ALBERTA SECURITIES COMMISSION

DECISION

Citation: Re Fauth, 2018 ABASC 175 **Date: 20181108**

Vernon Ray Fauth

Panel:	Maryse Saint-Laurent Ian Beddis Webster Macdonald, QC
Representation:	Garner Groome and Kelli McAllister for Commission Staff Jeffrey Thom, QC for the Respondent
Submissions Completed:	May 1, 2018
Decision:	November 8, 2018

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I. INTRODUCTION

[1] In a notice of hearing issued May 11, 2016 (**NOH**), Alberta Securities Commission (**ASC**) staff (**Staff**) alleged that the respondent, Vernon Ray Fauth (**Fauth**), contravened the *Securities Act* (Alberta) (**Act**) by illegally dealing in securities of Espoir Capital Corporation (**Espoir**), making misrepresentations to Espoir investors and perpetrating a fraud.

[2] A hearing into the merits of the allegations (**Hearing**) was held over 12 days, during which Staff tendered documentary evidence and called 12 witnesses: two current members and one former member of ASC investigative Staff, eight investors, and one individual who used to work with Fauth. Fauth, who was represented by legal counsel throughout, neither testified nor called any witnesses on his behalf, but he entered some documentary evidence through Staff's witnesses and cross-examined certain witnesses. We received written submissions from both parties, and we heard their oral arguments on May 1, 2018.

[3] Having reviewed the evidence and the submissions, we have found that Fauth breached ss. 75(1)(a), 92(4.1) and 93(b) of the Act. Our reasons for those findings follow.

II. ALLEGATIONS

[4] At the outset of the Hearing (and with Fauth's consent), Staff amended the NOH in two fairly minor respects: one, to correct the name of one of the companies involved and clarify its date of amalgamation, and the other to extend the outer date range for the misrepresentation allegations. Therefore, the specific allegations before us were that:

(i) from approximately September 28, 2010 to November 19, 2012, Fauth breached s. 75(1)(a) of the Act by acting as a dealer in securities while not registered to do so and without an exemption from that requirement;

(ii) from approximately October 6, 2006 to November 19, 2012, Fauth breached s. 92(4.1) of the Act by making representations he knew or reasonably ought to have known were materially misleading or untrue, or by failing to state facts that were required to be stated or necessary to make the statements not misleading; and

(iii) from approximately January 1, 2009 to September 30, 2014, Fauth breached s. 93(b) of the Act by directly or indirectly engaging or participating in an act, practice or course of conduct relating to a security that he knew or reasonably ought to have known perpetrated a fraud on investors.

[5] Particulars with respect to the misrepresentation and fraud allegations were outlined in the NOH and are discussed in detail later in these reasons. Stated briefly, Fauth was alleged to have solicited investments in Espoir and informed investors that their funds would be used to make certain types of secured investments that would generate returns of either 10.5% or 8% per annum. It was further alleged that contrary to those representations, investment funds were either diverted to other businesses Fauth owned, controlled or managed, or used to make payments to other investors.

III. PRELIMINARY MATTERS

A. Standard of Proof

[6] The applicable standard of proof in ASC enforcement proceedings is the civil standard, proof on a balance of probabilities (*Re Arbour Energy Inc.*, 2012 ABASC 131 at para. 36). A panel "must be satisfied that there is sufficiently clear, convincing and cogent evidence that the existence or occurrence of any alleged fact required to be proved is more likely than its non-existence or non-occurrence" (*Arbour* at para. 38; see also *F.H. v. McDougall*, 2008 SCC 53 at paras. 46, 49).

[7] A hearing panel may "draw inferences from the evidence as a whole" (*Arbour* at para. 39), including any circumstantial evidence. However, we remain mindful of the Alberta Court of Appeal's caution that we must ensure inferences are supported by evidence and not based on speculation (*Walton v. Alberta (Securities Commission)*, 2014 ABCA 273 at paras. 26-28).

B. Relevance and Use of Hearsay Evidence

[8] Section 29(e) of the Act stipulates that an ASC hearing panel "shall receive that evidence that is relevant to the matter being heard". Section 29(f) provides that "the laws of evidence applicable to judicial proceedings do not apply". This means that all relevant evidence – including hearsay – is admissible, subject to the rules of natural justice and procedural fairness and our discretion to determine the relevant evidence we will admit (*Lavallee v. Alberta (Securities Commission)*, 2010 ABCA 48 at paras. 14-18; *Arbour* at para. 45; see also *Maitland Capital Ltd. v. Alberta (Securities Commission)*, 2009 ABCA 186).

[9] A hearing panel must also assess the weight it will give to the evidence that it receives. In doing so, it must consider indicators of reliability, including the extent to which evidence is corroborated by other evidence (*Arbour* at paras. 46, 53-54). Since Staff are entitled to adduce any evidence – including hearsay – collected pursuant to ss. 40 and 42 of the Act, they commonly seek to enter into evidence transcripts of witness interviews conducted during their investigation (*Arbour* at para. 49). Past ASC decisions have observed that indicators of the reliability of such transcripts might include whether or not the witness was sworn to tell the truth or accompanied by legal counsel (*Arbour* at para. 54; see also *Re TransCap Corp.*, 2013 ABASC 201 at para. 65; and *Alberta (Securities Commission) v. Brost*, 2008 ABCA 326 (affirming *Re Capital Alternatives Inc.*, 2007 ABASC 79) at para. 34).

[10] In this matter, the parties differed early in the Hearing as to whether transcripts of witness interviews conducted by investigative Staff could be entered into evidence in lieu of calling those witnesses to testify before us. While Fauth did not object to the transcript of his own interview (**Interview**) being entered, he did object to Staff entering the transcripts of interviews of two investor witnesses (**Impugned Transcripts**). One of those witnesses (to whom we will refer by his initials, **CR**, as we will all other individuals who are not members of Fauth's immediate family in the interest of preserving privacy) died before the Hearing commenced, and the other, **OH**, was elderly and too ill at the time of the Hearing to testify in person. We were advised that OH died shortly after the last day of testimony.

[11] Fauth recognized our discretion to admit the Impugned Transcripts but urged us not to do so, primarily on the basis that CR and OH would not be available for cross-examination. Staff argued that this concern was attenuated because two of the investor witnesses who would be

testifying later in the Hearing were relatives of CR and OH respectively, had direct knowledge of the dealings CR and OH had with Fauth, and could be cross-examined on that evidence.

[12] Fauth made an alternative submission in the event we decided to admit the Impugned Transcripts: that we should ascribe them little to no weight – or, as phrased in his written argument, that they "should be viewed with caution". He relied on *Re Kapusta*, 2011 ABASC 322, a decision in which an ASC hearing panel stated as follows (at para. 10):

> The nature of the Investigative Interviews leads us to handle them with caution. Such evidence will generally be given less weight than direct evidence in the form of sworn or affirmed hearing testimony. Unlike testimony, transcripts of interviews conducted outside a hearing do not enable a hearing panel to observe interviewees as they give their interview evidence, or allow for testing or clarification of the interviewees' evidence (such as seemingly inconsistent statements) through cross-examination by other parties or panel questioning. The circumstances of the interviews must also be considered.

[13] The *Kapusta* panel noted that in that case, each of the interviewees had been sworn or affirmed before giving evidence at their interviews, "an indicator of seriousness that we consider would have been appreciated by the interviewees as they were interviewed" (at para. 11). However, the panel also considered it significant that each of the interviewees had appeared to give testimony in person at the hearing and could thus be tested on their interview evidence. Where their interview evidence was not so tested, the panel decided to give that evidence "little or no weight", and did "not rely exclusively on any Investigative Interview content in reaching [their] conclusions or making [their] findings" (at para. 11).

[14] In response before us, Staff argued that the evidence given in the Impugned Transcripts was relevant to the matters at issue in the Hearing, and therefore met the statutory threshold set out in s. 29(e) of the Act. Staff acknowledged that Fauth would not have the opportunity to cross-examine CR or OH, but submitted that we should follow *Kapusta* and simply include the lack of cross-examination as a factor to be considered when assessing the weight of the evidence. Staff also suggested we could assess the evidence in the Impugned Transcripts by assessing its consistency with other evidence, noted the necessity and reliability exception to the hearsay rule, and reiterated that CR's daughter and OH's son-in-law would be available to be cross-examined on matters pertaining to CR and OH.

[15] After considering these arguments from the parties, we admitted the Impugned Transcripts on the basis of relevance and ss. 29(e) and 29(f) of the Act. We were also persuaded by the reasoning of the panel in *Arbour*, which considered arguments with respect to investigative interview transcripts similar to those raised by Fauth (see, for example, para. 48). That panel noted that in a regulatory context such as this, natural justice and procedural fairness do not necessarily dictate that an opportunity to cross-examine must be provided, as long as a party is given "a reasonable opportunity to comment on and challenge such evidence" in another way (at paras. 49, 52). We were satisfied that Fauth would have that opportunity in the course of the Hearing.

[16] In addition, we considered it significant that both CR and OH were sworn and gave their interviews under oath. We took into account their unavailability to attend the Hearing in person, and we considered that relatives of CR and OH, who were available for cross-examination, had

personal knowledge of CR's or OH's investments and interactions with Fauth. In addition, CR's daughter was present at meetings CR had with Fauth.

[17] Like the panel in *Arbour*, however (at para. 54), we generally gave the statements made in the Impugned Interviews less weight than direct evidence given at the Hearing, and did not rely solely on such statements in making any particular findings on the allegations made in the NOH.

[18] That said, we treated Fauth's Interview somewhat differently. He, too, gave his interview evidence under oath, and he was accompanied by the same counsel who represented him throughout these proceedings. While it was Fauth's right to choose not to testify at the Hearing, he had the opportunity to do so if he had wished to augment or clarify anything he said during his Interview. He could also have called other evidence on his own behalf, whether through Staff's witnesses or his own. Moreover, in his written argument, Fauth expressly took the position that he did not call evidence in reply to Staff's case because his evidence "relating to his participation in these matters is already set out in the Fauth ASC interview, Summons documents, and Undertaking documents previously provided to ASC Staff. There was no need to supplement that evidence with other Respondent's evidence . . . ".

[19] As a result, we generally treated Fauth's Interview evidence similarly to the evidence given at the Hearing, especially evidence as to non-controversial matters and evidence consistent with other verbal or documentary evidence. We noted that Staff were aware of Fauth's Interview evidence before leading their case and thus had the chance to address it with their own evidence. At the same time, however, we took into account the fact that Fauth was not cross-examined and we had no opportunity to assess his credibility. This was consistent with Staff's urgings and the concession of Fauth's counsel on the point.

[20] Unless otherwise indicated, all references in these reasons to statements made by Fauth or to Fauth's evidence are references to the Interview.

C. Conflicting Evidence and Credibility

[21] In the course of arriving at our decision herein, this panel was required to draw conclusions with respect to the credibility of witnesses and assess conflicting evidence. In doing so, we were mindful of the following statement of law from *Faryna v. Chorny*, [1951] B.C.J. No. 152 (BCCA) at para. 11 (cited in a securities law context in *R. v. Boyle*, 2001 ABPC 152 at para. 107):

> The credibility of interested witness[es,] particularly in cases of conflict of evidence, cannot be gauged solely by the test of whether the personal demeanour of the particular witness carried conviction of the truth. The test must reasonably subject his story to an examination of its consistency with the probabilities that surround the currently existing conditions. In short, the real test of the truth of the story of a witness in such a case must be its harmony with the preponderance of the probabilities which a practical and informed person would readily recognize as reasonable in that place and in those conditions.

[22] In other words, we evaluated the source of the evidence, its consistency with other evidence we deemed reliable, such as documentary evidence, and the verbal testimony of neutral parties who had no motivation not to tell the truth. We also considered whether the evidence was logical in the overall circumstances and followed the Alberta Court of Appeal's caution in *Walton* (at para.

36) that disbelief of a witness does not necessarily mean that the opposite of his or her evidence is the truth – unless there is sufficient evidence to support that conclusion.

[23] We generally found the witnesses who appeared at the Hearing to be credible, especially where their evidence was consonant with other evidence and the totality of the circumstances. Although some witnesses could not specifically remember every detail of the relevant events, we attributed that to the passage of time rather than to any intent to dissemble.

IV. BACKGROUND

[24] We now summarize the relevant factual background. While not all of the evidence led at the Hearing may be specifically referred to in these reasons, we have carefully considered everything that was submitted, as well as the written and oral arguments of the parties.

A. Fauth

[25] Fauth is a resident of Calgary. He is married to Sharon Fauth (also known as **Sherri**, as we will generally refer to her in these reasons; we will generally refer to Fauth and Sherri collectively as **the Fauths**). The Fauths have three adult children: Darin, Byron and Sean.

[26] Fauth's background is in insurance sales and financial planning. At one time, he was a branch manager at a Manulife Financial office in Calgary. When he was interviewed by Staff in August 2015, he said that he had professional designations as a chartered life insurance underwriter, a certified financial planner and an elder planning counsellor. He was in the process of obtaining his designation as an executor advisor counsellor and had once held a designation as a trust and estate practitioner. However, he also indicated that he was experiencing health issues that had affected his ability to continue working.

[27] While Fauth was at one time registered with the Mutual Fund Dealers Association to sell mutual funds, he has not been registered with the ASC in any capacity since December 31, 2003.

[28] In October 2015, Fauth filed a Notice of Intention to Make a Proposal in bankruptcy.

B. Other Parties

1. Fauth Financial Group Ltd.

[29] Fauth operated his financial and estate planning business through Fauth Financial Group Ltd. (**Fauth Financial**), which was licensed to sell insurance and mutual funds. It also offered investment advice and opportunities to invest in annuities, limited partnerships (or **LPs**) and various private investments.

[30] Fauth recalled that he had founded Fauth Financial in 1993, but an Alberta corporate registry search in evidence indicated that the company was formed in Alberta by amalgamation of several predecessor entities on November 1, 2005. Given the time frame of the breaches alleged in the NOH, nothing turns on this discrepancy. The same search – dated April 7, 2015 – showed that Fauth was Fauth Financial's sole director and held 75% of its voting shares. The other 25% were held by "Fauth Family Trust II", of which other evidence suggested Fauth was trustee. Fauth described Fauth Financial as "[his] company", and himself as its president and controlling shareholder during the 2005-2009 time frame.

[31] In late 2009 Fauth took on a temporary role as interim chief executive officer (**CEO**) of FairWest Energy Corporation (**FairWest**). Although Fauth stated that he had during this period given his "interest" or his shares in Fauth Financial to his spouse, Sherri – who then took over as its president – we noted that the Alberta corporate registry search in evidence for Fauth Financial did not reflect any formal change in control. Further, other evidence – including Fauth's Interview – indicated that Fauth continued to deal personally with certain Fauth Financial clients.

[32] Insofar as Fauth turned day-to-day management over to Sherri, she was assisted by **KG**, a certified investment manager and elder planning counsellor who was with Fauth Financial from approximately 2005 to 2011. KG and Sherri were both licensed to sell life insurance and mutual funds, and Sherri had a certified financial planning designation.

[33] Other members of Fauth's family also appear to have been involved with Fauth Financial at various times. Fauth Financial documents in evidence suggested the Fauths' sons Darin and Sean were members of staff. Darin did group benefits for the Chamber of Commerce and at certain times held licenses to sell mutual funds and life insurance, while Fauth stated that Sean provided consulting services analyzing investments Fauth Financial was considering for its product shelf. Fauth's sister, **SS**, provided bookkeeping services.

[34] Fauth stated that he resumed his formal position at Fauth Financial in late 2012. By that time, its business was starting to wind down, as KG had taken the clients he (KG) worked with and moved to another company. At his Interview in August 2015, Fauth said that Fauth Financial was no longer in active business.

2. Espoir

[35] Espoir was incorporated as an Alberta numbered company in October 2002 and changed its name to Espoir shortly thereafter. Alberta corporate registry searches in evidence indicated that throughout the relevant period, Fauth was Espoir's sole director and holder of 100% of its voting shares. Fauth confirmed that he was the founder and sole shareholder, director, officer and signing authority of Espoir – in other words, and we find, he was its sole guiding mind. He was also the only person who met with clients interested in investing in Espoir, although he stated that Sherri performed some information technology and accounting work for it on a consulting basis.

[36] Fauth used Espoir to raise funds from the public for ostensible re-investment in other opportunities that would generate the returns to be paid to Espoir investors. He testified that he had set up the company "to invest in mortgages and . . . different types of investments, to . . . pay out a higher interest rate to people" who invested in it.

[37] We elaborate on Espoir and its business model later in these reasons.

3. FairWest

[38] FairWest was a publicly-traded oil and gas company listed on the TSX Venture Exchange. It was incorporated federally on August 18, 2005, registered in Alberta on August 29, 2005, and struck on February 2, 2015. Alberta corporate registry searches showed that its head office was in Calgary, and listed Fauth and his son, Sean Fauth, as two of its six directors as at January 1, 2012.

[39] In addition to acting as a director of FairWest, Fauth indicated that he invested "quite a bit of money" in it personally and was its second-largest shareholder. As mentioned above, at the end of 2009, he agreed to act as its interim CEO and conduct a search for someone who could permanently replace the outgoing president and CEO. In the meantime, he tried to raise money for it and find a third party who would purchase it. However, resource prices fell and FairWest reached the point that it was "losing a million dollars a month". Fauth said, "I did everything I could to try to save it". Despite his efforts, FairWest made an application under the *Companies' Creditors Arrangement Act* in December 2012.

[40] Fauth resigned as both director and as interim CEO in February 2013.

4. Limited Partnerships

[41] Fauth had interests in and control over a number of other oil and gas entities relevant to this matter which were associated in business with FairWest. This included Royalty Investments Limited Partnership (**Royalty LP**), which was registered in Alberta on April 22, 2009. Royalty LP's general partner was AFM Management Inc. (**AFM Management**), of which Fauth was president, sole director and sole voting shareholder.

[42] Fauth described Royalty LP as "a conglomeration of one corporation [i.e., AFM Management] and six partnerships", the business of which was closely aligned with FairWest and involved owning and operating oil and gas properties in Alberta. The six limited partnerships that were eventually "amalgamated into" Royalty LP in approximately 2011 were the following, some of which are mentioned again later in these reasons:

- AltaEast Production Limited Partnership (**AltaEast LP**), which was registered in Alberta on February 27, 2009. Its general partner was AltaEast Oil & Gas Inc. (**AltaEast Inc.**), of which Fauth stated he was president, a shareholder and one of two directors. The relevant Alberta corporate registry searches in evidence indicated that 100% of AltaEast Inc.'s voting shares were owned by FMM Capital Corporation (**FMM Capital**). Fauth was FMM Capital's sole director and voting shareholder.

