

THIS DECISION IS UNDER APPEAL.

ALBERTA SECURITIES COMMISSION

DECISION

Citation: Kustom Design Financial Services Inc., Re, 2010 ABASC 179 Date: 20100422

**Kustom Design Financial Services Inc., Kustom Design Group Inc.,
Hightide Management Inc., Synergy Group (2000) Inc.,
Michael Edward Lepitre, Mark Adrian Jones and Leonard Jonathan Zielke**

Panel: Glenda A. Campbell, QC
Beverley A. Brennan, FCA
Kenneth B. Potter, QC

Appearing: Tom McCartney
for Commission Staff

Michael Edward Lepitre and Mark Adrian Jones
for Kustom Design Financial Services Inc.,
Kustom Design Group Inc., Hightide
Management Inc. and themselves

Alistair Crawley and Anna K. Markiewicz
for Synergy Group (2000) Inc.

Dates of Hearing: 5-8 and 19 October 2009; and 5 January 2010

Date of Decision: 22 April 2010

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I. INTRODUCTION

[1] In an amended notice of hearing dated 1 October 2009 (the "Notice of Hearing"), staff ("Staff") of the Alberta Securities Commission (the "Commission") allege that seven respondents (the "Respondents") – Kustom Design Financial Services Inc. ("Kustom Financial"), Kustom Design Group Inc. ("Kustom Group"), Hightide Management Inc. ("Hightide"), Synergy Group (2000) Inc. ("Synergy"), Michael Edward Lepitre ("Lepitre"), Mark Adrian Jones ("Jones") and Leonard Jonathan Zielke ("Zielke") – contravened Alberta securities laws and engaged in conduct contrary to the public interest by trading and distributing securities without registration and a prospectus and, also, in the case of Kustom Financial, Lepitre and Jones, by acting as advisors without registration.

[2] Earlier, on 28 June 2007, the Commission issued an interim order against Kustom Financial, Kustom Group and Hightide (collectively, the "Kustom Companies") and Lepitre, directing that all trading in securities of the Kustom Companies cease, that they cease trading in all securities and that all exemptions contained in Alberta securities laws do not apply to them. The Commission subsequently extended that order, as modified, until the hearing in the matter is concluded and a decision rendered, or until otherwise ordered.

[3] The hearing into the merits of the allegations (the "Merits Hearing") began on 5 October 2009. All Respondents but Zielke participated in the Merits Hearing; Lepitre and Jones participated for themselves and apparently for the Kustom Companies, and Synergy was represented by counsel. We received documentary evidence and heard testimony from two Staff investigators, nine Alberta investors or purchasers (for privacy reasons, we identify investor and purchaser witnesses by their initials) and an officer of Synergy. Neither Lepitre nor Jones testified or called witnesses, and no one testified on behalf of or for the Kustom Companies. We received written submissions from Staff on 2 November 2009 and from all Respondents but Zielke on 30 November 2009, and we received written reply submissions from Staff on 7 December 2009. We heard oral submissions from Staff, Synergy and Lepitre on 5 January 2010.

[4] Our decision and reasons on the merits of the allegations against the Respondents follow. Stated briefly, we find that:

- contrary to sections 75(1)(a) and 110(1) of the *Securities Act*, R.S.A. 2000, c. S-4 (the "Act"):
 - Kustom Financial, Lepitre and Jones illegally traded in and distributed securities of the Kustom Companies;
 - Kustom Group illegally traded in and distributed securities of Kustom Group;
 - Hightide illegally traded in and distributed securities of Hightide; and
 - Synergy, Kustom Financial, Lepitre, Jones and Zielke illegally traded in and distributed securities issued in conjunction with Synergy's "Alternative Tax Strategy Program";

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- contrary to section 75(1)(b), Kustom Financial and Lepitre acted as advisors without being registered to do so; and
- in so doing, the Respondents engaged in conduct contrary to the public interest.

