shareholders, directors, officers and directing minds of FCCI. Subsequently, Kloss became a shareholder and de facto director or officer of FCCI. Kloss represented himself as the Chief Financial Officer and a Vice-President of FCCI.
5. From December 2017 to May 2018, the Respondents solicited investments in FCCI using two forms of investment contracts (**FCCI Investment Contracts**):
 - a. the Lending Mining Contract (**LMC**), also referred to as the “Investment Mining Contract”, which promised investors compounded monthly returns and that investor funds would not be subject to the volatility of the crypto asset market, but instead would be used to purchase mining rigs; and
 - b. the Crypto Security Plan (**CSP**), which promised investors annual returns on investor funds held in the crypto asset market.
6. The Respondents promoted FCCI Investment Contracts to the public in marketing materials, including using PowerPoint presentations, flyers, social media and a website.
7. The Respondents held weekly investment seminars at FCCI’s office in Whitby, Ontario to promote the FCCI Investment Contracts. At these seminars, the Respondents encouraged members of the public to invest in FCCI. The Respondents also promoted FCCI Investment Contracts from a booth at a flea market in Pickering, Ontario.
8. In addition to soliciting investors directly, the Respondents encouraged individuals to become “recruiters” of FCCI. FCCI recruiters were promised referral fees for soliciting investments in the FCCI Investment Contracts. The Respondents held training seminars and created training materials for FCCI recruiters.

9. The Respondents raised \$364,082 from 43 Ontario investors between December 2017 and May 2018 by entering into FCCI Investment Contracts. Most investors entered into the LMC investment contract.
10. Each of the Respondents engaged in, or held themselves out as engaging in, the business of trading in securities, contrary to s. 25(1) of the Act. None of the Respondents were registered with the Commission and no exemptions from registration were available to them.
11. The sales of the FCCI Investment Contracts were trades in securities not previously issued and therefore “distributions” under the Act. No preliminary prospectus or prospectus was filed with the Commission, nor were prospectus receipts obtained from the Director pursuant to s. 53(1) of the Act. The investments in the FCCI Investment Contracts did not qualify for any exemption from the prospectus requirement, and no reports of exempt distributions were filed with the Commission. Accordingly, each of the Respondents also participated in a distribution of securities, contrary to s. 53(1) of the Act.

(b) Prohibited Representations

12. The Respondents made numerous false or misleading statements that induced investors into signing FCCI Investment Contracts. Statements made to investors also omitted facts that FCCI investors would consider relevant. False and misleading statements were made in person, in marketing materials and in the FCCI Investment Contracts, and include the following:
 - a. the Respondents had mining rig facilities and enough mining rigs to meet obligations to investors;
 - b. LMC investment funds would be used to purchase mining rigs;
 - c. LMC investment funds were guaranteed and not subject to the fluctuation of the crypto asset markets;
 - d. FCCI had insurance that could protect LMC investment funds;
 - e. FCCI’s crypto asset holdings and mining rigs were protected by physical and technological security; and

f. FCCI would pay compounded monthly returns to investors in LMCs and annual returns to investors in CSP.

13. In reality, FCCI did not have established mining facilities. From December 2017 to May 2018, the Respondents could not purchase mining rigs to meet FCCI's obligations under the LMCs. While the Respondents attempted to source mining rigs, LMC investment funds were being held in volatile crypto assets, which were decreasing in value. Further, FCCI had no insurance on any mining rigs and no insurance that would purportedly protect principal investments of LMC investors.

14. Harris was primarily responsible for inducing individuals to invest with FCCI. He conducted the weekly presentations to prospective investors and prepared the marketing materials used at the presentations. While Carnie also had significant involvement in presentations to investors and preparing marketing materials, he was primarily responsible for purchasing mining rigs to meet obligations to investors and arranging for insurance on the mining rigs. Kloss' involvement with prospective investors was more limited and included executing FCCI Investment Contracts on behalf of the company, representing the company at the flea market in Pickering and overseeing the development of FCCI's website.

15. By the time the Respondents decided to shut the business down in June 2018, a substantial amount of investor funds had been lost. The Respondents asked investors to sign documents purporting to cancel the FCCI Investment Contracts and acknowledge that investors had been paid in full. For some investors, the Respondents also issued promissory notes promising to repay investor losses. Not only did the Respondents fail to repay the principal amounts originally invested in FCCI, the Respondents also failed to pay investors the monthly and annual returns promised.

16. A reasonable investor would consider the misrepresentations described above as relevant in deciding whether to enter into or maintain investments with FCCI. Accordingly, each of the Respondents made prohibited representations, contrary to s. 44(2) of the Act.

(c) Liability of Directors and Officers

17. From December 2017 to May 2018, Harris, Carnie and Kloss, as directors, officers or de facto directors or officers of FCCI, authorized, permitted or acquiesced in FCCI's breaches of ss.