- Battle River Production Limited Partnership (**Battle River LP**), which was registered in Alberta on April 1, 2008. Its general partner was Battle River Oil & Gas Inc. (**Battle River Inc.**), of which FMM Capital also owned 100% of the voting shares. Fauth was one of two directors of Battle River Inc., and its president.

- Garrington Limited Partnership (**Garrington LP**), which was registered in Alberta on May 4, 2007. Its general partner was Garrington Production Corporation (**Garrington Corp.**), of which Fauth, according to an Alberta corporate registry search, was the sole director. FMM Capital owned 100% of the voting shares of Garrington Corp.

- Neutral Creek Limited Partnership (**Neutral Creek LP**), which was registered in Alberta on October 29, 2007. Its general partner was Neutral Creek Corporation (**Neutral Creek Corp.**), of which Fauth, again according to an Alberta corporate

registry search, was one of two directors. FMM Capital owned 100% of the voting shares of Neutral Creek Corp.

- AltaEast Land Fund Limited Partnership, which was registered in Alberta on February 27, 2009. Its general partner was AltaEast Resource Corporation, of which Fauth, again according to an Alberta corporate registry search, was one of two directors. FMM Capital owned 100% of the voting shares of AltaEast Resource Corporation.

- Strategic Production Limited Partnership, which was registered in Alberta on June 24, 2009. Its general partner was Strategic Oil & Gas Production Inc., of which Fauth, again according to an Alberta corporate registry search, was one of two directors. FMM Capital owned 100% of the voting shares of Strategic Oil & Gas Production Inc.

[43] One further partnership associated with Fauth and his family and discussed later in these reasons was Axiom Foreign Exchange International (**Axiom**). According to an Alberta corporate registry search, Axiom was registered in this province on April 12, 2005, and its partners were 1162127 Alberta Ltd., 1162134 Alberta Ltd., 1162168 Alberta Ltd., 1162174 Alberta Ltd., and 1162816 Alberta Ltd. Other evidence suggested a sixth partner, 1162170 Alberta Ltd.

[44] 1162127 Alberta Ltd.'s sole director was Fauth's son, Sean Fauth, and its sole voting shareholder was 1162130 Alberta Ltd. – of which Sean Fauth was sole director and voting shareholder. 1162816 Alberta Ltd.'s directors were Fauth and his spouse, Sherri. An Alberta corporate registry search indicated that Fauth held 50.249% of 1162816 Alberta Ltd.'s voting shares in his personal capacity, and the rest in his capacity as "Trustee of the Fauth Family Trust #2".

[45] We were not directed to any evidence that indicated who controlled 1162134 Alberta Ltd., 1162168 Alberta Ltd., 1162174 Alberta Ltd. or 1162170 Alberta Ltd., but Fauth acknowledged during his Interview that Axiom was a related party.

C. The Investments

[46] From November 2002 through November 2012, Espoir issued approximately $15 million in debentures (**Debentures**) to over 70 investors in Alberta, British Columbia (**B.C.**) and Ontario. The Debentures were described as: (1) "unsecured"; and (2) "secured".

1. Unsecured Debentures

[47] Beginning in November 2002 until March 2009, Espoir offered what it described as "unsecured subordinated debentures" (**Unsecured Debentures**). The Unsecured Debentures matured after three years and, for the most part, paid interest semi-annually at the rate of 10.5% per annum. A handful of Unsecured Debentures in evidence that were issued in late March 2009 reduced the annual interest rate to 8%, but they otherwise had the same terms as the 10.5% version.

[48] The Unsecured Debentures were generally issued with the same package of documentation, although in some instances the copies before us – including those produced by Fauth from Espoir's records – were missing pages or were not fully executed. In some instances, Espoir and the

investors who gave evidence at the Hearing had in their possession different documents or pages from documents relating to the same transaction, such that different parts of the packages had to be pieced together from different sources. However, despite these limitations, we were satisfied that for most of the transactions, the packages included a one-page certificate (**Unsecured Debenture Certificate**), the 13-page text of the Unsecured Debenture itself, and a three-page subscription agreement (**Unsecured Debenture Subscription**).

[49] Each Unsecured Debenture Certificate stated on its face that it represented an "Unsecured Debenture", and gave the basic details of the transaction: its issue date, the name of the purchaser, the amount invested, the interest rate, the term, and the date of maturity. The Unsecured Debentures themselves (typically titled "Espoir Capital Corporation 10.5% [or 8%] Unsecured Subordinated Debenture") stated in their preambles that "[t]he Debenture is an unsecured obligation of [Espoir] and is specifically subordinated to Senior Indebtedness, as defined herein". "Senior Indebtedness" was defined to include all of Espoir's other indebtedness, apart from the Unsecured Debenture itself and any other subordinated indebtedness.

[50] Each Unsecured Debenture also included the following clause, headed "No Security":

> The Holder [i.e., the purchaser] acknowledges that no security interest is granted to the Holder by [Espoir] hereby and the Holder covenants that he shall not seek to cause any registration of the Debenture against [Espoir] or its assets in any jurisdiction.

[51] The Unsecured Debenture Subscriptions were all in the same form for each investment. Each stated in the first clause that the undersigned purchaser was subscribing for "10.5% [or 8%] unsecured subordinated debentures of [Espoir]". Each also included clauses whereby the purchaser represented, warranted or acknowledged that:

> 3. . . .
>
> (c) the undersigned is either: (i) a relative of a director, senior officer or control person of [Espoir]; (ii) a close personal friend of a director, senior officer or control person of [Espoir]; (iii) a person who through prior business dealings or other associations with a director, senior officer or control person of [Espoir] has common bonds of interest or association with such director, senior officer or control person of [Espoir]; or an entity controlled by an individual referred to in (i), (ii) or (iii);
>
> (d) if the undersigned is a resident of British Columbia, the undersigned is also an "accredited investor" as defined in Multilateral Instrument 45-103 Capital Raising Exemptions . . . ;
>
> (e) the undersigned is an investor who, by virtue of his net worth and investment experience, is able to evaluate the merits of, and risks associated with, an investment of [sic] the Debentures, or has sought advice from advisors as to the risks relating to an investment in the Debentures and is able to bear the economic risk of a total loss of the undersigned [sic] investment.
>
> 4. The undersigned hereby acknowledges that:
>
> (a) the undersigned is acquiring the Debentures pursuant to an exemption from the registration and prospectus requirements of applicable securities legislation . . .
>
> (b) [Espoir] is a "private issuer" within the meaning of the *Securities Act* (Alberta) . . .

[52] Starting in approximately 2010, Espoir became unable to repay the Unsecured Debentures as they matured. Fauth therefore began asking the Unsecured Debenture holders to enter into amending agreements (**Debenture Amendments**), the majority of which reduced the interest rate on those paying 10.5% to 8%, extended the term (usually for a further three years), and changed the timing of interest payments from semi-annually to quarterly. Fauth indicated during his Interview that after concluding Espoir could no longer afford to pay 10.5% interest, he looked at the assets it held and the money that was coming in and arrived at 8% as the figure he felt Espoir could afford to pay going forward.

[53] Although there were some variations, the majority of the Debenture Amendments were in the same basic form with the same provisions. Several Debenture Amendments in evidence extended maturity dates into 2011, 2012 and 2013, but most were made effective September 1, 2011 and extended maturity dates to August 31, 2014. In addition, the majority of the Debenture Amendments replaced the phrase from the preamble of the Unsecured Debentures stating that "[t]he Debenture is an unsecured obligation of [Espoir]" with a phrase stating that "[t]he Debenture is a secured obligation of [Espoir]". Where the Debenture Amendments provided for a shorter extension than an additional three years, they retained the reference to "an unsecured obligation of [Espoir]".

[54] At least two Unsecured Debenture holders negotiated a further modification of the Debenture Amendment to provide for payment of a "Balloon Fee": an additional 2.5% per annum payable at the time the principal of the Unsecured Debenture was repaid. These two Debenture Amendments also revised the last sentence of the Unsecured Debenture preamble to read: "The Debenture is a secured obligation of [Espoir] and is secured by investment assets of [Espoir] and is specifically subordinated to Senior Indebtedness, as defined herein."

2. Secured Debentures

[55] From November 2009 through November 2012, Espoir offered what it described as "Series II Secured" debentures (**Secured Debentures**). Like the Unsecured Debentures, the Secured Debentures had three-year terms, but paid interest quarterly at the lower rate of 8% per annum.

[56] Also like the Unsecured Debentures, the Secured Debentures were generally all issued with the same package of documentation. Again, in some instances the copies before us – including those produced by Fauth from Espoir's records – were missing pages or were not fully executed, and different parts of the packages had to be pieced together from different sources. Despite these limitations, we were satisfied that for most of the transactions, the packages included a one-page certificate (**Secured Debenture Certificate**), the 13-page text of the Secured Debenture itself, and a three-page subscription agreement (**Secured Debenture Subscription**).

[57] Each Secured Debenture Certificate stated on its face that it represented a "Secured Debenture" and gave the basic details of the transaction: the Secured Debenture's issue date, the name of the purchaser, the amount invested, the interest rate, the term, and the date of maturity. The Secured Debentures themselves (typically titled "Espoir Capital Corporation 8% Secured Debenture Series II") all had the same terms and stated in their preamble that "[t]he Debenture is a secured obligation of [Espoir]". However, each also had the same "No Security" clause as was included in the Unsecured Debentures, and provisions stipulating that the Secured Debentures were subordinated to "Senior Indebtedness".

[58] The Secured Debenture Subscriptions were all in the same form for each investment. Typically entitled "Subscription Agreement For Series II Secured Debentures" or simply "Subscription Agreement Series II", each stated in the first clause that the undersigned purchaser was subscribing for an "8.0% secured debenture of [Espoir]". Like the Unsecured Debenture Subscriptions, the Secured Debenture Subscriptions contained clauses whereby the purchaser made the representations, warranties or acknowledgements reproduced at paragraph [51] above.

[59] Some copies of Secured Debenture Subscriptions entered into evidence attached as a schedule a "Definition of Accredited Investor" as defined in the applicable securities regulatory instrument.

[60] According to Fauth, the only real differences between Espoir's Unsecured Debentures and its Secured Debentures were the interest rate and the date of issue. His evidence was that despite their names, both had "the same" underlying security: "the assets that were in . . . Espoir . . .".

3. Promissory Notes

[61] Espoir also issued a handful of promissory notes (**Espoir Notes**). At the time of his Interview, Fauth thought maybe "[t]wo or three", but he provided evidence of four totalling $305,000 in response to an Interview undertaking. Each had been issued in 2012, had a two-year term and paid 8% interest per annum. However, one of the Espoir Notes provided by Fauth simply reflected the reallocation of $60,000 initially used to purchase a Secured Debenture the previous December to an Espoir Note, and not a separate investment.

[62] A fifth Espoir Note for $200,000 was in evidence. While it was also issued in 2012 and paid 8% interest, it was in a different form than the others, and had only a three-and-a-half-month term. Other evidence suggested at least two other Espoir Notes were issued: one in October 2011 for $50,000 (which was repaid the subsequent April), and one in December 2012 for a further $50,000.

[63] In total, therefore, the evidence indicated that $545,000 was raised under the Espoir Notes from five different investors.

4. Payment on Debentures

[64] By mid-2013, Espoir ceased making interest payments to Debenture holders. While various evidence suggested that some Debentures were redeemed, paid out or surrendered over the years (including payout of all four Debentures held by Royalty LP prior to maturity), as of December 31, 2014, Espoir's financial records showed that it owed its investors over $12.3 million.

[65] In response to a written inquiry posed in a Summons to a Witness issued by investigative Staff on May 22, 2015 (**Summons**), Fauth advised that by mid-2015, "[a]ll [Espoir] [D]ebentures [were] in default and asset values [had] disappeared with no opportunity to payout [sic] [D]ebenture holders".

5. Documentary Information Provided to Espoir Investors

[66] A number of documents describing Espoir's business and the investments it offered were in evidence at the Hearing.

(a) Espoir Summaries

[67] Between February 2003 and October 2011, several versions of a one-page information document appeared to have been created and distributed to some Espoir investors (**Espoir Summaries**). Although there were minor variations among the versions, all of them provided a list of the kinds of investments Espoir purported it would make, along with a few details about the type of Debenture that was available at that time. The Espoir Summaries were described as "promotional sheets" in Fauth's response to the Summons. At his Interview, Fauth said he gave Espoir Summaries to some people who bought or were interested in buying Espoir Debentures over the years, but not necessarily all of them; it depended on whether they asked for such information or "how the appointment went".

[68] The earliest version was dated February 26, 2003 (**February 2003 Espoir Summary**) and read as follows:

> Espoir is a company that was established to invest in a pool of interest paying investments such as:
> - Money Market
> - Treasury Bills
> - Bankers Acceptance Paper
> - Commercial Paper
> - Guaranteed Investment Certificates & Term Deposits
> - Bonds – Government, Corporate
> - Debentures - Secured
> - Promissory Notes - Secured
> - 1st & 2nd Mortgages
> - Lease Paper – Commercial
>
> Espoir Capital Corporation issues secured and unsecured debentures.
> The debenture interest rates are:
>
> - **Unsecured Debentures – 10.5%**
> The culmination of the return of the investment pool results in a rate to the unsecured investor of 10.5%.
>
> Each issued debenture has a three-year term with interest paid semi-annually.
>
> - **Secured Debentures – 8.0%**
> Secured debentures are matched to specific investment holdings.
>
> Each issued debenture has a three-year term with interest paid semi-annually.

[69] The earliest version received by any of the investors who gave evidence at the Hearing was identical, but dated January 1, 2007 (**January 2007 Espoir Summary**). A similar version – but dated January 2009 (**January 2009 Espoir Summary**) – was produced by Fauth during the investigation. The difference between the February 2003 Espoir Summary and the January 2009 Espoir Summary was that the latter indicated the interest rate on the Unsecured Debentures was 8% and the interest rate on the Secured Debentures was 5.5%.

[70] A version dated September 2009 (**September 2009 Espoir Summary**) stated as follows:

> Espoir Capital Corporation (Espoir) is a company that was established to invest in secured investments such as:
> - Money Market
> - Treasury Bills
> - Bankers Acceptance Paper
> - Commercial Paper
> - Guaranteed Investment Certificates & Term Deposits
> - Bonds – Government, Corporate
> - Debentures - Secured
> - Promissory Notes - Secured
> - 1st & 2nd Mortgages
> - Lease Paper – Commercial
>
> Espoir Capital Corporation is currently issuing *a Series II - Secured Debenture*.
>
> The Series II - Secured Debenture
>
> - The annual interest rate is 8%, simple interest paid quarterly
> - The culmination of the return on the investments held by Espoir, are distributed to the investors on calendar quarters (Mar 31, Jun 30, Sept 30, Dec 31).
> - Each issued debenture has a three-year term.

[71] Another version, dated January 2010 (**January 2010 Espoir Summary**), began by stating that "Espoir Capital Corporation was established in 2002 to invest in a pool of secured interest paying investments such as", and then gave the same list of items as appeared in the top half of each of the other Espoir Summaries. The bottom half was similar to the September 2009 Espoir Summary, but presented the information in a slightly different way:

> Espoir Capital Corporation currently issues secured debentures.
>
> The current debenture interest rate is:
> - **Secured Debentures – 8.0%**
>
> The culmination of the return of the investment pool results in a rate to the investor of 8.0% simple interest.
>
> Each issued debenture has a three-year term with interest paid on the calendar quarters (March 31, June 30, September 30, December 31).

[72] The final version was dated October 2011 (**October 2011 Espoir Summary**). Apart from a minor formatting difference, it was the same as the January 2010 Espoir Summary.

(b) Espoir Investor Capital Breakdown

[73] Another document provided to at least some Espoir investors was an undated sheet titled "Investor Capital" (**Espoir Investor Capital Breakdown**). It suggested that "VF" had invested $1,589,319 in Espoir and 37 "Investors" had invested $8,671,567 for a "Total" of $10,260,886 – with $10,002,000 of that from "Debentures". It then concluded with the following short table, which broke down the $10,260,886 into categories of investment with the percentage yield from each category and the total yield as both a dollar figure and as a percentage:

% of Total			Assets	Yield
2.52%	Cash – T-Bills	:	$258,886	1.20%
70.18%	Mortgages	:	$7,201,440	8.75%
11.70%	Leases	:	$1,200,240	11.00%
15.60%	Other Secured	:	$1,600,320	8.00%
	Total Revenue	:	$893,286	
	Current Average Yield	:	8.71%	

[74] During his Interview, Fauth testified that he did not recognize this document and was unsure whether the reference to "VF" at the top of the page was a reference to him. However, he thought that the $8,671,567 and $10,260,886 figures and the number of investors (37) were accurate or close to accurate. He also relied on the $1,589,319 personal investment and the $8,671,567 investor contribution figures as accurate in his written closing argument (**Fauth Argument**).

(c) Net Worth Statements

[75] Some Fauth Financial clients received net worth statements as at certain specific dates (**Net Worth Statements**). The Net Worth Statements broke down the client's assets and liabilities by category, including "Lifestyle Assets", "Guaranteed Securitized Investments", "Equity Investments" and "Real Estate". Espoir Debentures were listed under the category of "Guaranteed Securitized Investments".

(d) Secured Debenture Solicitation Letter and Term Sheet

[76] In October 2009, Espoir sent letters to at least some existing Debenture holders soliciting new investments in the "Series II, 8% 3 year debenture" Espoir then had on offer (**Secured Debenture Solicitation Letter**). These letters advised that "[o]nce again these debentures will be securitized by assets (i.e. mortgages)" and enclosed "a Term Sheet detailing the debenture offering and a Subscription Form".

[77] The "Term Sheet" for the "Series II – Secured Debenture" (**Secured Debenture Term Sheet**) provided information such as the minimum subscription amount, the interest rate and the options available on maturity. It also included a "Use of Proceeds" section which stated: "[t]he proceeds will be invested into securitized debt instruments with terms from 1 – 3 years", and then provided the same list of investment categories as appeared at the top of each of the Espoir Summaries.