II. PRELIMINARY MATTER

A. Evidentiary Standard

[5] The appropriate standard of proof in Commission enforcement proceedings is the balance of probabilities civil standard. That standard of proof was recently clarified by the Supreme Court of Canada in *F.H. v. McDougall*, 2008 SCC 53 (at paras. 40, 45-46):

... I think it is time to say, once and for all in Canada, that there is only one civil standard of proof at common law and that is proof on a balance of probabilities. Of course, context is all important and a judge should not be unmindful, where appropriate, of inherent probabilities or improbabilities or the seriousness of the allegations or consequences. ...

...

To suggest that depending upon the seriousness, the evidence in the civil case must be scrutinized with greater care implies that in less serious cases the evidence need not be scrutinized with such care. I think it is inappropriate to say that there are legally recognized different levels of scrutiny of the evidence depending upon the seriousness of the case. There is only one legal rule and that is that in all cases, evidence must be scrutinized with care by the trial judge.

... evidence must always be sufficiently clear, convincing and cogent to satisfy the balance of probabilities test. ...

[6] Thus, we are to determine whether Staff proved, on a balance of probabilities, the allegations made against the Respondents in the Notice of Hearing.

B. Evidentiary Basis for Findings

[7] In making our findings, we rely on the testimony given before us and on the documents admitted into evidence. The latter included documents relating to investments or purchases (entered into evidence through either a Staff investigator or investor or purchaser witnesses), corporate registry records and excerpts from transcripts of four interviews of Lepitre, Jones, Gary Akins ("Akins") and Enrique (also known as Chico) Toscano ("Toscano") conducted under oath or affirmation by Staff investigators. Thus, while Staff, in their written submissions, referred us to portions of these transcripts not admitted into evidence, we do not consider or rely on any such portions in making our findings.

[8] We find the evidence to be sufficiently clear, convincing and cogent to support our findings and conclusions as discussed below.

III. FACTUAL BACKGROUND

[9] We summarize the factual background relevant to our decision, derived from the testimony heard and the documentary evidence received.

A. Respondents and Other Entities

[10] Lepitre and Jones are residents of Calgary, Alberta. Neither Lepitre nor Jones has ever been registered to trade in securities, and neither is registered to act as an advisor, in Alberta.

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Zielke, a British Columbia resident during the relevant period, has never been registered to trade in securities in Alberta.

[11] According to Alberta Corporate Registration System ("CORES") records, Kustom Financial was incorporated in Alberta as 1136974 Alberta Ltd. on 9 November 2004 and renamed "Kustom Design Financial Services Inc." on 20 January 2006. Also according to CORES records, Jones and Lepitre were Kustom Financial's directors at incorporation and as of 1 January 2007, and each owned 50% of its shares. Kustom Financial held educational – financial and tax planning – seminars and offered and sold investments in the Kustom Companies (which then re-invested the invested money in other ventures) and "units in small to medium sized, privately owned businesses" through Synergy's "Alternative Tax Strategy Program" (the "Synergy Tax Program").

[12] Kustom Financial has never been a reporting issuer, and is not registered to act as an advisor, in Alberta. We also infer from the evidence relating to the investments in the Kustom Companies, with emphasis on that relating to the Kustom Companies' purported reliance on the "family, friends and business associates" exemption, that Kustom Financial is not registered to trade in securities in Alberta. Kustom Financial has never filed a prospectus with the Commission or received a receipt therefor.

[13] According to Nevada corporate registry records, Kustom Group was incorporated in Nevada on 2 June 2006 (which status was revoked on 1 July 2008), Lepitre was its president and director and Jones was its secretary and treasurer. Through undertakings, Lepitre informed that Kustom Group is owned by a Belize company of the same name. It appears that Kustom Group's business activity was limited to the sale of investments in itself and the re-investment of the invested money in other ventures.