25(1), 53(1) and 44(2) of the Act (as described above) and thereby are deemed to have not complied with Ontario securities law, pursuant to s. 129.2 of the Act.

(d) Conduct Contrary to the Public Interest

18. The Respondents engaged in conduct contrary to the public interest by breaching the Act as described above.
19. The Respondents also engaged in conduct contrary to the public interest by failing to operate the business in a manner that protected FCCI investors and investor funds.
20. The Respondents assumed the role of registrants, but lacked the proficiency, integrity and solvency necessary to protect investors. The Respondents accepted investor funds without any business plan and lacked the skills, knowledge and experience needed to manage those funds.
21. The Respondents failed to adequately maintain basic documentation regarding FCCI's operations, including a complete list of investors and contracts, support for the receipt, exchange, segregation and partial return of investor funds and a complete list of the blockchain wallet addresses used by the Respondents.
22. Further, upon winding down the business, the Respondents cancelled access to corporate email accounts, liquidated crypto asset balances and deleted records, including all records of blockchain wallet addresses. The importance of protecting investor interests by maintaining accurate and complete books and records is heightened when operating in the crypto asset sector. The lack of records impeded the Respondents' ability to make repayments to investors after FCCI was shut down. While Kloss assumed the role of Chief Financial Officer and responsibility for recordkeeping and administrative tasks, each of the individual Respondents had some involvement in collecting, managing or tracking of investor funds and each had a responsibility to ensure FCCI kept accurate and complete books and records.

C. BREACHES OF ONTARIO SECURITIES LAW AND CONDUCT CONTRARY TO THE PUBLIC INTEREST

23. Enforcement Staff allege the following breaches of Ontario securities law and conduct contrary to the public interest:

- a. the Respondents made statements that were untrue or omitted information necessary to prevent the statements from being false or misleading in the circumstances in which they were made that a reasonable investor would consider relevant in deciding whether to enter into or maintain a trading or advising relationship with the Respondents, contrary to s. 44(2) of the Act;
- b. the Respondents engaged, or held themselves out as engaging, in the business of trading in securities without being registered in accordance with Ontario securities law, and where no exemption to the registration requirement was available, contrary to s. 25(1) of the Act;
- c. the Respondents engaged in a distribution of securities without a preliminary prospectus or prospectus, or an exemption from the prospectus requirements, contrary to s. 53(1) of the Act;
- d. Harris, Carnie and Kloss, as directors, officers or de facto directors or officers of FCCI, authorized, permitted or acquiesced in FCCI's breaches of ss. 25(1), 53(1) and 44(2) and thereby are deemed to have not complied with Ontario securities law, pursuant to s. 129.2 of the Act; and
- e. the Respondents engaged in conduct that is contrary to the public interest.

24. Enforcement Staff reserve the right to amend these allegations and to make such further and other allegations as Enforcement Staff may advise and the Commission may permit.

D. ORDER SOUGHT

25. Enforcement Staff request that the Commission make the following orders:
- a. trading in any securities or derivatives by the Respondents cease permanently or for such period as is specified by the Commission, pursuant to paragraph 2 of s. 127(1) of the Act;
 - a. the acquisition of any securities by the Respondents be prohibited permanently or for such period as is specified by the Commission, pursuant to paragraph 2.1 of s. 127(1) of the Act;
 - b. any exemptions contained in Ontario securities law not apply to the Respondents permanently or for such period as is specified by the Commission, pursuant to paragraph 3 of s. 127(1) of the Act;

- c. the Respondents be reprimanded, pursuant to paragraph 6 of s. 127(1) of the Act;
- d. Harris, Carnie and Kloss resign any positions they may hold as a director or officer of any issuer or registrant, pursuant to paragraphs 7, 8.1 and 8.3 of s. 127(1) of the Act;
- e. Harris, Carnie and Kloss be prohibited from becoming or acting as a director or officer of any issuer or registrant permanently or for such period as is specified by the Commission, pursuant to paragraphs 8, 8.2 and 8.4 of s. 127(1) of the Act;
- f. the Respondents be prohibited from becoming or acting as a registrant or promoter permanently or for such period as is specified by the Commission, pursuant to paragraph 8.5 of s. 127(1) of the Act;
- g. each Respondent pay an administrative penalty of not more than \$1 million for each failure to comply with Ontario securities law, pursuant to paragraph 9 of s. 127(1) of the Act;
- h. each Respondent disgorge to the Commission any amounts obtained as a result of non-compliance with Ontario securities law, pursuant to paragraph 10 of s. 127(1) of the Act;
- i. that each Respondent pay costs of the Commission investigation and the hearing, pursuant to s. 127.1 of the Act; and
- j. such other orders as the Commission may consider appropriate in the public interest.

DATED this 27th day of May, 2020.

Staff of the Ontario Securities Commission

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