[78] During his Interview, Fauth acknowledged that the Secured Debenture Term Sheet had been prepared by a lawyer "for Espoir . . . debenture holders". Some investors who testified at the Hearing appeared to have received it independently of a Secured Debenture Solicitation Letter.

D. Investor Evidence

[79] As noted at the outset of these reasons, eight investor witnesses testified at the Hearing, and the evidence of two other investors – CR and OH – was adduced through the Impugned Transcripts. We summarize below the most pertinent parts of this evidence.

1. RP

[80] RP was introduced to Fauth in approximately 2000 by an acquaintance who recommended Fauth for investment planning. At the time, RP had minimal experience investing apart from employee stock purchase plans and mutual funds. Among other things, Fauth recommended that RP and his spouse, KP, put their residence in KP's name, then have her leverage the equity to make investments. They did so, and KP purchased an Unsecured Debenture for $100,000 in January 2003. In February 2005, RP purchased another Unsecured Debenture for $100,000.

[81] Copies of RP's and KP's Unsecured Debentures, Unsecured Debenture Certificates and Unsecured Debenture Subscriptions were in evidence. RP and KP were also among the Espoir investors for whom a Net Worth Statement was in evidence. Theirs was dated February 2, 2011 and listed their Unsecured Debentures under the category, "Guaranteed Securitized Investments".

[82] According to RP, his goal was generally to preserve his capital and achieve long-term growth. Fauth had told RP that the money RP and KP put into Espoir was "secure" and "invested in real estate", and that they were the "first secured lender". While RP did not recall Fauth mentioning any specific properties that funds in Espoir were used for – and he (RP) did not ask for those specifics – he understood from Fauth that "there was no way, if anything happened, we would ever lose our money" because there was enough equity in the property to pay them back. Fauth had indicated "it was about as safe as anything you could -- could do".

[83] In light of his testimony with respect to his understanding of the security behind the Unsecured Debentures, RP was asked on cross-examination about the fact that the investment documentation clearly referred to *Unsecured* Debentures. RP acknowledged that he never asked Fauth about that, nor did he recall reading the statements in the Unsecured Debenture Subscriptions with respect to the possibility of losing all his funds. However, on re-direct examination, he asserted that that possibility was in opposition to what Fauth had told him verbally – which had been to the effect that Espoir "couldn't be any more secure".

[84] KP's Unsecured Debenture matured in 2006, and RP's Unsecured Debenture matured in 2008. While they initially left the money in Espoir and continued to receive their interest payments, RP said that by 2008 and the weakening of the financial and real estate markets, he started asking Fauth to pay them out. In approximately 2010 ("[g]ive or take a year"), Fauth told RP and KP that because the real estate market had fallen, "a lot of the properties had taken a hit", and the only way they could preserve their capital would be to agree to a reduced interest rate on the Unsecured Debentures so that the property owners would not go into default and leave Espoir and its investors with properties they would not be able to sell.

[85] In the hope they would get their capital back, RP and KP each agreed to enter into a Debenture Amendment, effective as of September 1, 2011. From the discussions he had with

Fauth in 2011 at the time the Debenture Amendments were executed, RP said he "still understood that the money [invested in Espoir] was being used for real estate mortgages".

[86] RP and KP received the interest payments on their Unsecured Debentures until approximately late 2012 or 2013. On August 19, 2013, RP sent an e-mail to Fauth which noted that he and KP had not received any interest payments "in sometime [sic] now". The e-mail went on to request ". . . a detailed listing of the assets that supposedly are supporting the interest payments. Obviously, there's a major issue with the assets or there are not any assets backing the debentures." Fauth advised him to send a formal letter of default, which RP did in October 2013.

[87] Later, RP and KP retained a lawyer, who sent a further demand letter to Fauth's counsel in December 2013. RP indicated that while his lawyer had been informed by Fauth's counsel that director and officer insurance may have been available to cover their losses, he and KP have never received any of their principal back.

[88] When asked how this experience has affected his attitude toward investing, RP stated that especially given his current "phase in life" (as a 60-year-old retiree), he "would not invest in Alberta capital markets" again.

2. MT

[89] MT met Fauth in 1998 or 1999, when she and her spouse at the time were referred to him by their accountant for financial services. She was an inexperienced investor, and initially used Fauth simply to assist her with her annual RRSP contributions.

[90] MT got divorced in 2003, and at her annual RRSP contribution meeting with Fauth in approximately 2005, Fauth suggested they review her changed financial situation. One of his recommendations was that she take out a line of credit against her home and use the funds to make investments. While she was nervous about doing so, she followed Fauth's advice and secured credit of $350,000 for that purpose.

[91] In 2006, MT's father, CR – who was also an inexperienced investor – was looking for assistance with his financial affairs. MT respected and trusted Fauth, so she referred her parents (CR and MR) to him for advice. Since she was aware that her parents had a "[v]ery low" risk tolerance, she told Fauth in a June 14, 2006 letter that CR and MR "would like low risk investments".

[92] MT was present with her parents at their first meeting with Fauth in the summer of 2006, at which Fauth described the opportunity to invest in Espoir's Debentures. According to MT, he told them the funds invested would be pooled by Espoir and "lent to developers secured against land registered on title", and that while "they would be paid out" after three years, they could get their money out at any time on request. MT said further that Fauth "emphasized that we were always registered on title", and therefore the Debentures were "no risk". On Fauth's recommendation, in October 2006 MT used $200,000 from her home equity line of credit to buy an Unsecured Debenture. Between July 2006 and March 2009, CR and MR bought five Unsecured Debentures for a total of $600,000.

[93] At the Hearing, MT was asked about the fact that she purchased an *Unsecured* Debenture, and that the Unsecured Debenture Subscription she signed stated that she was subscribing for "10.5% unsecured subordinated debentures". She testified that she had not understood what that meant at the time, as she believed and understood from Fauth that her Unsecured Debenture was a secure investment. She explained as follows in response to questions from this panel:

> Q And was that unsecured money or secured money; what did you believe?
>
> A I believed it was unsecured, but [Fauth] always referred to it as it's secured, because it's held against assets, it's security, we're registered on title.
>
> And at one point when I said -- I corrected him, and I said, I'm registered on title. He said, No, Espoir's registered on title. So I did believe that my debenture was unsecured even though he always said it was secured, secured guaranteed.
>
> . . .
>
> Q You're saying that you believed that your investment in Espoir was unsecured, but Espoir was secured through the properties; is that what you believe?
>
> A Through?
>
> Q Property.
>
> A Yes, correct.
>
> Q And did you take from that that you believed that your investment, ultimately, was secured or unsecured?
>
> A I believed secured with that information.

[94] MT remembered receiving an Espoir Summary, although her copy was not in evidence. She recalled that it had a list of investment categories at the top like the list at the top of the January 2010 Espoir Summary, and that it indicated Espoir had been "established in 2002 to invest in a pool of secured interest paying investments". She also recalled that, like the February 2003 Espoir Summary, the version she received referred to both the 10.5% Unsecured Debentures and 8% Secured Debentures. Fauth had explained that the difference was that Secured Debentures were "tied to one secured asset", whereas the funds from the Unsecured Debentures were "pooled funds" attached to "more than one asset". She chose an Unsecured Debenture because Fauth had said, "they're all secured against assets . . . why take 8 when you can take 10-and-a-half percent".

[95] MT assisted her parents with their dealings with Fauth. Her father "did not want to lose his capital, and at every meeting that [she] ever was at, [her] father would repeat over and over and over to [Fauth], No risk, no risk, no risk. He did not want to lose his principal." Accordingly, while Fauth had mentioned FairWest as another investment opportunity, she felt that it was too risky for her parents. However, both she and her parents invested in certain of the oil and gas limited partnerships described earlier in these reasons, as Fauth had said they "were relatively no risk because they held hard core assets" that could be sold, and that after the limited partnership investments' three-year term, "FairWest would buy these assets back and possibly buy them for more than what we had purchased the units for".

[96] In September 2010, MT received a letter from Fauth which was headed "Espoir Capital Corporation Update" (**September 2010 Update Letter**). It stated in part as follows:

> Espoir . . . was founded on August 20, 2002. The business purpose of Espoir was to invest in first and second short term mortgages, with a 1 to 3 year maturity term, short term secured debentures, secured promissory notes & loans, commercial lease finance paper, t-bills, bonds and other securitized short term investments. These types of short term secured investments offered to Espoir a higher average rate of interest income than was available to traditional interest investments. The earnings from these investments are used to pay the interest due to the debenture holders.
>
> The business plan was to have all investments securitized with real assets and the amounts to be invested would be limited to a percentage of the current asset valuation. Espoir . . . raised private capital by issuing 3 year debentures paying 10.5% interest annually and the annual interest was paid every 6 months (semi annually).
>
> . . .
>
> The Global Economic Recession [sic] that has plagued all investments throughout the world has also had a negative impact on some of the investments held by Espoir. Specifically, Espoir currently has several matured mortgages where the mortgagee has been unable to payout [sic] the matured mortgage or find alternate financing. Espoir has had to work with these borrowers by extending the matured contracts. In some cases Espoir has had to reduce the interest rate or has had to be flexible on the timing of the loan payments due. When Espoir receives interest payments on an irregular basis it puts pressure on interest and maturity payouts. The highest priority for Espoir is to protect the distributions to all debenture holders including the matured debenture holders until the matured mortgages are paid.

[97] The letter then went on to explain that Espoir had not been able to pay out some Debentures as they matured because it wanted to preserve its cash for interest payments. However, it would pay them out as "the matured mortgages" in which Espoir had invested were paid out. Espoir did not want to foreclose on any of those mortgages, as Fauth had determined that ". . . Espoir may not be able to dispose of the asset that is held as security during these current economic times". The letter further advised that the interest rate to be paid "on rollover of matured debentures" would therefore be reduced to 8%. It concluded by asking for patience because "[t]he economy [was] on the mend", and Fauth expected Espoir to be in a position to pay out matured Debentures "over the next 6 months".

[98] MT noted that the description of Espoir's "business purpose" and "business plan" in the September 2010 Update Letter accorded with her understanding of Espoir: "It was all to be secured. It listed other things, but [Fauth] only ever talked about lending to developers." The discussion of mortgages held by Espoir also accorded with her understanding. She asked Fauth about where the underlying properties were located "many times", and recalled him mentioning Edmonton, Airdrie and Okotoks.

[99] Initially, MT declined to accept a reduced interest rate. In 2011, however, Fauth asked her to enter into a Debenture Amendment. MT was still reluctant to accept a reduced interest rate, so Fauth added the additional 2.5% "Balloon Fee" referenced earlier in these reasons. He also told her that if all of the Espoir Debenture holders did not agree to Debenture Amendments, no one would receive any further interest payments. Out of concern for the interest income on which her parents relied, she agreed to sign. She understood that her father had also signed, because he was "more concerned about protecting his principal" and wanted to save the investment.

[100] In July 2013, Espoir was still in difficulty. MT had a telephone conversation with Fauth during which he advised her "that there would be no interest payments for July, and that Espoir was facing challenges, and that [he would] be issuing amended agreements at the end of July 2013". Fauth came to her house for a meeting to discuss the situation shortly after this telephone call, on July 16, 2013. MT made an audio recording of the meeting, and a transcript of the recording was created. Fauth's counsel stipulated that the transcript was an accurate representation of the audio recording and did not dispute the identity of the participants in the conversation. As a result, we determined that in addition to accepting the transcript into evidence, we would also admit the recording. During the Hearing, Staff highlighted and played certain portions of the recording.

[101] At the meeting, MT told Fauth that she and her parents wanted their Unsecured Debentures paid out, and her parents wanted the $300,000 they had invested into the limited partnerships back. She also asked about how the funds invested in Espoir had been used. Fauth told her that "[i]t's in different assets" and noted that "everybody's got the same list" – a reference to the list of investment categories at the top of the Espoir Summaries. He further indicated that investment in real estate was only "a small part of it", as there were also "all kind[s] of other investments". This included investments in or loans to FairWest and the oil and gas limited partnerships.

[102] MT confronted Fauth about the representations he had made to her and her parents about Espoir, and said, "[w]e didn't know it's [i.e., the investment funds] going to FairWest Energy. We didn't know it's going into the limited partnerships. We believed that they are going into real estate – land – on mortgages – were secured on title. That's what we believed." Fauth acknowledged that with a "[y]ep", and MT went on to say, "[w]e were not informed of the risk of the debentures. They were guaranteed. You even said if it can't be paid back, you will pay it back", and that her father told him "no risk, no risk".

[103] Fauth suggested to MT that the investments Espoir had made were "secured . . . at the time", as "FairWest had an asset that valued at $18 million" when the associated "bank debt was around $6 million". He explained that while Espoir's "primary focus was only mortgages initially" and "in 2002 [it] had mostly mortgages", that focus "changed over the course of time". He further maintained that the Espoir Debentures "are actually quite secure . . . because if there's assets behind it, it's secured – it's security" and those assets "are still . . . there" – although he acknowledged that there was a question as to the value of those assets at that time. He also acknowledged that "we didn't have a security that really should have been there" but explained that "to get that type of security, like a GIC or that type of thing, you have to get a lot lower interest rates. You know, that changes the yield but you want to get in real estate and have 8.5% so you had to have a little bit of risk on that debt instrument and that's what ended up happening . . .".

[104] By the time the meeting concluded, Fauth had indicated that Espoir would be sending Debenture holders a letter in the near future outlining the possible options for eventual repayment. However, he also mentioned several times during the course of the meeting that if the investors were not patient and any were to sue him, Espoir would be put into receivership or bankruptcy. He apologized, expressed his regrets, and told MT that this was not the outcome for Espoir he had planned.

[105] MT testified that by the end of the meeting, she understood that, given her parents' circumstances, Fauth would make an exception and pay her parents the interest that was by then in arrears and buy back their Unsecured Debentures with a promissory note. Her parents received a $12,000 cheque from FMM Capital dated July 17, 2013. That was the last interest payment MT or her parents received, and they have never been repaid the principal of their Unsecured Debentures. They filed a lawsuit against Fauth, Fauth Financial, Espoir and other parties on December 3, 2013 and obtained summary judgment, but at the time of the Hearing they had not recovered any funds.

[106] At the Hearing, MT explained the impact that the loss of their investment funds had had on her and her parents. Her parents lost "almost all of their accessible cash, and they just live on CPP and old age security. And now that my father has passed, my mother is no longer able to sustain the cost of living in her home, so now she's being forced to sell her home, because she can't afford to live there." MT personally experienced significant stress and worry, and noted that at age 60, she would have to work longer before retirement to make up for what she had lost.

3. CR

[107] As mentioned, CR died before the Hearing commenced, so his evidence was adduced through one of the Impugned Transcripts – the transcript of his investigative interview conducted May 9, 2014. His daughter, MT, was present throughout that interview and gave additional evidence at the Hearing where she had personal knowledge of her parents' investments with Fauth, as recounted above. CR acknowledged that he did not always understand everything Fauth said to him because English was not CR's first language and he found that Fauth spoke too quickly.

[108] CR was approximately 77 years old when MT referred him and MR (his spouse and MT's mother) to Fauth for investment advice in the summer of 2006. CR was not an experienced investor and said that he told Fauth right from the beginning that he had a very low risk tolerance and did not want to risk his money; he was willing to accept a lower return in exchange for security. As CR explained, "[e]very time [Fauth] came for money, I told him, I don't want to lose my money. I want guarantee." Fauth assured him, "[i]t's no risk because it's all covered with real estate".

[109] Between July 26, 2006 and March 20, 2009, CR and MR bought five Unsecured Debentures for a total of $600,000: a $180,000 Unsecured Debenture on July 26, 2006; a $120,000 Unsecured Debenture on October 17, 2007; a $100,000 Unsecured Debenture on February 1, 2008; a $100,000 Unsecured Debenture on July 25, 2008; and a $100,000 Unsecured Debenture on March 20, 2009. A Net Worth Statement in evidence indicated that in addition to their investments in Espoir (listed in the "Guaranteed Securitized Investments" category), CR and MR had invested another $300,000 in Garrington LP, Neutral Creek LP, Battle River LP and AltaEast LP. CR and MR received a Secured Debenture Solicitation Letter and a Secured Debenture Term Sheet in October 2009, but they did not pursue that opportunity.

[110] Although they did not appear to have been in evidence at the Hearing, CR testified that he executed Debenture Amendments with respect to his Unsecured Debentures in 2011. He did not recall Fauth explaining why an amendment was necessary, but agreed to the reduction in interest because he still felt 8% was a good return, and still thought the investment was secured. However, he and MR stopped receiving interest payments on their Unsecured Debentures in 2013.

Consistent with MT's testimony, the evidence indicated that the last interest payment they received was the July 17, 2013 cheque from FMM Capital for $12,000.

[111] On August 24, 2013, CR – with MT's assistance drafting – submitted a complaint to the ASC. It reiterated that CR had told Fauth repeatedly that he and his spouse had a "very low" risk tolerance, and that Fauth had assured them the Espoir Debentures were "NO risk, secured and guaranteed" since Espoir was "on title of land". However, they had subsequently been unable to "get a truthful answer out of [Fauth] as to what he has done with our money, what assets are secured against the debentures".

[112] CR noted that as of the date of the interview, he and MR had not received repayment of the $900,000 they invested with Fauth. The impact on their finances was significant; as of the date of the interview, CR stated that they only had about $50,000 in savings and chequing accounts, and another $80,000 held for them in trust by their daughter.

4. BC

[113] BC first met Fauth in the 1980s, when Fauth was selling insurance and BC's drugstore business purchased a policy from him. BC started investing with Fauth personally in late 1999 or 2000.

[114] At the time BC and his partners were in the process of selling their drugstore business, Fauth introduced him to the Espoir opportunity. BC understood that Espoir was Fauth's company, and that "it was a [sic] investment in -- in mortgages". BC used $500,000 of the proceeds from the business sale and bought an Unsecured Debenture in July 2008.

[115] BC told us that after his father died, he helped his mother, MC, with her finances. Later, when MC sold her house, she and BC used the sale proceeds to purchase three $100,000 Secured Debentures in November 2011. They purchased a fourth $100,000 Secured Debenture in 2012. After MC died in August 2012, her four Secured Debentures were conveyed to BC and his sisters, including WC.