[14] Kustom Group has never been a reporting issuer in Alberta. We infer from the evidence relating to the investments in the Kustom Companies, with emphasis on that relating to the Kustom Companies' purported reliance on the "family, friends and business associates" exemption, that Kustom Group is not registered to trade in securities in Alberta. Kustom Group has never filed a prospectus with the Commission or received a receipt therefor.

[15] According to CORES records, Hightide was incorporated in Alberta on 27 October 2006, Jones and Lepitre were its directors at incorporation and as of 22 July 2008, and each owned 50% of its shares. It appears that Hightide's business activity was limited to the sale of investments in itself and the re-investment of the invested money in other ventures.

[16] Hightide has never been a reporting issuer in Alberta. We infer from the evidence relating to the investments in the Kustom Companies, with emphasis on that relating to the Kustom Companies' purported reliance on the "family, friends and business associates" exemption, that Hightide is not registered to trade in securities in Alberta. Hightide has never filed a prospectus with the Commission or received a receipt therefor.

[17] Kustom Design Professional Services Corp. ("Kustom Professional") provided tax and accounting services. It, according to CORES records, was incorporated in Alberta on 1 June 2004, Jones and Lepitre were its directors at incorporation and as of 1 June 2006, and each

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owned 50% of its shares. We refer to the Kustom Companies and Kustom Professional together as the "KD Group".

[18] According to Ontario corporate registry records, Synergy was incorporated in Ontario on 15 June 2004. Zielke was its western regional manager (regional manager for British Columbia, Alberta and Saskatchewan). Synergy described itself as specializing in "effective tax 'compression' combined with efficient wealth development" and offered alternative tax strategies. Units in the Synergy Tax Program were sold in Alberta by Kustom Financial pursuant to an "Agent Agreement" between Synergy and Kustom Financial (the "Agent Agreement").

[19] Synergy has never been a reporting issuer, and is not registered to trade in securities, in Alberta. It has never filed a prospectus with the Commission or received a receipt therefor.

[20] According to Ontario corporate registry records, Integrated Business Concepts Inc. ("IBC") was incorporated in Ontario on 14 June 1994. We infer from the evidence relating to the Synergy Tax Program that IBC and Independent Business Consulting Association ("IBCA"), entities also involved in the program, shared Synergy's view that the program was not subject to Alberta securities laws. Accordingly, and there being no evidence to the contrary, we further infer that neither IBC nor IBCA filed a prospectus with the Commission or received a receipt therefor in relation to the Synergy Tax Program.

B. Investments and Purchases

1. Money Raised

[21] From April 2004 through April 2006, Kustom Financial raised approximately US\$1.9 million, most of which came from Alberta investors.

[22] From June 2006 through December 2006, Kustom Group raised almost US\$3.2 million, a significant portion of which came from Alberta investors.

[23] From April through October 2006, Hightide raised approximately US\$613 210 from Alberta investors.

[24] From December 2005 through January 2007, Kustom Financial sold units in the Synergy Tax Program that raised approximately \$2.4 million, most of which came from Albertans.

2. Solicitation Activities

(a) The Kustom Companies

[25] The Kustom Companies operated out of the same Calgary office (the "Kustom Office"). Kustom Financial solicited prospective investors to purchase investments in the Kustom Companies, and Kustom Group and Hightide solicited prospective investors to purchase investments in their respective companies, using the following means:

- Kustom Financial sponsored educational seminars or information sessions addressing the elimination of debt, minimization of tax and accumulation and preservation of wealth. Those attending these information sessions – apparently promoted in part via e-mail and online – were introduced to investments in the Kustom Companies as well as "products", such as tax products, carried through Kustom Financial's "strategic alliances".

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- About 20 commissioned associates employed by or under contract to Kustom Financial (whose names were provided through counsel for Lepitre) referred prospective investors to investments in the Kustom Companies.
- Some of those seeking tax or accounting advice or services from the KD Group were introduced to investments in the Kustom Companies.
- The Kustom Companies apparently used the Internet to draw attention to investments, presumably including investments in the Kustom Companies.