[116] BC testified that he is an experienced investor with a fairly high risk tolerance who is willing to take some chances. With respect to Espoir, however, BC stated that he understood it was a "very low" risk investment because it was secured against assets:

> . . . my understanding was the funds were going to be secured against a -- a piece of land or . . . a house or an apartment or a condo or -- or something, but a -- but a mortgage. And it may be a first; it may be a second; or it may be a third, but it would be secured with that asset. And that was my understanding. And, really, that's what I wanted.

[117] Fauth did not tell him there was any risk of losing the funds. This was of particular importance to BC with respect to his mother's investments. He said he told Fauth it was his mother's money, "so put it in something very safe. And I understood it was going into mortgages and that it would be safe."

[118] The usual package of documentation for both the Unsecured Debenture and the Secured Debentures appeared to have been issued to BC and MC with respect to their Espoir investments. However, BC testified that he did not think Fauth reviewed the content of the Unsecured Debenture

or the Unsecured Debenture Subscription with him, and that he may not have seen the Unsecured Debenture until after he gave Fauth his $500,000. He did not recall Fauth pointing out the Debentures' "No Security" clause.

[119] Similarly, while BC had copies of the January 2007 Espoir Summary, the October 2011 Espoir Summary and the Secured Debenture Term Sheet, he was unsure whether he received them before or after the decisions were made to purchase an Unsecured Debenture and, later, the Secured Debentures.

[120] BC told us that after he bought his Unsecured Debenture, he spoke to Fauth on the telephone fairly frequently about his investments, including Espoir, but also FairWest and Royalty LP, in which he had also invested. Fauth's Espoir updates included information about the mortgage investments it was making, but BC acknowledged that Fauth did not mention any specific properties, and did not provide him with any financial statements.

[121] While he did not specifically remember receiving it, there was in evidence a copy of the September 2010 Update Letter addressed to BC. BC testified that he understood some of the mortgagors to whom Espoir had loaned money had become unable to pay the mortgage or interest, and Fauth had had to renegotiate with some of them to lower the interest rates. The September 2010 Update Letter notified investors of this development, and that Espoir would have to reduce the interest rate on the Debentures because it could no longer afford to pay 10.5%. BC was not happy about this development but accepted it because he thought Fauth was doing the best he could and it would all work out in the end – especially since BC understood Fauth had invested his own money in Espoir.

[122] BC's Unsecured Debenture matured July 30, 2011, but he agreed to roll it over for another term. In October 2011, he executed a Debenture Amendment similar to most of the other Debenture Amendments in evidence, except that he was one of the investors who negotiated the additional 2.5% per annum "Balloon Fee". Even at 8%, he still considered it a decent investment with a decent return, "as long as you have an asset that's with it".

[123] BC thought that he received interest payments on his Debentures until early 2013 – demand letters he sent to Fauth suggested the last payment was dated March 31, 2013. Fauth had recommended BC send formal demand letters, as Fauth "thought that he would be covered by insurance for Espoir". However, BC never received repayment of his Unsecured Debenture, nor have he and his sisters received repayment of the Secured Debentures they inherited from their mother.

[124] One of BC's sisters (WC) and her spouse (TB) invested in Espoir's Secured Debentures on BC's recommendation. TB testified at the Hearing, and his evidence is summarized later in these reasons. BC was asked during his evidence what he knew about TB's and WC's experience with Espoir. He confirmed TB's evidence that "their quality of life has been hampered and, in fact, devastated by -- by these events".

[125] By contrast, even though BC invested around $3 million with Fauth and lost all of it, he indicated that he was diversified enough that he was not financially devastated by the loss.

5. TS

[126] TS was introduced to Fauth and Fauth Financial by his nephew, TP, in approximately 2011, for the purpose of obtaining investment advice. Prior to meeting Fauth, TS had only invested in mutual funds, so he was "looking for a better way" to invest his money. In addition to other possible investments, Fauth outlined the Espoir opportunity for TS and TS's spouse, and told them that "it was a very secure investment". He gave them a copy of the January 2010 Espoir Summary, indicating that it set out a list of "what he was going to put the money into when he got the money" – i.e., "money market, treasury bills, banker acceptance, commercial papers, guaranteed investment bonds, debentures, promissory notes, and lease papers", as shown on the document.

[127] Fauth also told them that when he put Espoir money into first and second mortgages, "the debenture would be first on title if something happened to these mortgages". However, TS acknowledged on cross-examination that other than what is shown on the January 2010 Espoir Summary, Fauth did not provide specifics as to how Espoir's money would be invested.

[128] TS told us that he invested in Espoir because of the 8% return, and because he understood that Espoir Debentures involved "[v]ery little risk". While it was not important to him that Espoir specifically invest in mortgages secured on title, he would not have invested in Espoir if he had known the money would be invested in the oil and gas industry, as he considered that industry "risky" and felt that such an investment "would be not guaranteed whatsoever". Because he was retired, he "didn't have a very high risk tolerance", and his spouse was opposed to risk.

[129] TS and his spouse purchased a $200,000 Secured Debenture in August 2011. According to TS, Fauth did not point out the "No Security" clause in the Secured Debenture, but reviewed the Secured Debenture Subscription with them at the time they signed it. However, on cross-examination, TS told Fauth's counsel that during that review, Fauth did not point out the clause in the Secured Debenture Subscription which stated that the purchaser was an investor who could withstand a total loss of the investment. TS knew that his spouse would not have signed the Secured Debenture Subscription if she had seen that clause.

[130] TS and his spouse received the interest payments due on their Secured Debenture until approximately March 2013, but nothing thereafter. TS told us that losing the $200,000 has caused him "some anxiety", and frustration that he would not have those funds to leave to his grandchildren. He said he does not have "a very good attitude" about investing anymore, and has been "discouraged . . . completely" from investing in Alberta's capital market.

6. TP

[131] TP was referred to Fauth for investment advice over 20 years ago by a former employer. He considered Fauth his investment advisor throughout that time, and made various investments through Fauth Financial over the years – some of which did very well. Two that did not do well were his investments in FairWest and Espoir.

[132] TP invested in Espoir through his tree farm business. Because the business was seasonal in nature, during the off season he put its cash into short-term investments to generate a return. He would then cash the investments out when capital was needed for business operations the following season. At Fauth's suggestion, TP's tree farm loaned $50,000 to Espoir in the fall of 2011, and was apparently issued an Espoir Note. That Espoir Note was not in evidence, but other records

before us indicated that the tree farm had received interest on it at the rate of 8% per annum and that it had been repaid in full as requested by TP in April 2012.

[133] In 2012, TP's tree farm loaned a further $165,000 to Espoir under two additional Espoir Notes. The first, for $65,000, was dated January 16, 2012, and the second, for $100,000, was dated October 17, 2012. Both indicated that interest was payable quarterly at the rate of 8% per annum. Although the Espoir Notes stated on their face that they had a two-year term, TP testified that he understood they were payable on demand with 30 days' notice. Since Fauth had never given him copies of the Espoir Notes, TP had never actually seen them until Staff showed them to him prior to the Hearing.

[134] TP described his investment in Espoir as a loan "for the purpose of investing in first commercial-type mortgages". On introducing the Espoir opportunity, Fauth had told TP the funds would be invested in "commercial-type real estate opportunities and mortgages" which "were a hundred percent secured . . . by property". When asked by Staff at the Hearing how secure he had thought his investment in Espoir was, TP stated: "100 percent. I thought it was like a bank."

[135] On cross-examination, TP acknowledged that he did not receive any written materials with respect to Espoir prior to making his loans, but instead relied on what Fauth told him verbally. TP agreed with Fauth's counsel that he knew Espoir was going to invest his loan funds, and agreed that Fauth had told him the funds would be put into "short-term investments in some kind of real estate". Fauth did not mention any specific real estate, and TP agreed that he did not ask for specifics because he "trusted [Fauth]". At a later date, however, TP learned from his uncle, TS, that the funds had not been invested in real estate, but had instead been advanced to FairWest.

[136] TP drew a distinction between his investments in FairWest and the tree farm's loans to Espoir. He considered FairWest riskier (on cross-examination, he agreed with Fauth's counsel's characterization of FairWest as a "gamble"), and only invested "money that [he] was prepared to lose". By contrast, the funds loaned to Espoir were the tree farm's operating capital, which he did not want to put "in any kind of jeopardy". Therefore, he testified, he would not have given loans to Espoir if he had known those funds would be put into FairWest. He was "disappointed and shocked" to hear that that was what had occurred.

[137] Interest on the two Espoir Notes appeared to have been paid almost monthly until June 30, 2013, at which time, the payments ceased. At the time of the Hearing, the principal and remaining accrued interest on the two Espoir Notes were still outstanding

7. OH

[138] As mentioned, TP's father-in-law, OH, did not testify at the Hearing due to his precarious health. Instead, OH's evidence was adduced through one of the Impugned Transcripts – the transcript of his investigative interview conducted in September 2014. TP also answered questions with respect to his knowledge of OH's interactions with Fauth and Espoir, as TP had originally introduced OH to Fauth and was present for most (if not all) of OH's interview by Staff.

[139] At the time of the interview, OH was an 89-year-old farmer with plans to retire the following year. Through his farm's corporation, he purchased four Secured Debentures in 2011: one for $100,000 in April, one for $100,000 in October, and two for $100,000 each in November.

In October 2012, he and his spouse purchased a fifth Secured Debenture in the amount of $50,000. OH's farm corporation also loaned $200,000 to Espoir on March 14, 2012, as evidenced by an Espoir Note promising repayment of the principal plus interest at 8% per annum "on or before" June 30, 2012.

[140] OH stated that he received several information sheets with respect to Espoir from Fauth but did not think he received them prior to purchasing the Secured Debentures. He typically met with Fauth at a coffee shop to discuss a transaction, Fauth would tell him "how good it is" (we presumed "it" meant the investment opportunity), OH would give Fauth a cheque, and Fauth would send him documentation afterwards. This appeared to have included copies of the September 2009 Espoir Summary, the January 2010 Espoir Summary, the Secured Debenture Term Sheet and the Espoir Investor Capital Breakdown.

[141] OH said that Fauth told him the Secured Debentures were a safe investment, but the interview transcript suggested that OH was somewhat uncertain as to whether Fauth had specifically referred to "security" or whether OH understood what was meant by "security". Because Fauth did not provide documents to OH at their meetings, Fauth had not pointed out the "No Security" clause in the Secured Debenture. When asked why he thought the Secured Debentures were a "safe investment", OH said Fauth told him "he got so much land leased, they got leases on so much land, they're drilling for oil and all those things" and that Fauth "put everything on the rosy side". However, he understood that the funds loaned under the Espoir Note would in turn be loaned to someone who planned to purchase land in the Okotoks area for later subdivision use before the town expanded.

[142] At the Hearing, TP testified that he knew about OH's Espoir investments because he had discussed them with OH over the years. He described himself as OH's "confidante" with respect to OH's investments. TP acknowledged that he had not been present when OH met with Fauth and provided investment cheques but indicated that OH would tell him about those meetings afterwards. He described OH as a "[v]ery trusting" investor with a low risk tolerance who wanted his investments to be "guaranteed". He was of that view that it was "[a] hundred percent" important to OH that his investments be secured, and that OH would not have made the investments if he had known they were not secured.

[143] According to TP, OH understood that funds from the Secured Debentures would be used for "a secured mortgage on -- on a strip mall or some other commercial building", and that the funds loaned under OH's Espoir Note would be invested "in a piece of property that was in the Okotoks area" which would be held "for future development". OH never indicated to TP that he understood money invested in Espoir would be transferred to FairWest or any other company Fauth owned or controlled.

[144] Espoir records in evidence suggested that OH received quarterly interest payments on his Secured Debentures until April 2013, and monthly interest on the Espoir Note up to and including the end of June 2013. TP testified that as far as he knew, OH had received the interest payments indicated on those records, but he had not received repayment of his principal.

8. HM

[145] HM, a heavy-duty mechanic, ran his own oil and gas service company in southern Alberta. The company did work for FairWest, and HM initially met Fauth in that context in approximately mid-2006. Fauth talked to HM about investing in FairWest, but HM said that his company had had enough trouble collecting on invoices it issued to FairWest, so he did not want to "give them some more money on an investment side". He was not a particularly experienced investor, although he invested through an advisor and held some rental properties.

[146] Eventually, Fauth introduced HM to Espoir, and told him an investment in Espoir would generate a good return. Fauth said Espoir invested "in mortgages, second mortgages, and in property" around Alberta – and specifically mentioned investing in a strip mall in Edmonton. In an e-mail he sent to HM on December 1, 2011, Fauth indicated that Espoir's Secured Debentures were "secured by the assets of Espoir".

[147] On January 8, 2012, Fauth sent HM an e-mail giving "an overview of Esp[oi]r Capital, the history, the current status and growth plans for the future". The e-mail explained that Espoir had been established in 2002, and its business plan was "to seek out investments" with a one- to three-year time horizon. Espoir sought investments which met three criteria: (i) they "[m]ust be secured with assets that could be liquidated if required"; (ii) they must offer an "[a]bove average interest rate yield"; and (iii) the term of the investments had to be three years or less. Fauth indicated that he was including "a schedule of the type of investments Espoir selected and invests in", and attached a copy of the October 2011 Espoir Summary.

[148] Fauth's January 8, 2012 e-mail also provided the following information:

> Espoir participated in developer land mezzanine financing for land acquisition and development until the bank refinanced and Espoir's secured mezzanine financing was paid out. Espoir participated in financing on several Canmore developments. The term was usually 2 to 3 years.
>
> Financing was secured with an assignment on the actual land and the financing was never more than 50% of our appraisers [sic] valuation. The mezzanine financing interest rate ranged from 11% to 14%. Espoir invested in secured leases and lease back arrangements and also in a diversified list of other secured investments.
>
> . . . The yield on the total investments in Espoir have [sic] averaged around 11% until 2009.
>
> . . .
>
> Espoir is now investing in commercial real estate in a Joint Venture as a lender for the purchase and renovation of select commercial properties.
>
> The yield will be 9% to 11% with a term 3 years or less. Espoir will continue to be diversified and maintain 8% interest on the debentures.

[149] Also attached to the e-mail was what Fauth described as "a summary capital break down for Espoir" – the document we have referred to as the Espoir Investor Capital Breakdown. As noted, this document suggested that "VF" had invested over $1.5 million in Espoir. HM indicated that he understood from his conversations with Fauth that Fauth had put a substantial amount of his own money in Espoir, although HM did not know how much.

[150] At some point, HM also received a copy of the January 2010 Espoir Summary. He recalled discussing this document with Fauth, and testified that Fauth "kept telling [HM] that he [Fauth] was buying or investing in first and second mortgages, that he was investing in property, he was investing in that debenture project for 8 percent, and in that property in Edmonton in that mall".

[151] Ultimately, HM decided to go ahead and invest in Espoir, and mentioned three reasons: it was "a secured investment; . . . a secured debenture"; he "believed [Fauth]"; and he felt an 8% return was good given the economy at the time. Through his numbered investment corporation, HM bought a $250,000 Secured Debenture in March 2012, and bought an additional $1 million Secured Debenture in June 2012. He did not recall going through the text of the Secured Debentures with Fauth, or Fauth pointing out the "No Security" clause to him. He also did not recall if he went through the Secured Debenture Subscriptions with Fauth. However, it was HM's understanding that his money would be invested in the mall in Edmonton that Fauth had mentioned, and in first and second mortgages. He specifically told Fauth he did not want the funds to go into FairWest, and Fauth assured him they would not, as he "had other things to invest it in".

[152] On cross-examination, HM acknowledged that he had never seen a list of specific assets Espoir held, and had left it to Fauth's "discretion" to decide where, specifically, HM's funds would be used. Despite this, HM reiterated that he had had numerous discussions with Fauth during which Fauth assured him Espoir was a secured investment, and also reiterated that he had expected his funds would be used within the "categories" he and Fauth had discussed – i.e., real estate (including a mall in Edmonton) and first and second mortgages.

[153] HM testified that some time around "midsummer, early fall of 2012", he asked Fauth for the address of the Edmonton strip mall so he could have his son check it out on a trip his son planned to take to that city. Since Fauth said, "What are you talking about? There's no mall", HM asked Fauth what had been done with his money. Fauth said he had put it into mortgages. HM testified that he was "really shocked" to hear there was no mall, and that that was when he realized that he "couldn't take [Fauth] for his word anymore".

[154] HM acknowledged that he received interest payments on his two Secured Debentures until approximately the middle of 2013. From the work his service company did for FairWest, HM knew that by that time, FairWest was in financial trouble. He therefore asked Fauth if his investment in Espoir had been put into FairWest after all, and testified that Fauth admitted it had. When HM asked for his money back, Fauth told him not to worry because the money was "insured with a company down East" and Fauth was going to contact the insurer "to cover . . . these funds". HM received neither any insurance proceeds nor any other repayment of his invested principal.

[155] HM told us that losing this amount of money has caused him and his family "a lot of stress", and that when they moved from their farm into the city of Medicine Hat, they had to take out a mortgage because he did not have any cash left. His experience with Espoir soured him on investing, and he said he would never invest in the Alberta capital market again.

9. RT

[156] RT testified that he first decided to invest through Fauth Financial in the mid- to late 1990s after seeing that the investments his partner, SL, had made through Fauth over the years had paid her good returns. He could not recall what his money had specifically been put into in those years,

but based on the account statements he received, he was happy with the returns he got. He acknowledged that he was not a sophisticated investor, so he "put a lot of faith" in what Fauth told him.

[157] RT could not recall when he first heard about Espoir as an investment opportunity, but knew that SL had invested in it. Since she seemed to be receiving good returns paid regularly and on time, after RT sold his house and had the proceeds available for his retirement, he decided to invest in Espoir, too. Because they had discussed it, RT said Fauth knew that RT was using his retirement funds to purchase his $300,000 Secured Debenture in May 2012. Although RT appeared to have executed a Secured Debenture Subscription, he did not recall reading the document before signing it, or having Fauth explain it to him. He also did not recall Fauth taking him through the text of the Secured Debenture or pointing out the "No Security" clause. Instead, RT had relied on Fauth's word that the investment was secured.

[158] RT told us that before he decided to put his $300,000 into Espoir, Fauth tried to convince him to invest in FairWest. He had not been interested, as he did not think it was a secure investment like Espoir. Fauth always "stressed" that Espoir was "secured", although he did not specifically explain how. Based on their conversations, however, RT said he had understood investments in Espoir were secured by real estate – "property and stuff". While he acknowledged that Fauth never specifically told him how his money would be used, Fauth did not tell him the funds might go to Fauth personally, or to FairWest, FMM Capital, or any of the oil and gas limited partnerships. RT said he would not have bought the Secured Debenture if he had had such information, or if he had known that his funds might be lost.

[159] RT had in his possession the September 2009 Espoir Summary and the October 2011 Espoir Summary. He thought he had received them from Fauth and that Fauth gave him the October 2011 Espoir Summary when they met to complete the investment paperwork. RT also had a copy of the Secured Debenture Term Sheet, which he thought either he had received or SL had received from Espoir. SL was the recipient of a Secured Debenture Solicitation Letter which made reference to an enclosed "Term Sheet".

[160] RT acknowledged receiving some payments of interest on his Secured Debenture, but noted that payments ceased in 2013. He has never received repayment of his principal. He told us that he has since concluded his money – which he described as his "life savings" – has been lost.

10. TB

[161] As mentioned, TB is married to BC's sister, WC. Although WC had held a few investments through the Raymond James firm in the past, TB and WC had put most of their money into their house in Ontario, which they planned to sell upon retirement and move to B.C. They wanted to find a short-term investment in which they could place the proceeds from their house sale "for a short period of time that would be safe and secure and show a good amount of return" until they made their move and purchased a new house. BC suggested that TB and WC consult Fauth, and put them in touch with Fauth in 2012.

[162] TB recalled speaking to Fauth on the telephone in late August 2012. Fauth told him and WC about Fauth Financial's financial planning services and the Espoir opportunity. Fauth said

that any funds they invested "would be going into commercial real estate mortgages, first and second mortgages, shopping centres and business office buildings and that kind of thing". According to TB, he and WC had explained to Fauth on the telephone that the money from their home was "basically, [their] life savings and that [they] couldn't afford to lose it". Consequently, they needed to invest in something secure with no risk of loss. In an e-mail to TB following the telephone conversation, Fauth confirmed his understanding that, "[t]he immediate priority is to consider a secured investment strategy that will give you an income of $50,000 a year from a portion of the proceeds from the sale of your home".

[163] In late September 2012, Fauth sent an e-mail to TB advising that he was attaching "an Investment Summary, a Sample Debenture and a Subscription Agreement" – the October 2011 Espoir Summary, a blank Secured Debenture and a blank Secured Debenture Subscription. Based on the October 2011 Espoir Summary, TB testified that he understood that "whatever investment we made would be secure", and that "our investment would be returned at 8 percent, paid quarterly, and that we would be buying debentures that were secured by, our understanding was, through our conversation on the telephone, commercial real estate mortgages and office buildings and shopping malls".

[164] TB and WC met with Fauth in Toronto in October 2012. When asked what Fauth told them about Espoir at the meeting, TB replied in part:

> [Fauth] said that it was a secured investment -- secured and that our money would be going into commercial real estate, mortgages, shopping malls, and office buildings and that the investment was secured by those properties; and in the case that the mortgagee would default, they would seize the buildings, sell them, and return our investment by the money they recouped from the sales of the buildings.

[165] As TB wanted their money to go exclusively into "first and second commercial mortgages" and none of the other categories on the October 2011 Espoir Summary list, he had Fauth "X" out the top section on a copy of that document, write "investment in first and second commercial mortgages" on it, and initial it. However, TB said he sent the document with these notations back to Fauth with their completed investment paperwork, so it was not in evidence at the Hearing.

[166] At the October 2012 meeting, TB and WC also "emphasized [to Fauth] the fact that these were [their] life savings and that [they] couldn't afford to lose any of the money", as they were going to need it shortly to buy a new house when they moved. Fauth reiterated "how secure . . . this investment was", and assured them that "he had never lost a penny of anyone's money and didn't intend to do so now".

[167] Having heard about FairWest's financial difficulties from BC, TB noted that he specifically advised Fauth they did not want any of their money to go into FairWest. Fauth assured them at the October 2012 meeting that it would not. TB told us that he and WC would not have invested in Espoir if they had known their funds would be used for FairWest, or that their investment was not secured.

[168] TB further recalled that at the meeting, Fauth showed them the Espoir Investor Capital Breakdown or something similar, which indicated that 70.18% of Espoir's funds were in

"Mortgages". This list reinforced the assurance Fauth had given them that their money would go into commercial mortgages and real estate.

[169] TB summarized the reasons why he and WC made the decision to go ahead and invest in Espoir:

> During our meeting, Mr. Fauth stressed that these were secured investments that would go into commercial real estate mortgages. He went on at length about what good Christians he and his family were and how they had more money than they would ever need; so they did good in the world by helping other people to have secure investments for their future.
>
> And, basically, he convinced us that he would do what he said he was going to do, that he would invest our money safely and securely in commercial investments -- mortgages and that we would see the return he promised us and that when we need to, we could get the money out to buy a house, and that none of our money would go anywhere near FairWest.

[170] By November 2012, TB and WC were closing the sale of their Ontario home, and TB e-mailed Fauth to indicate that once they had the proceeds, they would contact him "regarding an investment in Espoir". In his reply, Fauth wrote: "If you decide to use the 8% Espoir Capital Debenture as an investment to receive quarterly income for a period of time, we can build your financial plan projections around that secured base of income." At the Hearing, TB said that Fauth's reference to a "secured base of income" again gave them assurance their investment was secured: "On -- on many of the communications -- almost all of the communications we had concerning Espoir with Mr. Fauth, this statement of secured investment was included, and so it led us to further believe that our investment would be secured."

[171] In mid-November 2012, TB and WC invested $500,000, signed a Secured Debenture Subscription, and received five Secured Debentures worth $100,000 each. At around the same time, WC inherited the aforementioned $100,000 Secured Debenture she had been left by her late mother, MC.

[172] During his testimony at the Hearing, Staff pointed TB to the "No Security" clause in the Secured Debenture. TB indicated that he "didn't really have a full understanding of it at any time". He reiterated that he and WC understood the Espoir investment was "low risk" because of the security in place. They also relied on Fauth's assurance that "our investment was safe with him".

[173] When the interest payment due in July 2013 did not arrive, TB called and e-mailed Fauth to inquire. Fauth told TB "there was a problem at Espoir" and he was "restructuring", but assured him they should not worry "because [their] investment was safe".

[174] TB testified that in a telephone conversation that October, Fauth admitted that TB's and WC's money had gone from Espoir to FairWest despite his promise to the contrary. However, in subsequent e-mail communications with TB, Fauth stated that he had been mistaken, and that "the debenture funds Espoir received from you, none of these funds went to Fairwest [sic] Energy. Espoir has [sic] put funds into Fairwest [sic] years earlier and my reference to that was not specific to funds received from you."

[175] TB and WC had various communications with Fauth in the subsequent weeks, generally to plead for repayment of their investment funds. Ultimately, they retained legal counsel and filed a Statement of Claim against Fauth in late October 2013. They also filed a claim in Fauth's bankruptcy. They received $22,000 from that process in March 2017, but as of the date TB testified at the Hearing, they had not heard anything about their claim since.

[176] According to TB, the impact of his and his spouse's experience with Fauth and Espoir has been devastating. Both have experienced a range of physical, emotional and mental health issues they attribute to the loss of their life savings, and suffered a significant attenuation of the lifestyle they expected to enjoy on retirement – both needed to resume work on at least a part-time basis, and they could no longer afford to buy their own home. When TB was asked by Staff if he will ever invest in the Alberta capital market again, he replied, "[n]ever".

E. KG's Evidence

[177] In addition to the Staff witnesses and investor witnesses who testified at the Hearing, Staff led evidence from Fauth's former colleague, KG. As mentioned, from approximately 2005 to 2011, KG provided financial services to clients through Fauth Financial, including life insurance and mutual fund sales. At the time he testified at the Hearing, he was a vice-president at a private investment counselling firm, and in charge of its Calgary office.

[178] KG confirmed that while Fauth stepped back from financial planning when he (Fauth) was focused on running FairWest, Fauth was still the only person who was involved in promoting investments in Espoir. Although KG was not present when clients met with Fauth about Espoir, KG said that he had some knowledge of what was discussed through either his conversations with those clients after the fact, or his conversations with Fauth. It was his understanding that Fauth told people money invested with Espoir would be invested further "with developers", and that the investments were guaranteed. He also recalled Fauth telling him some of the money was put into banker's acceptance paper and a money market fund. While he did not know for certain where the funds were actually going, he "trusted what [Fauth] said he was doing with the money" and relied on Fauth's assertion that lawyers had "checked [Espoir] through, and it was all legal and aboveboard".

[179] Eventually, however, KG said he started to have some concerns about "[w]hat was potentially happening on the investment side" at Fauth Financial, including with respect to the Espoir Debentures. Although Debenture holders were still receiving their interest payments when they were due at the time KG left Fauth Financial in 2011, he testified that he had been contacted prior to his departure by Fauth Financial clients who were having difficulty getting Fauth to pay out their principal when their Debentures matured. As a result, he became increasingly uncomfortable with the situation and "the fact that people couldn't get their money out". In response to a question from the panel, KG also told us that he had concerns about the suitability of an investment in Espoir for some clients, but felt "it was out of [his] hands".

[180] As discussed later in these reasons, Fauth Financial, the Fauths and the Fauths' son, Sean Fauth, issued invoices to Espoir in January 2014 which were used to offset various amounts those parties owed to Espoir. Although he was no longer working at Fauth Financial when the invoices were issued, because the invoices indicated they covered the time period from 2002 or 2003 through 2013, KG was asked at the Hearing whether he knew anything about the services billed.

He said that he had no idea why Fauth Financial would invoice Espoir for "Operational Services", or why Sean Fauth would invoice Espoir for "Economic and Financial Modeling" when it was his understanding that Sean Fauth did not have a background in that area. In addition, KG indicated that he did not think Fauth disclosed to clients that he (Fauth) was invoicing or would invoice Espoir for over a million dollars in management and director's fees.

F. Sources and Uses of Espoir Funds

[181] EAQ is a former Staff investigative accountant. He specializes in investigative and forensic accounting and is a certified fraud examiner. He prepared a source and use analysis (**Source and Use Analysis**) with respect to Espoir funds for the period from January 1, 2009 through September 30, 2014 (**Financial Review Period**) based on Espoir's banking records and other documents collected during the course of the investigation. EAQ noted that there were no significant transactions in Espoir's bank account after September 30, 2014, at which time its balance was $57.45.

[182] Fauth did not call any evidence in specific response to Staff's Source and Use Analysis, although his counsel cross-examined EAQ at the Hearing. In addition, Fauth answered questions with respect to Espoir's source and use of funds during his Interview, and produced some of the financial information used by EAQ to prepare the Source and Use Analysis. EAQ attended Fauth's Interview and asked many of the questions concerning financial matters.

1. Sources

[183] According to the Source and Use Analysis, less accounting adjustments of $45,000 for a returned cheque and an erroneous deposit, $8,453,915.49 was deposited to Espoir's bank account during the Financial Review Period. This was comprised of:

- $4,162,000 raised from Espoir Debentures and $545,000 raised from Espoir Notes;
- $3,743,947.14 received from non-arm's length parties;
- $2100 in income from an investment in a third-party real estate company; and
- $868.35 in bank fee rebates or reversals.

[184] The Debentures and Espoir Notes issued during the Financial Review Period included ones issued to CR and MR, BC and MC, TS and his spouse, RT, TB and WC, OH and his spouse, OH's company, TP's company, and HM's company. No Debentures or Espoir Notes appeared to have been issued after the end of December 2012.

[185] The non-arm's length parties who made payments to Espoir during the Financial Review Period included the Fauths, Fauth's sister (SS), and a number of partnerships and corporations controlled by Fauth or other Fauth family members (or both) – including FairWest, Fauth Financial, Royalty LP, AFM Management, AltaEast LP, FMM Capital and Battle River LP. While it was not always possible to determine from the evidence the purpose of these payments, it was clear that $400,000 was paid to Espoir by Royalty LP to purchase four $100,000 Secured Debentures. Most of the other payments to Espoir by non-arm's length parties seemed to represent

interest or repayments of principal owed on loans Espoir had made to those parties. A few may have represented investment income or investment in Espoir without issuance of a Debenture.

[186] Some of the loans on which payments were made during the Financial Review Period were apparently given by Espoir prior to January 1, 2009, as the total amount of payments into Espoir's account by non-arm's length parties during that time exceeded the payments out.

[187] Although the Espoir Investor Capital Breakdown indicated that at some point in time "VF" had invested $1,589,319 in Espoir, EAQ testified that the financial records he reviewed did not support this figure. The Source and Use Analysis showed a total of $706,055 deposited to Espoir during the Financial Review Period by the Fauths and the "Vern Fauth Investment Account". There were no Debenture certificates or Espoir Notes in Fauth's name among the Hearing exhibits, and Fauth stated during his Interview that neither he nor any companies he controlled invested in Espoir Debentures. Apart from the Secured Debentures purchased by Royalty LP, which were all redeemed early, this is consistent with the other evidence.

2. Uses

(a) Overview

[188] According to the Source and Use Analysis (less the mentioned $45,000 in accounting adjustments), $8,531,124.25 was paid from Espoir's bank account during the Financial Review Period. This was comprised of:

- $5,851,581.24 in interest and principal paid to holders of Debentures and Espoir Notes;
- $2,585,414.87 in payments to non-arm's length parties;
- $82,053.14 in business expenses (i.e., professional fees, banking fees and telephone bills); and
- $12,075 representing two cheques EAQ was unable to allocate to an identifiable payee.

[189] EAQ concluded that funds received by Espoir – including those received from investments in Debentures and Espoir Notes – were generally used for three things: (i) to pay interest and principal owed to Espoir investors; (ii) to benefit the Fauths through the payment of management fees and transfers to other companies; and (iii) to benefit entities related to Fauth or over which Fauth had "significant influence".

[190] EAQ testified that he saw no uses of Espoir funds during the Financial Review Period that would match any of the investment categories listed on the Espoir Summaries or the Espoir Investor Capital Breakdown. As he reviewed some of Espoir's financial records with Fauth during the Interview, EAQ asked Fauth how certain specific Espoir investments fell within those investment categories, and also whether Fauth could point out any investments Espoir had made which did. Fauth acknowledged that the ones he was asked about did not fall within the categories and that he could not point to any which did – apart from a handful of first and second mortgages discussed below. While he speculated that some Espoir funds may have been temporarily

"park[ed]" in money market funds, treasury bills or bankers acceptance paper from time to time, he agreed that such investments were never a large part of Espoir's business, and would only have been made with excess funds before they were used for something else.

[191] Among other inquiries, the Summons issued to Fauth by Staff asked for details as to how Espoir used funds from investors, including a description of: (a) "specific investment products money was invested in;" (b) "names of corporations money was invested in;" and (c) "types of security Espoir Capital received in connection with its investments". Fauth's written response to (a) was: "Espoir Capital invested in mortgages, business loans, public company shares, personal loans, promissory notes, limited partnership units, Fairwest Energy Inc. shares, loans, debentures and promissory notes." His response to (b) was: "Fairwest Energy Inc." His response to (c) was: "Fairwest Energy Inc. shares were unsecured common shares."

(b) Espoir Investors

[192] The holders of the Debentures and Espoir Notes who received payments from Espoir during the Financial Review Period included RP and KP, MT, CR and MR, BC and MC, TS and his spouse, OH and his spouse, OH's company, HM's company, RT, TB and WC, and TP's company. The last such payment appeared to have been made in July 2013. Some of the payments were made on Debentures originally issued prior to the Financial Review Period, but some were made on Debentures and Espoir Notes issued during the Financial Review Period.

[193] According to EAQ and Espoir's financial records, during the 2006-2013 period, funds newly invested in Espoir were used to pay interest and principal to previous investors because none of the businesses Espoir had invested in or loaned money to generated sufficient income. EAQ characterized such payments as indicative of a Ponzi scheme. For example, Espoir's 2009 financial statements and trial balance show receipt of interest and other revenue for the year in the amount of $752,190, but interest paid on long-term debt (i.e., the Debentures) in the amount of $978,540. Espoir's 2010 financial statements and trial balance show receipt of interest revenue for the year in the amount of $682,381, but interest paid on long-term debt in the amount of $1,002,922.

[194] During his Interview, Fauth initially indicated that Espoir had income from loans and investments – including loans to and investments in FairWest – and used that income to pay the interest owed to its investors. Later in the Interview, however, he confirmed that funds from newer Espoir investors were used to make payments to existing investors.

[195] As mentioned, Espoir's financial records showed it owed its Debenture holders $12,379,726.14 by the end of 2014. Fauth thought this included both principal and unpaid interest. During his Interview, he stated that while he would like to pay this debt, he agreed that he had no "realistic plan" to enable him to do so.

(c) Non-Arm's Length Parties

[196] The non-arm's length parties who received payments from Espoir during the Financial Review Period included Fauth, Fauth's sister, and partnerships and corporations controlled by Fauth or other Fauth family members (or both) – including FairWest, Fauth Financial, AFM Management, AltaEast LP, FMM Capital and Royalty LP. Espoir's payments to Royalty LP included repayment in full of Royalty LP's four $100,000 Secured Debentures prior to their

maturity dates, and payments of interest on those Secured Debentures. As mentioned, Royalty LP was controlled by Fauth through AFM Management.

[197] Where it was possible based on the financial records to ascertain the purpose of Espoir's payments to the other non-arm's length parties, they appeared to fall into several general categories: (i) loans to or investments in those parties; (ii) payments of interest and repayments of principal on loans made by those parties to Espoir; and (iii) payments of fees or expenses. Fauth provided some additional information with respect to the payments during his Interview, as follows:

- Espoir loaned funds to AFM Management for operations, and to enable AFM Management to purchase oil and gas assets. Fauth could not recall the loan terms or whether a loan agreement was entered into, but did not think AFM Management paid the loan back.

- Espoir funds were used to make loans to and purchase units of the related limited partnerships. Fauth was initially unsure if this included units of AltaEast LP, but the financial records in evidence suggested that Espoir bought 100 AltaEast LP units in 2009 for $100,000. Later in the Interview, Fauth acknowledged that $98,465.07 of this sum had been written off by the end of 2009 as a partnership loss.