[26] In his investigative interview, Lepitre stated that, at Kustom Financial, "I am training people [Kustom Financial associates] to educate people on Biblical principles of finance". Lepitre elaborated about Kustom Financial's five-step plan or program (the "Five-Step Program"):

We have a five-step plan, and the first step involves putting people in what's called a closed-circle budget. Most people, I find, have not learned of finances in high school; they don't get the proper training. So everything -- we learn and we grow to teach people so that they can, first of all, get on a budget; second of all, eliminate debt; third of all, legally minimize tax; and fourth of all, accumulate wealth; fifth of all, preserve the wealth that they've created.

...

What we basically have done is, on the education component, it gives people the free education that empowers them. Then they can choose different strategic alliance and different products we may carry through our strategic alliances . . .

(b) Synergy

[27] Similarly, through its information sessions, commissioned associates and apparently the Internet, Kustom Financial solicited the purchase of units in the Synergy Tax Program. Also, some of those seeking tax or accounting advice or services from the KD Group were told that they could minimize taxes if they purchased units in the Synergy Tax Program through Kustom Financial.

[28] In his investigative interview, Jones also spoke of the Five-Step Program:

We have a five-step program, and we work our way through starting with creating -- helping people create proper budgets. We call it a closed-circle budget, and we help them understand what a good debt is and a bad debt is and help them find different ways to eliminate their bad debts and, where possible, turn them into good debts. And we discuss different tax strategies, ways of minimizing your taxes, this would be step three, minimizing your taxes through write-offs, through tax shelters, through different types of programs, like the Synergy program. Step four was helping them create wealth, and step five is to help them maintain wealth through family trusts, et cetera.

[29] Under the Agent Agreement, Synergy retained Kustom Financial to place "clients" into the Synergy Tax Program. The Agent Agreement provided for Synergy's payment to Kustom Financial of commissions described as "a percentage of client's funds committed to the Alternative Tax Strategy Program". The Agent Agreement, although not signed or dated, showed Zielke, western regional manager, as the signatory for Synergy and Lepitre as the

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signatory for Kustom Financial. Synergy ultimately paid Kustom Financial commissions of approximately \$240 000.

[30] Although Zielke did not attend the Merits Hearing or offer any evidence, Synergy's executive vice-president David Prentice ("Prentice") explained Zielke's role at Synergy. Zielke was Synergy's western regional manager throughout the relevant period, although at the time of the Merits Hearing he was no longer with Synergy. While Synergy's western regional manager, Zielke was responsible for recruiting and guiding agents (also referred to as associates or advisors) such as Kustom Financial, entering into agent agreements (such as the Agent Agreement) for the sale of units in the Synergy Tax Program on behalf of Synergy, providing the program documentation to agents, setting up presentations and attending seminars to speak about the program, and dealing with existing and potential purchasers under the program. Indeed, agents such as Kustom Financial were "under the direct guidance of [Zielke]".

IV. INVESTMENTS IN KUSTOM COMPANIES

A. Documentation

[31] Investments in the Kustom Companies generally involved the same documentation. The three principal documents for each investment were: a promissory note ("PN"); an irrevocable letter of assignment ("ILA"); and a private funds management agreement ("PFMA").

[32] The PNs generally identified the Kustom Company involved as the borrower, identified the investor as the lender and indicated the amount of the loan. Interest payable under the PNs for investment in Kustom Financial or Kustom Group ranged from 3 to 5% per month, payable quarterly. Interest payable under the PNs for investment in Hightide was 50% per annum, payable 30 days after the year's end. According to the PNs, once an investment was "placed", the PN in question was to be "replaced" by an ILA.

[33] The ILAs, generally on the letterhead of the Kustom Company involved as the borrower, purported to limit the liability of that Kustom Company to the principal only, identified the investor and stated the amount invested and often the security therefor (for example, "RBC Centura Bank" in Georgia, "Bank: Great Florida Bank", and "Lien on Land" in Alberta).