- While the Source and Use Analysis indicated that FairWest received $330,000 from Espoir during the Financial Review Period, Fauth estimated that in total Espoir invested approximately $1 million in FairWest. Espoir also made periodic short-term loans to FairWest, but Fauth stated that FairWest always repaid them. However, he acknowledged that Espoir did not ultimately recoup all of its investment in FairWest.

- Espoir loaned money to Fauth Financial, which Fauth Financial then invested in or loaned to FairWest and the related oil and gas limited partnerships. Fauth testified that Fauth Financial may also have used some of the money to fund its operations, make other investments and loans, or even make payments to him. However, he could not account precisely for all of the uses to which it had been put: ". . . I don't know exactly what it was, but, you know, it was used".

- In addition to fees Espoir paid to Fauth and his family members "for services rendered", Espoir loaned money to them which they then invested in FairWest and the related oil and gas limited partnerships, or used to purchase real estate. According to Fauth, there were no written loan agreements for these loans. In his written response to an inquiry posed by investigative Staff in the Summons, Fauth advised that:

> Espoir Capital owed amounts to Vern Fauth and Sharon Fauth for their years of services rendered to Espoir Capital. During those years of service there were various deposits and withdrawals to or from Vern Fauth and Sharon Fauth, with withdrawals being money advanced to them and utilized by them to invest, and deposits being money returned to Espoir Capital by Vern Fauth or Sharon Fauth as repayments of such advances (with interest), all of which occurred prior to

> 2014. In January 2014 the residual amount owing from Espoir Capital to Vern Fauth and Sharon Fauth for their services was invoiced by Vern Fauth and Sharon Fauth to Espoir Capital, and that amount owing to them by Espoir Capital was paid by being set off against the remaining debt owed to Espoir Capital by Vern Fauth and Sharon Fauth, the result being a zero balance remaining payable by Vern Fauth and Sharon Fauth to Espoir, and a very minor remaining balance payable by Espoir Capital on the services invoices issued to it by Vern Fauth and Sharon Fauth.

- Espoir loaned money to FMM Capital so the latter could help start a trucking company. Fauth did not think there was a written loan agreement, and by the time of his Interview, the trucking company had no value.

[198] Based on Espoir's financial records in evidence, we made some additional observations with respect to non-arm's length transactions both before and during the Financial Review Period (some of which were also pointed out by EAQ during his testimony):

- As at the end of 2006, Espoir was owed at least $6,420,693.96 by non-arm's length parties, including $2,066,437.14 owed by the Fauths under a promissory note, $2,285,156.82 owed by Fauth Financial, and $94,100 owed by Sean Fauth and Darin Fauth. This total also included loans to Axiom (discussed further below) and a loan to 1162816 Alberta Ltd. Fauth indicated that the latter two were later repaid.

- As at the end of 2007, the total owed to Espoir by non-arm's length parties had increased to at least $7,396,087.89, including $1,790,088.90 owed by the Fauths, $4.2 million owed by Fauth Financial, and $126,100 owed by Sean Fauth and Darin Fauth. Espoir had also made a $500,000 investment in FairWest in 2007.

- As at the end of 2008, the total owed to Espoir by non-arm's length parties had increased to at least $7,493,789.71. This included $1,937,679.71 owed by the Fauths under a promissory note and a mortgage, $4.2 million still owed by Fauth Financial, and $126,100 still owed by Sean Fauth and Darin Fauth. Espoir still held its $500,000 investment in FairWest, and added another $210,000 in FairWest shares during the year. It had also invested $200,000 in Battle River LP, which was written down to $21,244.36 by year's end.

- As at the end of 2009, the total owing to Espoir by non-arm's length parties had decreased to at least $7,052,519.80. This included $1,941,149.89 owed by the Fauths under a promissory note and two mortgages, $4.2 million still owed by Fauth Financial, $126,100 still owed by Sean Fauth and Darin Fauth, and $242,000 owed by FairWest on two loans. Espoir had maintained its $710,000 investment in FairWest, and the value of its investment in Battle River LP was adjusted upwards to $34,443.82. Espoir invested $100,000 in AltaEast LP in 2009, which was written down to $1534.93 by the end of the year.

- The numbers as at the end of 2010, 2011 and 2012 remained fairly consistent overall. At the end of those years, non-arm's length parties owed Espoir at least $6,764,419.91, $7,710,679.31 and $7,354,150.81 respectively. Of note was that:

(i) the balance on the promissory note from the Fauths was down to zero by the end of 2010, although the mortgage receivable of $1,730,000 remained owing; (ii) in 2011 and 2012, $1,246,990.30 in unpaid interest was reclassified from accounts receivable to amounts due from non-arm's length parties, accounting in part for the increase in that total from 2010 to 2011; and (iii) in 2012, $1,413,406.43 in unpaid interest was owed to Espoir by Fauth Financial. The value ascribed to Espoir's investments in FairWest, AltaEast LP and Battle River LP increased from $725,826.13 in 2010 to $911,901.76 in 2011 and 2012, largely because an additional $200,000 was ascribed to the value of Espoir's investment in FairWest in 2011.

- By the end of 2013, $7,163,272.39 in debt owed to Espoir by non-arm's length parties (including $5,940,406 in principal and interest owed by Fauth Financial) was written off as uncollectible, as was the $911,901.76 in investments in FairWest, AltaEast LP and Battle River LP. The mortgage receivable of $1,730,000 remained owing by the Fauths, as did the $126,100 owed by Sean Fauth and Darin Fauth.

- In 2014, as described in Fauth's Summons response cited above, the mortgage receivable owed to Espoir by the Fauths was reversed and offset by invoices the two issued for services ostensibly rendered from 2002 through 2013. Similarly, the amount owing by Sean Fauth was offset by an invoice he issued for ostensible past services rendered from 2003 through 2013. A balance of $574,560 was shown as owing to Fauth Financial as at the end of 2014 further to an invoice it issued for "Operational Services" rendered from 2002 through 2013.

[199] With respect to how Fauth Financial used the $4.2 million it had been loaned by Espoir as of October 31, 2007, EAQ testified that he obtained yearly trial balances for Fauth Financial prepared by its accounting firm. Those records disclosed that between mid-2006 and the end of October 2013, Fauth Financial had made a few investments in accounts held with third-party investment firms, as well as investments in FairWest and other entities with links to Fauth or members of his family. However, the total did not approach $4.2 million. Moreover, while the investments in FairWest appeared to have generated some relatively small amounts of income for Fauth Financial in 2006 and 2007, by October 31, 2012, they had been written down as impaired.

[200] It was therefore unclear how the full $4.2 million Espoir loaned to Fauth Financial was used. When asked about this during his Interview, Fauth indicated that approximately $1.6 million had been invested in FairWest, and, as mentioned, he speculated that the balance had either been loaned or paid to him, used for operations, or invested, including investments in the related oil and gas limited partnerships.

3. Security

(a) General

[201] Related to the issue of Espoir's use of funds is the question as to whether any of Espoir's loans or investments were protected by security. Fauth was asked a number of questions about security for investments in Espoir and security for investments Espoir made using the funds it raised from the public.

[202] With respect to the former, Fauth told investigative Staff that the security for both the Unsecured Debentures and the Secured Debentures was "the assets that were in . . . Espoir . . .". When asked how those assets were "secured for the [D]ebenture holders' benefit", he said: "Well, they weren't. They were just -- they were just assets." He drew no apparent distinction between the Unsecured Debentures and the Secured Debentures in this regard and referred to them as "exactly the same" – both were secured by "the assets of the company".

[203] With respect to any such assets of the company, Fauth was asked if he secured them "through land titles or through personal property security". He advised that he did not. When questioned about specific loans or investments Espoir had made involving non-arm's length parties – including those reflected in the Source and Use Analysis – he indicated that either they were not secured, or he did not think they had been secured.

[204] In the Summons, Fauth was asked: "If Espoir Capital sold securities that were secured, provide confirmation as to whether the security was in real estate or other property and whether the security was registered through a land registry system, or through a personal property registry system". Other than a general reference to the Secured Debentures being "secured against Espoir Capital's assets", Fauth's response referred only to two second mortgages Espoir was granted on properties he and Sherri owned in Edmonton and Calgary. Those mortgages are discussed further below.

(b) General Security Agreements

[205] Fauth gave several undertakings during his Interview to produce loan documentation relating to Espoir's loans to Fauth Financial and to Axiom. In response, he provided a copy of an October 31, 2007 General Security Agreement between Fauth Financial as "Debtor" and Espoir as "Secured Party". Pursuant to this document, Fauth Financial pledged security "over all of its present and after-acquired property including its accounts receivable as security for all monies owing or which may become owing" to Espoir. In addition, an associated October 31, 2007 $4.2 million "floating charge debenture" gave Espoir "a floating charge and security interest" over all of Fauth Financial's assets. However, the financial records in evidence suggested that the size of the debt well exceeded Fauth Financial's assets, at least during the 2006 to 2013 period. Fauth Financial reported net losses in each of those years.

[206] In further response to his undertakings, Fauth produced a copy of a Loan Agreement between Axiom (as borrower) and Espoir (as lender). The Loan Agreement was dated August 4, 2005, and provided that Espoir would loan Axiom $100,000 secured by a 12-month, 11% promissory note and a General Security Agreement. The General Security Agreement was dated April 15, 2005 and applied not only to the $100,000 loan, but also to ". . . all loans and advances made by the SECURED PARTY to the DEBTOR including all future advances and re-advances . . .". The collateral was "[a]ll of the DEBTOR'S present and after-acquired personal property".

[207] The total of Espoir's outstanding loans to Axiom between April 2005 and December 2008 reached as high as $2.1 million, but the loans were paid in full with interest by early February 2009. The final $660,909.59 in principal and interest payments from Axiom to Espoir in January and February 2009 were reflected in the Source and Use Analysis.

(c) Mortgages

[208] EAQ testified that based on his review of Espoir's financial records, since at least 2005, Espoir only ever held three third-party mortgages worth a total of $351,000. All three were extant as of the end of 2005 but appeared to have been paid out in full by the end of 2007.

[209] Subsequent to those, the only other mortgages reflected in the evidence were the ones associated with properties owned by the Fauths and mentioned above. While the Fauths had owed Espoir $1,790,088.90 under a promissory note as of the end of 2007, that figure was reduced to $1,157,679.71 by the end of 2008 because it had been offset by a $780,000 mortgage receivable relating to a property in Edmonton. That amount was further reduced to $211,149.89 by the end of 2009, as it was offset by an additional $950,000 mortgage receivable relating to a property in Calgary.

[210] The Edmonton property was purchased by the Fauths in early 2003 for $287,500. Although Fauth initially suggested that the funds for the purchase may have been raised by leveraging other real estate he and Sherri owned, he acknowledged that they had actually borrowed the purchase money from Espoir once he was shown the relevant Espoir banking records. In September 2007, a $450,000 ING Bank of Canada mortgage was registered on title. On December 15, 2008, the $780,000 second mortgage in favour of Espoir was registered on title. Although no money was paid on the second mortgage, it was discharged on January 23, 2013.

[211] The Calgary property was purchased by the Fauths in late 2003 for $320,000. While it was ultimately unclear from both Fauth's evidence and Espoir's financial records whether the Fauths borrowed the money from Espoir in order to purchase this property, Fauth acknowledged that it was possible they had done so. In September 2007, a $573,750 TD Bank mortgage was registered on title, and, according to Fauth, the mortgage funds were directed to FairWest. On December 8, 2009, the $950,000 second mortgage in favour of Espoir was registered on title. Although no money was paid on the second mortgage, it was discharged on January 23, 2013. The property was sold to a third party in June 2013 for $650,000, but according to Fauth, none of the proceeds were paid to Espoir.

[212] During his Interview, Fauth confirmed that the Espoir second mortgages on the Edmonton and Calgary properties were for amounts higher than the fair market value of the properties at the time. He explained that no mortgage funds had actually been advanced by Espoir; the mortgages had been placed on the titles simply to "put some more security for Espoir on its balance sheet". The mortgages were later discharged because they had no value, being well in excess of the remaining equity in the properties after consideration of the first mortgages.

V. ANALYSIS

[213] We set out earlier the allegations made by Staff in their NOH. We now set out the law relevant to the allegations and analyze each in turn.

A. Limitations

1. The Law

[214] From 2002 through December 16, 2014, s. 201 of the Act provided that "[n]o proceedings under this Part [i.e., Part 16 of the Act, Enforcement] shall be commenced in a court or before the

[ASC] more than 6 years from the day of the occurrence of the event that gave rise to the proceedings."

[215] As of December 17, 2014, the section was modified slightly to provide that "[n]o proceedings under this Part shall be commenced in a court or before the [ASC] more than 6 years from the day of the occurrence of the last event on which the proceeding is based."

2. Staff's Position

[216] In the NOH, Staff alleged that Fauth's conduct in soliciting investors, taking investment funds, providing false and misleading information to investors and disbursing proceeds in ways that were inconsistent with representations to investors constituted a "continuing course of conduct".

[217] In their final written submissions (**Staff Argument**), Staff contended that none of the allegations in the NOH were limitation-barred by s. 201 of the Act, and that Fauth engaged in a continuing course of conduct with respect to Espoir which started in 2002 and continued until 2014. Staff characterized it as a continuing course of conduct because early investors were led to believe the same thing about the security of an investment in Espoir as were later investors. Staff pointed to the fact that at the time Fauth started asking investors to enter into the Espoir Amendments, the reason he gave was that the underlying mortgagors were having trouble making their interest payments – which Staff argued was a continuation of the original representations Fauth made to investors about their funds being used to invest in mortgages. At the time of the last Espoir investment – that of TB and WC on November 19, 2012 – Fauth was still telling investors the same story about secure investment in real estate or mortgages.

[218] In support of their position, Staff relied on the recent ASC decision in *Re Breitkreutz*, 2018 ABASC 37, a matter with respect to which a notice of hearing was issued on August 22, 2016 alleging a fraud that occurred between August 1, 2006 and September 24, 2015. They also cited *R. v. Aitkens*, 2015 ABPC 21, and *Re Williams*, 2016 BCSECCOM 18.

3. Fauth's Position

[219] While there was no analysis of any of the applicable law or direct consideration of the arguments made by Staff, the Fauth Argument relied on a six-year limitation period extending from the date the NOH was issued in May 2016 back to May 2010.

[220] The May 2010 date was significant, Fauth argued, because Espoir paid investors approximately $2 million more than it took in from investors during the Financial Review Period (we note that according to the Source and Use Analysis, the difference was actually closer to $1.15 million). Therefore, "any personal benefit that may have accrued to Vern Fauth (or Fauth related entities) occurred only in the time period prior to the limitation period" (emphasis in original). Thus, he argued, "any benefit from any alleged wrongdoing, occurred if at all only prior to the May 2010 limitation period".

4. Discussion and Conclusion on Limitations

[221] Since the NOH was issued on May 11, 2016, the operative date for the purposes of s. 201 of the Act was, as Fauth indicated, in May 2010 – specifically, May 11, 2010. Accordingly, we needed only consider any effect of s. 201 on the allegations that Fauth breached ss. 92(4.1) and

93(b) of the Act. The breaches of s. 75(1)(a) alleged in the NOH all occurred after May 11, 2010 and therefore within the six-year limitation period.

[222] The misrepresentation and fraud allegations in the NOH overlapped in that both arose from the same alleged events: that Fauth told Espoir investors their funds were secure because Espoir would only invest those funds in certain types of investment vehicles, but he instead caused Espoir to use the funds in a manner inconsistent with what had been represented.

[223] The investors who testified at the Hearing purchased Debentures or loaned money under Espoir Notes as early as January 2003 (RP and his spouse, KP), and as late as November 2012 (TB and WC). As discussed in more detail later in these reasons, all of the investors who testified told a similar story with respect to what Fauth said about Espoir and its business model, and all had a similar understanding as to how their funds would be used and what that meant for the level of risk of their investments. This and the ongoing payment of returns induced some early investors to keep funds with Espoir past initial maturity dates and to purchase additional Debentures or make additional loans.

[224] In addition, the investors received documentation with respect to Espoir and its business model which was consistent with their understanding and which varied little – if at all – over the same period of time. Other communications Fauth sent to Espoir investors over the years reinforced that understanding, including the communications concerning the reasons Espoir had to reduce the interest rate it paid from 10.5% to 8% per annum. These representations induced investors to enter into Debenture Amendments extending Debenture maturity dates.

[225] By contrast, the financial records in evidence suggested that as early as its first year of operation, Espoir used investor funds in a manner inconsistent with what investors such as RP and KP had been told. That pattern continued through at least the end of 2012, as the $500,000 TB and WC paid for their Secured Debentures was used largely to repay principal and interest due to earlier investors. Within days of that $500,000 deposit (which brought Espoir's bank balance to $517,469.94), Espoir paid out a Secured Debenture for $300,000 plus interest, followed by numerous other payments of interest to other holders of Debentures and Espoir Notes.

[226] The facts in *Breitkreutz* were similar in a number of respects. The panel there found that investors had been led to believe their money would be loaned to third parties and secured by first mortgages on real estate located in Alberta, but the money was instead used to finance oil and gas developments in the United States, and to pay returns to other investors (see paras. 35, 82, 147). The panel characterized this as a Ponzi scheme, and noted that by its nature, it involved continuing activity and a continuing course of conduct because issuing payments and account statements showing accrued returns perpetuated the appearance of a successful investment and attracted additional funds and investors (at paras. 102-103, 147).

[227] The *Breitkreutz* panel specifically considered the meaning of "the day of the occurrence of the last event on which the proceeding is based". It concluded that because the fraud at issue was a continuing course of conduct, the "last event" was the last deposit of investor funds in September 2015. Since the notice of hearing was issued on August 22, 2016, none of the allegations were statute-barred by s. 201 (at paras. 100, 104-105). The panel also considered whether the different wording in the previous version of s. 201 altered the analysis, and concluded that it did not because

"the day of the occurrence of the event that gave rise to the proceedings" meant, when referring to a continuous course of conduct, the last day of the occurrence of the event (at paras. 106-108).

[228] In *R. v. Aitkens*, a pre-trial decision on applications brought by the accused, the Court rejected the argument that conduct which was part of a continuing course of conduct and occurred more than six years before the commencement of the proceeding was statute-barred (at paras. 70, 74). Like the panel in *Breitkreutz* (at para. 107), the Court agreed (at para. 79) with the B.C. Securities Commission (**BCSC**) in *Re Dennis*, 2005 BCSECCOM 65: "When a series of events or transactions in a continuing course of conduct spans a period of time, the 'date of the events', in the ordinary sense of that phrase, can only mean the date of the last event in the series that allows staff to allege a breach of the legislation . . ." (at para. 37).

[229] *Williams*, a more recent decision of the BCSC, also had facts similar to those in this case and was cited by the panel in *Breitkreutz* (at para. 102). In *Williams*, investors loaned money on the representation that it would be "put into safe investments", but in reality the funds were used for other purposes, including payments to earlier investors (at paras. 19-20). The panel concluded that it was a Ponzi scheme involving ongoing acts of deceit which persisted until the scheme collapsed. Accordingly, it was found to constitute a continuing course of conduct and none of it was held to be statute-barred (at paras. 229-233).

[230] We are persuaded by these authorities and find that the misrepresentations and fraud alleged in this case likewise constituted an ongoing scheme and continued course of conduct. Moreover, we agree with the following observation from *Dennis* (at para. 41):

> In our view, this construction and interpretation is the one which best ensures the attainment of the objects of the securities legislation. The purpose of the limitation period is to provide some certainty and finality to respondents while nevertheless allowing the regulator to pursue a course of conduct which may extend over a considerable period of time. That purpose is not achieved (and certainty and finality [are] not prejudiced) by cutting a continuing course of conduct in two so that events falling before the six year period are not caught.

[231] Accordingly, we have taken into account with respect to the misrepresentation allegations the entire course of conduct from October 6, 2006 to November 19, 2012, and with respect to the fraud allegations the entire course of conduct from January 1, 2009 to September 30, 2014. We would have been prepared to consider conduct preceding those dates, but have limited ourselves to the time frames pleaded in the NOH.

[232] We address Fauth's argument with respect to any financial benefit he or entities related to him may or may not have obtained from his conduct (either before or after May 11, 2010) in the context of our analysis of the merits of Staff's fraud allegation below.

B. Illegal Dealing

1. The Law

[233] Since September 28, 2009, s. 75(1)(a) of the Act has prohibited anyone from acting as a "dealer" in securities "[u]nless registered in accordance with Alberta securities laws". Several terms defined in the Act are relevant:

- a "dealer" includes "a person or company engaging in or holding itself out as engaging in the business of . . . trading in securities . . . as principal or agent" (s. 1(m));

- a "trade" includes both "any sale or disposition of a security for valuable consideration" and "any act, advertisement, solicitation, conduct or negotiation made directly or indirectly in furtherance" of such a sale or disposition (s. 1(jjj)); and

- a "security" is broadly defined and includes, among other things, "any . . . debenture, note or other evidence of indebtedness" (s. 1(ggg)).

[234] Also since September 28, 2009, the Companion Policy (**31-103CP**) to National Instrument 31-103 (originally titled *Registration Requirements and Exemptions* but now titled *Registration Requirements, Exemptions and Ongoing Registrant Obligations*) (**NI 31-103**) has set out a non-exhaustive list of factors considered relevant in determining whether a party has engaged or held itself out as engaging "in the business" of trading in securities. These include:

- engaging in activities similar to a registrant (such as "promoting securities or stating in any way that the individual or firm will buy or sell securities");

- intermediating trades or acting as a market maker (which "typically takes the form of the business commonly referred to as a broker" or "[m]aking a market in securities");

- directly or indirectly carrying on the activity with repetition, regularity or continuity;

- being, or expecting to be, remunerated or compensated; and

- directly or indirectly soliciting securities transactions.

[235] If a party has engaged or held itself out as engaging "in the business" of trading in securities in Alberta and thus acted as a "dealer" in securities, it must either be registered with the ASC to do so or have an exemption from the requirement to register. NI 31-103 sets out the available exemptions. However, as noted in *Re Cloutier*, 2014 ABASC 2 (at paras. 308-309):

> Those who seek to rely on an exemption from the [requirement to register] must make a "reasonable, serious effort – or take whatever steps were reasonably necessary – to satisfy themselves that the exemption was available" at the time of the trade . . . of the security (*Re Robinson*, 2013 ABASC 203 at para. 151). It is insufficient to assume or hope that an exemption was available at the time of the trade or distribution of the security. Nor is it sufficient that some, but not others, of the trades . . . qualify for a claimed exemption.
>
> Once Staff have proved that a respondent has traded securities without registration . . . , the onus shifts to the respondent to demonstrate the availability of, applicability of, and strict compliance with the conditions of, a claimed exemption [*Arbour* at para. 737].

2. Staff's Position

[236] In the NOH, Staff alleged that between approximately September 28, 2010 and November 19, 2012, Fauth acted as a dealer by engaging in the business of trading in Espoir securities while not registered to do so and without an exemption from that requirement. In accordance with the list of factors cited from 31-103CP above, the NOH and the Staff Argument referenced the following particulars as indicative of Fauth's conduct contrary to s. 75(1)(a) of the Act:

- he engaged in activities similar to a registrant – i.e., "promoting and trading in purportedly exempt market products . . . for a business purpose";
- he acted as an intermediary between Espoir and its investors by seeking and accepting investor funds, and providing investors with materials describing the investment;
- he carried on trading with repetition, regularity or continuity;
- he directly solicited investments and advised or recommended that individuals make those investments; and
- he "[c]ompensated himself for his efforts on behalf of Espoir" by invoicing for management and director's fees, and had potential to be indirectly compensated through his interests in the businesses to which he diverted Espoir investor funds.

[237] Staff further alleged that Fauth was not able to rely on any exemptions from the dealer registration requirement, and pointed out in the Staff Argument that Fauth had the onus to demonstrate the availability of an exemption and not only failed to do so, none of the registration exemptions outlined in s. 8.5 of NI 31-103 applied anyway.

3. Fauth's Position

[238] In the Fauth Argument, Fauth asserted that prior to September 28, 2009, National Instrument 45-106 – then titled *Prospectus and Registration Exemptions* – provided exemptions from the prospectus requirement under Alberta securities laws which were also applicable to, as he described it, "the dealer registration" requirement. "In other word[s]," he argued, "by having a prospectus exemption available, by default there was an equivalent dealer registration exempt[ion] available." However, with the advent of NI 31-103 on September 28, 2009, the "prospectus and dealer exemptions were effectively decoupled", and "having a prospectus exemption to rely upon did not necessarily equate to a dealer registration exemption".

[239] Fauth then argued that what has become a breach of s. 75(1)(a) of the Act since September 28, 2009 was not a breach prior to that date "if there was a prospectus exemption". As a result, he asserted, "from 2002-2009 [he] did not need to be registered as a dealer in order to comply with the dealer requirements in the Act, because he was exempt if the transaction was also prospectus exempt". He went on to note that because of certain transitional provisions in NI 31-103, he was not required to register as a dealer until September 28, 2010.

[240] Fauth further argued that after September 28, 2009,

> . . . he was doing the exact same thing (but now inadvertently breaching the Act) that he had been doing perfectly legally from 2002-2009. Thus, his evidence that his lawyers had advised him that what he was doing by way of fundraising was okay and compliant with the Act, was in fact correct for the first seven years of Espoir's fundraising activities.

[241] Fauth simply "was not made aware of the change" in the law and continued as he had before.

[242] It was not entirely clear which "evidence" Fauth was relying on in this regard, but we noted that during his Interview, he stated that "the lawyers" advised him that "as an owner", he could raise capital for Espoir using debentures under an exemption – but he did not know which exemption purportedly applied.

[243] In the same vein, Fauth pointed to the fact that he was only alleged to have breached s. 75(1)(a) of the Act beginning September 28, 2010 – and suggested that that was because what he was doing on and before that date "was not unlawful, due to it being subject to the same exemption as the prospectus exemption for Espoir's fundraising activities".

[244] In oral argument, Fauth's counsel indicated that while he was not advancing an "affirmative defence" to this allegation on Fauth's behalf, he did not concede it, either, and put Staff to the proof thereof. Later, he repeated the assertion from the Fauth Argument that Fauth's conduct in this regard "wasn't an offence prior to September 2010", but "the law was changed, and he got caught". Counsel accepted that "ignorance of law is not an excuse" as Staff had argued, but submitted that it was "at best, . . . a technical breach and . . . it ought to be seen as such".

4. Discussion and Conclusion on Illegal Dealing

[245] To determine whether Fauth breached s. 75(1)(a) of the Act as alleged, we must find that between September 28, 2010 and November 19, 2012: (i) there was a security as defined in the Act; (ii) there was a trade as defined in the Act in relation to that security; (iii) Fauth engaged in or held himself out as engaging in the business of trading in securities; (iv) Fauth was not registered; and (v) Fauth could not rely on an exemption from the registration requirement (*Cloutier* at para. 304).

[246] Secured Debentures and Espoir Notes were issued between September 28, 2010 and November 19, 2012, including to several of the investors who testified at the Hearing. As "debentures", the Secured Debentures clearly fell within the definition of "security" cited above. As the Espoir Notes were "evidence of indebtedness", they, too, fell within the definition.

[247] During the same period, Fauth engaged in sales and dispositions of Secured Debentures and Espoir Notes in exchange "for valuable consideration" (cash). He therefore "traded" in the Secured Debentures and the Espoir Notes. He also engaged in various activities "in furtherance of" such sales and dispositions. These activities included soliciting investments and introducing, promoting and discussing the Espoir investment opportunity with investors and prospective investors (*Cloutier* at para. 301).

[248] After considering the factors set out in 31-103CP, we are also satisfied that Fauth engaged in and held himself out as engaging "in the business" of trading in securities. He promoted the

Secured Debentures and the Espoir Notes and solicited investments, he issued Secured Debentures and Espoir Notes to investors in exchange for cash, and he did so "with repetition, regularity or continuity" – over a span of approximately two years, 24 Secured Debentures were issued to 19 individual investors for $3,525,000, and over a span of just over one year, seven Espoir Notes were issued to six individual investors for $545,000. Moreover, Fauth was the sole guiding mind of Espoir and the only person involved in promoting and selling its securities. While it does not appear that Espoir paid him a sales commission *per se*, he nonetheless received the proceeds from the investments he solicited and obtained the benefit of them for himself, his family and entities he owned, controlled or managed – including in the form of management and director's fees.

[249] Finally, we are satisfied that Fauth was not registered to deal in securities at the relevant time, and that he did not have an applicable exemption from that requirement.

[250] In this regard, we note that while Fauth's analysis of the impact of the changes to s. 75(1)(a) in September 2009 and the issuance of NI 31-103 was more or less correct, it was not relevant to the allegations in the NOH. Conduct which may or may not have constituted a breach of s. 75(1)(a) of the Act prior to September 28, 2010 was not alleged by Staff.

[251] Moreover, Fauth's argument with respect to his conduct prior to September 28, 2010 was premised on the assumption that there was a prospectus exemption available for Espoir's distributions of its Debentures at that time. He had the onus to prove the availability of and compliance with all of the terms of an exemption, but he did not do so – in fact, he did not even advise us which prospectus exemption he believed was applicable to Espoir's activities at that time. We are unpersuaded by the unsubstantiated assertion that "the lawyers" advised him "that what he was doing by way of fundraising was okay and compliant with the Act". Evidence is required to prove reliance on legal advice: *Re Aitkens*, 2018 ABASC 27 (at paras. 80-81).

[252] We are similarly unpersuaded by Fauth's suggestion that Staff's choice of timeframe for the allegation was somehow an acknowledgement by Staff that what he was doing on and before September 28, 2010 "was not unlawful". Staff were at liberty to make prosecutorial decisions, and may have done so for a variety of reasons. We do not view this particular decision as somehow endorsing Fauth's earlier conduct.

[253] We are cognizant of the fact that the Unsecured Debenture Subscriptions and the Secured Debenture Subscriptions in evidence contained language whereby the subscribers, by signing, ostensibly acknowledged that Espoir was a "private issuer" and warranted they either were family, friends or close business associates of a "director, senior officer or control person" of Espoir (i.e., Fauth) or were accredited investors. If proved, these facts may have established that a prospectus and registration exemption was available prior to September 28, 2010 as Fauth argued, but he had the onus to adduce such evidence and did not do so. In fact, in at least some instances, the evidence led at the Hearing suggested the contrary. As one example, the documentary evidence – CR's and MR's Net Worth Statement as at December 31, 2005 – and the testimony of MT and CR showed that CR and MR were neither family, friends or close business associates of Fauth nor accredited investors at the time they purchased their first Unsecured Debenture in July 2006.

[254] Finally, we are unpersuaded by Fauth's contention that while the law changed in September 2009, he was simply unaware of it and did not mean to contravene it, so that should be construed as a mitigating factor – a "technical breach". In some cases, unfamiliarity with the workings of the capital market may be considered a mitigating factor in the context of determining an appropriate sanction. Fauth, however, was a past registrant with considerable experience in the capital market and the associated regulatory environment. He was therefore aware that there were registration requirements, and, according to his own evidence, he had legal counsel at some point who could advise him on securities matters. As such, we agree with Staff that he could and should have learned of the applicable law before raising over $4 million from the public after September 28, 2010.

[255] Accordingly, we find that Fauth breached s. 75(1)(a) of the Act as alleged.

C. Misrepresentations

1. The Law

[256] During the period relevant to the allegations in the NOH, s. 92(4.1) of the Act provided that:

> (4.1) No person or company shall make a statement that the person or company knows or reasonably ought to know
>
> (a) in any material respect and at the time and in the light of the circumstances in which it is made,
>
> (i) is misleading or untrue, or
>
> (ii) does not state a fact that is required to be stated or that is necessary to make the statement not misleading,
>
> and
>
> (b) would reasonably be expected to have a significant effect on the market price or value of a security . . .

[257] Therefore, to establish a misrepresentation under s. 92(4.1), Staff must prove that:

> (i) a statement was made by a respondent; (ii) the respondent knew or reasonably ought to have known that the statement was, in a material respect, untrue or omitted a fact required to be stated or necessary to make the statement not misleading; [and] (iii) the respondent knew or reasonably ought to have known that the statement would reasonably be expected to have a significant effect on the market price or value of a security . . . [*Arbour* at para. 753].

[258] The inquiry as to whether or not a statement or omission "would reasonably be expected to have a significant effect on the market price or value of a security" may be usefully restated as an inquiry into "whether there is a substantial likelihood that such facts would have been important or useful to a reasonable prospective investor in deciding whether to invest in the securities on offer at the price asked" (*Arbour* at para. 765, citing *Capital Alternatives* at para. 239 and *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23 at para. 61). That said, misrepresentations made to both prospective investors and existing investors are "within the

contemplation of" s. 92(4.1), as misleading information may "prompt existing investors to continue with or augment their investments" (*Re Mandyland Inc.*, 2012 ABASC 436 at paras. 196, 203).

[259] Investor evidence on the issue of materiality may be of assistance, but it is not required. ASC hearing panels are comprised of experts "with specialized knowledge of the Alberta capital market and securities regulation" who are "well[-]positioned and able to draw inferences as to the objective view of a reasonable investor" (*Arbour* at paras. 763-765).

[260] Similarly, it is not necessary for Staff to prove reliance by specific investors on any specific statement or omission alleged to constitute a misrepresentation. Again, such evidence is potentially useful to the determination, but it is not required. The reason was explained in *Arbour* (at para. 768):

> Securities regulation does not focus on what the market or investors do with mandated information provided to them. Rather, the objective of securities regulation is to oblige those who seek money from public investors and the capital market to provide current, truthful and accurate information in prescribed formats, which can then be used by those in the capital market as a basis for making reasonably informed investment decisions. That a particular investor or investors may not read or rely on such information in making investment decisions does not relieve an issuer of its obligations to provide accurate and reliable information and to comply with Alberta securities laws when soliciting money from the public.

[261] As in the ASC's recent decision in *Aitkens*, use of investment funds was one of the central issues in this case. We agree with that panel's statement (at para. 140) that "accurate disclosure of an issuer's intended use of investment funds is among the most important information an investor can and should be given". Many prior ASC panels have remarked on this point, noting that such disclosure has been a requirement of securities offering documents for many years (see, for example, *Arbour* at paras. 775-776, *Re Dobler*, 2004 ABASC 927 at para. 220 and *Re Shire International Real Estate Investments Ltd.*, 2011 ABASC 608 at para. 185).

[262] Like those panels, we consider it self-evident that investors care about the use to which their funds will be put, and that information in that regard can reasonably be expected to have a significant effect on their willingness to invest at the price asked.

2. Staff's Position

[263] Staff alleged in the NOH that between approximately October 6, 2006 and November 19, 2012, Fauth breached s. 92(4.1) of the Act "by making representations, by act or omission, which he knew or reasonably ought to have known were materially misleading or untrue, or both, or did not state facts that were required to be stated or necessary to make the statements not misleading", and which "would reasonably be expected to have a significant effect on the market price or value of the securities in Espoir, and the willingness of the investors and prospective investors to invest in them".

[264] Staff set out the following specific misrepresentations:

- "investment funds would be used [to invest] in a strip mall";
- "[the] Espoir [D]ebenture[s were] secured";

- ". . . [i]nvestments [in Espoir] were guaranteed, safe or secure";

- "investment funds would only be invested in money market, treasury bills, bankers acceptance paper, commercial paper, guaranteed investment certificates and term deposits, government and corporate bonds, secured debentures, secured promissory notes, first and second mortgages and lease papers";

- "failing to disclose that investment funds would be diverted to FairWest";

- "failing to disclose that some investment funds would be used by [Fauth] to repay other investors"; and

- "failing to disclose that some investment funds would be diverted to businesses which [Fauth] owned, controlled and/or managed".

[265] The Staff Argument referenced various evidence in support of these particulars, and contended that Fauth "told a consistent and materially misleading story about Espoir to investors", both orally and in writing. They argued that Fauth emphasized the security of an investment in Espoir, given the manner in which he claimed it would use investor funds, and failed to disclose how it actually used those funds and the associated level of risk. This disinformation, Staff contended, "would reasonably be expected to have a significant effect on the market price or value" of Espoir's securities, and Fauth knew that to be the case.