[34] The PFMA's, also generally on the letterhead of the Kustom Company involved as the borrower, identified that Kustom company as the "Private Funds Manager" and the investor as the "Private Funds Principal", stated the amount invested and the rate of return and purported to incorporate an accompanying "explanation/summary package". When asked in his investigative interview who set the 3% rate of return in Kustom Financial PFMA's, Jones responded: "[Kustom Financial] with probably consultation between myself and [Lepitre]". The PFMA's stated that the Private Funds Manager had a loan agreement with another entity or an individual – Safeguard Asset Management Inc. ("Safeguard"), Sweet Water Equities Inc. or Sweet Water Equity ("Sweet Water"), Knight Capital Corporation ("Knight", which was, according to Lepitre's answer to an undertaking, Sweet Water renamed) or Akins – and that, if that entity or individual defaulted on payment, then the Private Funds Manager would activate a "protection mechanism", which would result in "all placed [principal] funds" being returned to the Private Funds Principal, in certain circumstances with a 10% administration fee deducted by the Private Funds Manager. The PFMA's also stated: "The Private Funds Manager is to have unconditional authority to manage and direct the Private Funds Management activities for the benefit of the parties herein."

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[35] Typically, an investor executed a PN in conjunction with the following additional investment documents (the "Supplementary Forms"): "Participant Information" ("PI"); "Beneficiary Designation" ("BD"); and "Non-solicitation/Non-disclosure/Non-Circumvention Agreement" ("NSA") (we consider a page on which "ALL PARTIES ACKNOWLEDGE THEY HAVE READ, UNDERSTOOD, AND AGREE TO THE TERMS SET FORTH IN THIS AGREEMENT [emphasis in original]" as part of the latter). Then, at a later date, the investor executed a PFMA and might execute a "Letter of Intent" ("LI"), and an ILA was completed.

B. Use of Investors' Money

[36] Typically, for an investment in Kustom Group, an investor who signed a PN and the Supplementary Forms would pay the money for the investment to Custom House, a currency exchange business situated in Calgary, or into a lawyer's trust account. The investor's money was then pooled with other investors' money until approximately \$1 million was collected. At that point, the pooled money was apparently loaned to or placed with – after going through a lawyer's trust account if it had not already – Sweet Water or Knight. The investor's execution of a PFMA and the completion of an ILA followed. Somewhat similarly for an investment in Kustom Financial or Hightide, an investor's money was pooled with other investors' money – in at least some instances with Custom House involvement – until at some point the pooled money was apparently loaned to or placed with Safeguard, Sweet Water or Akins, as the case may be. We note that, among the Kustom Companies investor documentation in evidence, there are copies of two Kustom Financial investors' cheques made out directly to Kustom Financial. We also note that, in his investigative interview, Jones stated that he and Lepitre had signing authority on the Kustom Group bank account.

[37] The Kustom Financial PFMA's stated that investors' money was loaned to either Safeguard or Sweet Water. The Loans Receivable ledger for Kustom Financial showed that 15 payments totalling approximately US\$2.2 million were made to undisclosed recipients between 1 May 2004 and 5 April 2006. There is in evidence little information about Safeguard and what it did with any investors' money it received from Kustom Financial. According to CORES records, Safeguard was incorporated in Alberta in 2003, a Merle Hartzler ("Hartzler") was one of its directors, and Safeguard was struck on 2 September 2005. Investor witnesses KK and SS, whose Kustom Financial investments involved their money apparently being loaned to Safeguard, testified they were told that someone had taken or run off with the money. Evidence before us concerning Sweet Water's dealings with any investors' money relates only to money invested in Kustom Group.

[38] The Kustom Group PFMA's stated that investors' money was loaned to Sweet Water or Knight. The Loans Receivable ledger for Kustom Group showed that three payments totalling approximately US\$3.2 million were made to undisclosed recipients between 15 July and 20 September 2006. According to Nevada corporate registry records, Knight (which was, as noted, Sweet Water renamed) was incorporated in Nevada on 31 August 2006 and Toscano was its president, treasurer and director. In his investigative interview, Lepitre said that Kustom Group received no reporting on the performance of Sweet Water's investments but that he would usually be notified by telephone that money from Sweet Water had "arrived" in Kustom Group's bank account. According to Toscano's investigative interview and other communications with Staff through his counsel, Kustom Group placed US\$2.8 million in Toscano's lawyer's account in Vancouver, which money was then forwarded by Knight to Virginia-based International

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Fiduciary Corp. ("IFC"), whose principal was a Preston Pinkett ("Pinkett"), for investment in medium-term notes. In a 20 February 2008 decision (*Re International Fiduciary Corp SA*, 2008 BCSECCOM 107) of the British Columbia Securities Commission (the "BCSC") concerning allegations against, among others, IFC and Pinkett, a BCSC panel found (at para. 38): "The IFC investment scheme was a sham. The so-called 1st Tier medium term bank notes do not exist." Earlier, in 2007, the United States Securities and Exchange Commission (the "SEC") obtained orders appointing a receiver over the assets of IFC, permanently banning IFC and Pinkett from trading in securities and ordering IFC and Pinkett to disgorge approximately \$24 million and \$5.1 million, respectively.

[39] The Hightide PFMAs stated that investors' money was loaned to Akins. The Hightide ILAs identified, as security for the money loaned, a lien on a described quarter-section of land in Alberta. The Loans Receivable ledger for Hightide showed that one payment of \$613 210.45 was made to an undisclosed recipient on 30 June 2006. In his investigative interview, Akins said that the money invested in Hightide was paid to a lawyer's office in Florida and was to be used to fund a Florida lawsuit by a company called "Mambaliq", an opportunity presented through Hartzler. According to Florida corporate registry records, a corporation named "Manbaliq Corporation", of which Hartzler was a director, was incorporated in Florida on 6 August 2004 and apparently active in 2006. An Alberta land title certificate in evidence indicated that the quarter-section of land described in the Hightide ILAs was registered in Akins' name and had two mortgages registered on title as of 17 March 2008 – a first mortgage dated 26 June 2006 in the amount of \$1 044 000 and a second mortgage dated 6 February 2007 with Hightide as mortgagee in the amount of \$683 729. As of 25 August 2008 the first mortgagee was apparently pursuing foreclosure in relation to this land.

C. Investors' Evidence

1. Investments in Kustom Financial

(a) KK

[40] KK, an Alberta resident, invested US\$50 000 in Kustom Financial in December 2005.

[41] KK dealt at the KD Group with Lepitre, Jones and others. However, in making his investment in Kustom Financial, KK dealt mostly with Lepitre and did not have any dealings with Jones. Prior to making this investment, KK knew both Lepitre and Jones: Lepitre was one of the accountants for KK and his company, and Lepitre's stepfather worked with KK; and KK would review the final accounting paperwork with Jones at the end of each accounting year. KK had also attended a few "[i]nformational meetings" at which Lepitre and Jones had been present. As to whether KK considered Lepitre a friend at the time KK made this investment, KK testified: "I had known [Lepitre] for two years. I guess I could consider [Lepitre] a friend, yes, at the time."

[42] KK told Lepitre he was "looking for something to invest in". Lepitre informed KK that the Kustom Financial investment involved "a loan to this Alberta corporation that was going to be grouped together into a larger investment . . . , and I would just collect interest on my money", the money would be invested "in an international bank fund" and "[m]y return would be 3 percent per month, paid out quarterly". According to KK, Lepitre gave information to KK about – but did not encourage or pressure KK to invest in – the Kustom Financial investment. Lepitre also mentioned a real estate investment and possibly other investments, in which KK was not interested.