[266] With respect to some of the language used in the documents and in the conversations Fauth had with the investors who testified, Staff argued that while "[t]he words 'secure' or 'securitized' or 'guaranteed' have technical, legal definitions", what was being represented was that an investment in Espoir was safe and low-risk. The investors relied on this, and were "prevented . . . from making an informed investment decision based on reliable and accurate information". In this vein, Staff pointed out that "a loan secured by a mortgage and registered on title is a materially different investment than an unsecured loan to a junior oil and gas company".

[267] Staff also addressed the "No Security" clause contained in both the Unsecured Debentures and the Secured Debentures. They argued that the presence of this clause did not negate the other representations made with respect to security, and cited *Re Campbell*, 2015 ABASC 604 (at paras. 118-119).

3. Fauth's Position

[268] In oral closing argument, Fauth's counsel indicated that while Fauth was not advancing an "affirmative defence" to the misrepresentation allegations, either, he was not conceding them, and put Staff to the proof thereof. He later stated that, "[w]ith respect to . . . the misrepresentations, clearly there is written documentation late in the day to the investors suggesting that, at that time, funds were being placed into mortgages when they simply weren't. There's no denying those facts. I can't argue against that."

[269] Despite this apparent concession, however, in both written and oral argument, Fauth's counsel raised two main points and alluded to a third, perhaps as mitigating considerations for us to take into account when deciding whether Staff's misrepresentation allegations had been proved.

[270] First, Fauth's counsel argued that, "from its inception in 2002 and in the early years (prior to Vern Fauth's taking an executive position with FairWest) Espoir did invest in mortgages" and therefore the Espoir Summaries "were arguably initially accurate" as "funds in the early years were in fact invested in mortgages". The materials simply "became inaccurate in the later years when investor funds were re-directed towards loans to FairWest and the LP's [sic] and buying shares, debentures and units of FairWest and the LP's [sic]".

[271] This argument was consistent with some of Fauth's Interview evidence. When asked whether he used funds invested in Espoir in the way he said he was going to, Fauth said he "[t]ried to", but "divers[ified] into other things" when Espoir was unable to generate sufficient funds to keep up with the interest payments it owed its Debenture holders. However, as he acknowledged elsewhere during his Interview, the Espoir Summaries did not capture the "other things" in which Espoir ultimately invested (such as FairWest, the oil and gas LPs and "private loans"); moreover, no informational documents were prepared and distributed which did capture them. Fauth also said that he "d[id]n't think" investors were advised in any way that their funds might be used to pay principal or interest to other investors.

[272] Second, Fauth relied on the fact that the list of investment categories set out in the Espoir Summaries was introduced by the words "such as", and therefore did not purport to be "an exhaustive list of the investments planned for Espoir". In oral argument, however, Fauth's counsel tempered this somewhat with an acknowledgement that investors reading an Espoir Summary may not have appreciated that that meant Espoir might invest in other sorts of things, too.

[273] Finally, there was some suggestion in the Fauth Argument that Fauth had also relied on legal advice that because Espoir was a "private company", he was not required to disclose to investors the exact investments Espoir made or intended to make.

4. Discussion and Conclusion on Misrepresentations

[274] While seven specific misrepresentations were alleged in the NOH, we consider them in two groups or categories: the first four, which alleged positive misrepresentations as to the safety of an investment in Espoir and how funds invested in Espoir would be used; and the latter three, which alleged misrepresentation by omission as to the reality of how those funds were used.

[275] We set out our findings on each group below.

(a) Security and Use of Funds

(i) Statements Made

[276] As mentioned, the witness testimony and the documentary evidence led at the Hearing established that during the period from October 6, 2006 (the date of MT's Unsecured Debenture) through November 19, 2012 (the date of TB's and WC's five Secured Debentures, the last Debentures sold by Espoir) – and even prior to October 2006 – Fauth communicated a very consistent story about Espoir and its business model.

[277] Investors were told that the Espoir Debentures were secured. Not only did the Secured Debentures describe themselves as "secured" and as "a secured obligation of [Espoir]", Fauth told purchasers of both types of Debentures – as well as lenders under Espoir Notes – that the investments were secured by mortgages and real estate assets. In some instances, investors reported that he even referred to real estate in specific locations such as Edmonton, Airdrie and Okotoks.

[278] Unsecured Debenture holders who received the Secured Debenture Solicitation Letters in 2009 were told that "*[o]nce again* these debentures will be securitized by assets (i.e. mortgages)" (emphasis added). This implied that the Unsecured Debentures had also been secured in this way. It also accorded with Fauth's Interview evidence that he considered the Unsecured and Secured Debentures to be "exactly the same", with the same security: "the assets of the company".

[279] The word "securitize" has a specific definition in securities parlance. We note that Fauth used it in the Secured Debenture Solicitation Letters (and sometimes elsewhere) instead of the word "secured". However, we are satisfied based on the manner and the various contexts in which Fauth used the two words that he considered them to be equivalent in meaning. We are also satisfied that Espoir investors interpreted them as such.

[280] Fauth further reinforced the impression that Espoir's Unsecured Debentures were actually secured when he told holders (verbally, and by way of the September 2010 Update Letter) that the Debenture Amendments were necessary to keep the underlying mortgagors from defaulting. Most of the Debenture Amendments added to the expectation of security by purporting to amend the Unsecured Debentures such that they also became "secured obligation[s] of [Espoir]".

[281] Although Fauth did not attempt to rely on the "No Security" clause in the Debentures, it was referenced in the Staff Argument as set out above. We agree with Staff that the clause did not negate the multiple other representations to the contrary made to investors both verbally and in writing. As the panel in *Campbell* put it with respect to another disclaimer, it "did not erase or undo the fact of the impugned statements having been made" (at para. 119). Moreover, the investor witnesses who were asked about it had no recollection of Fauth drawing it to their attention. Fauth said during his Interview that he "d[id]n't know" if it had been pointed it out to them.

[282] By contrast, the investor witnesses clearly remembered Fauth's assurances with respect to safety and minimal risk – that investments in Espoir were guaranteed, safe or secure because of the types of investments Espoir would make using investment funds. Representations to the same effect were made in documents and written communications. To cite just two examples, Net Worth Statements described Unsecured Debentures as "Guaranteed Securitized Investments", and the Espoir Investor Capital Breakdown indicated that Espoir had only made investments in treasury bills, mortgages, leases and "Other Secured" vehicles.

[283] Similarly, the oral and documentary evidence established that from Espoir's earliest years and through the relevant period, investors and prospective investors were told their funds would be invested in the money market, treasury bills, bankers acceptance paper, commercial paper, guaranteed investment certificates and term deposits, government and corporate bonds, secured debentures, secured promissory notes, first and second mortgages, and lease papers – representations that would have reinforced an investor's expectation that his or her investment in

Espoir was guaranteed, safe or secure. This list appeared in all of the Espoir Summaries from February 2003 to October 2011, as well as in the Secured Debenture Term Sheet. A similar list appeared in the September 2010 Update Letter. TS testified that when Fauth gave him the January 2010 Espoir Summary, Fauth told him it described how funds invested in Espoir would be used. In an e-mail to HM, Fauth attached the October 2011 Espoir Summary and said it contained "a schedule of the type of investments Espoir selected and invests in".

[284] Finally, while not set out in any of the documents entered into evidence, there was *viva voce* testimony from some who invested after October 6, 2006 that Fauth told them their investment funds would be used to invest in a mall or strip mall. HM was the clearest on this point, as he had a distinct recollection of Fauth discussing a strip mall in Edmonton.

(ii) Awareness that Statements Made Were Untrue

[285] All of these statements were untrue, and given Fauth's position with Espoir, he knew or reasonably ought to have known that that was the case.

[286] According to Fauth's own evidence, he was the only one who dealt with Espoir investors; he therefore knew what they were told about Espoir. He was also Espoir's only signing authority; he therefore knew how Espoir used the funds it raised, and whether or not it had security for those funds. He knew that Espoir's Debentures – including the purportedly "Secured" Debentures – were not actually secured, and that investments in Espoir were not guaranteed, safe or secure. He knew that Espoir did not restrict its investments to the categories listed in the Espoir Summaries and similar documents, and he knew that it did not invest in a strip mall.

[287] As noted, when questioned about whether Espoir Debentures were secured, Fauth said that the security was simply the assets in Espoir. However, the financial records showed that Espoir was in a deficit position throughout the relevant period – a deficit which increased each year from $213,247 in 2006 to $13,904,658 in 2014. Moreover, its assets during those years were comprised solely of its loan receivables and other investments – almost all of which, by Fauth's own admission, were unsecured and, in many cases, undocumented. During his meeting with MT in July 2013, he acknowledged that the security "that really should have been there" had not been there.

[288] The only exceptions disclosed by the evidence were the mortgages and General Security Agreements described earlier, but these were far from securing Espoir's total obligation to its investors. The three third-party mortgages on Espoir's books in 2005 were only worth a total of $351,000, and were paid out in full by the end of 2007. The two second mortgages on the Calgary and Edmonton properties owned by the Fauths were of minimal (if any) value given the size of the first mortgages and the value of the properties. Fauth Financial pledged its assets under one of the General Security Agreements, but its financial records indicated those assets were nowhere near sufficient to support the $4.2 million Fauth Financial owed to Espoir from 2007 through 2013. We do not have sufficient evidence with respect to Axiom to determine whether or not its General Security Agreement with Espoir had better effect, but even if Espoir's loan to Axiom were fully secured, Espoir's liability to its Debenture holders far exceeded the maximum amount loaned.

[289] With respect to the list of investment categories set out in the Espoir Summaries and other documents, the Fauth Argument conceded that the Summaries "became inaccurate" in Espoir's

later years. While Fauth suggested that they were "initially accurate" because Espoir invested in mortgages early on, we find that at best, they were only partially accurate at certain times and only accounted for a small proportion of the funds Espoir had raised from Debentures. The majority of the funds had been used in ways which did not conform with anything on the list: unsecured or under-secured loans to and investments in related parties.

[290] Fauth made a further concession with respect to the list during his Interview. As mentioned, when he was asked to point out in the financial records any investments Espoir had made which would fall within the Espoir Summary list, he only referred to the aforementioned mortgages. He speculated that some funds may have been temporarily placed in certain short-term investment vehicles by Espoir's bookkeeper without his knowledge, but acknowledged that such investments were not a large part of Espoir's business, and would only have been made with excess funds before they were used for something else.

[291] With respect to Fauth's reliance on the words "such as" as an indicator that the list was not meant to be exhaustive, Staff pointed out that other documents given to investors which had the same list (or a substantially similar list) did not include those words. More significantly – and as Fauth's counsel fairly conceded in oral argument – we do not think it likely most investors reading an Espoir Summary would necessarily have appreciated that the phrase "such as" meant Espoir might invest in "other things". This is especially so in light of the other representations that were made, and the fact that the list was restricted to investments of a certain nature – secured investments. This would have created an expectation that any "other things" in which Espoir invested would also be secured.

[292] Indeed, some of the Espoir Summaries stated as much. The September 2009 version said Espoir "was established to invest in *secured investments such as . . .*", followed by the list (emphasis added). The January 2010 and October 2011 versions said Espoir "was established in 2002 to invest in a pool of *secured interest paying investments such as . . .*", followed by the list (emphasis added). Similarly, the Secured Debenture Term Sheet stated, "[t]he proceeds will be invested into *securitized debt instruments* with terms from 1 – 3 years", and then set out the list (emphasis added).

[293] As for the suggestion in the Fauth Argument that Fauth received legal advice to the effect that he was not required to disclose to investors the exact investments Espoir made or intended to make, we note again that evidence is required to prove reliance on such advice. In any event, we consider it self-evident that if a party chooses to make representations with respect to a security in our regulated environment – whether obliged to do so or not – those representations must be true.

(iii) Awareness that Statements Would Affect Market Price or Value

[294] We conclude that the misrepresentations discussed above would reasonably be expected to have a significant effect on the market price or value of Espoir's securities and a reasonable prospective investor's willingness to invest in the securities on offer at the price asked, or to re-invest and forbear demand for repayment.

[295] We observed earlier that it was not always clear whether the investor witnesses received certain documents before or after they had already made the initial decision to invest and provide Fauth their money. Since both prospective and existing investors are within the contemplation of

s. 92(4.1) of the Act, however, the timing is not determinative. Given the testimony with respect to the basis on which the witnesses made the decision to invest in Espoir, documents containing the impugned representations received after that decision would simply have reinforced or confirmed what they had been told verbally. Such representations may also have prompted them "to continue with or augment their investments" as contemplated in *Mandyland*. It was clear that several of the Unsecured Debenture holders agreed to enter into Debenture Amendments based on Fauth's representations concerning the state of the underlying mortgages.

[296] The investor witnesses were unanimous in their understanding that their Debentures were secured, and that their investments in Espoir were, as RP put it, "as safe as anything you could . . . do". This was largely based on their understanding that Espoir would only use their funds to make secure investments with collateral in place which could be seized and sold if necessary. Moreover, it was clear that most of them specifically invested on that basis, as they had a low risk tolerance and would not have invested at all if they had known there was a chance their funds – life savings in some instances – could be lost.

[297] During his Interview, Fauth suggested more than once that what Espoir investors were really interested in was the high rate of return that was offered. While we agree that the 8% to 10.5% interest rate was likely a draw for investors, the witnesses were clear that they wanted and expected minimal risk – i.e., a secured investment.

[298] With respect to the materiality of a representation that an investment is secured, we concur with the following statement by the panel in *Re Platinum Equities Inc.*, 2014 ABASC 71 (at para. 107):

> A "legal" form of "security" is significant because it enhances a mere promise to pay. It becomes not merely a promise to deliver an outcome, but couples that promise with something extra – something important – to ensure that the outcome is delivered even if the promiser defaults. We are in no doubt that a reasonable investor would generally . . . ascribe significantly more value to an investment secured by commercial real estate than to a similar investment not so secured.

[299] Similar findings were made by the panel in *Campbell*, which also noted that such representations would encourage debenture-holders to forbear demanding repayment of their debentures on maturity (at paras. 134, 222).

[300] We further conclude that Fauth, an experienced financial planner and former registrant, knew or reasonably ought to have known the effect these representations were likely to have. Not only do we consider it obvious that a reasonable person would rather invest his or her money with little to no risk of loss, we are of the view that Fauth's ongoing conduct showed that he knew – and relied on – the enticement of a low-risk investment secured by real assets:

- Despite Espoir's ostensible diversification into "other things" once it found mortgages were not generating enough income to keep up with the interest owed to investors, the Espoir Summaries remained substantially the same – with their claim that Espoir only invested in certain types of secured investments. We do not believe that this was simply an instance of inadvertence, or that Fauth stopped using the Espoir Summaries. Enough care was taken to edit portions of them and change the

dates on them, and Fauth provided the last version (dated October 2011) to prospective investors as late as November 2012.

- Despite the fact that the evidence showed the Espoir Investor Capital Breakdown was not accurate at any point during the relevant period, Fauth still provided it or showed it to prospective investors. This included providing it to HM in January 2012 as an attachment to an investment solicitation e-mail filled with claims about Espoir's history in making profitable, secured investments and its plans to do so in the future.

- Despite the fact that Espoir held no mortgages of any value after 2007, the Secured Debenture Solicitation Letter sent out in 2009 claimed that the new Debentures on offer would once again "be securitized by assets (i.e. mortgages)". The September 2010 Update Letter – and conversations Fauth had with some investors to the same effect – claimed that the reason an extension and a reduction in interest rate were necessary was the perilous status of the underlying mortgages.

[301] We have no doubt that the reason for all of the foregoing was Fauth's understanding that people would be more willing to invest in Espoir – and extend their matured Debentures – if they thought it was low-risk and their money was secure.

(b) Actual Use of Funds

(i) Omissions

[302] As noted, Fauth was the sole guiding mind of and sole signing authority for Espoir. We thus have no doubt that he knew how its money was spent, and that investors were not given that information. Specifically, and as alleged in the NOH, the evidence showed that in describing Espoir's intended use of funds to people during the relevant period, Fauth did not disclose – and knew that he did not disclose – the fact that funds would be diverted to FairWest, used to repay other investors, or diverted to other businesses he owned, controlled or managed. He was the only person who met with Espoir investors, and was thus the person in control of the information they were given.

[303] While Fauth suggested at one point during his Interview that he spoke to investors about funds being used in a variety of ways – including corporate and individual loans and investments in FairWest and the oil and gas LPs – that accorded with neither the testimony of the investor witnesses nor the documentary evidence. None of the written materials provided to investors mentioned investments of that nature, and none of the investor witnesses reported receiving such information from Fauth.

[304] In addition, Fauth acknowledged during the Interview that the written materials did not disclose all of the ways in which Espoir actually used investment funds. When asked if the list in the Espoir Summaries and other documents accurately described Espoir's "investment profile" from 2003 through 2011, he stated that, "we also invested in other things, too". According to his evidence, those "other things" included loans to and investments in FairWest, investments in the oil and gas LPs, and "private loans to individuals". Elsewhere during his Interview, he acknowledged that Espoir also gave loans to AFM Management and bought units in and made

loans to certain of the LPs. He further acknowledged that while some investor funds were used to make payments to earlier investors, he did not think the investors had been told of that possibility.

[305] Other evidence confirmed these non-disclosed uses of investment funds. During the meeting MT recorded, Fauth admitted directing funds to FairWest and the LPs. HM and TB both testified Fauth admitted to them Espoir funds had been directed to FairWest. The Source and Use Analysis confirmed uses not disclosed to investors, including use of investment funds to pay earlier investors. In his written response to the query in the Summons with respect to use of funds, Fauth mentioned, among other uses, investments in "business loans, public company shares, personal loans, . . . limited partnership units, Fairwest Energy Inc. shares, loans, debentures and promissory notes".

[306] Based on Espoir's financial records, we observed that, as Fauth had claimed during his Interview, Espoir did realize some income from its loans and investments – at least during its earlier years. However, it was apparent that its primary sources of funding were sales of its Debentures and, later, loans under Espoir Notes. The banking records also showed many instances where investment funds were deposited and then almost immediately applied in ways that were not disclosed to the investors. The following are just a few examples:

- On July 31, 2008, Espoir invested $200,000 in Battle River LP, which took Espoir's bank balance to a deficit of approximately $140,000. The balance was reinstated to a positive position after deposit of BC's $500,000 for purchase of his Unsecured Debenture on the same date.

- On November 24, 2009, Espoir's bank balance was $1910.25. $300,000 from a Debenture purchase was deposited the same day, followed by another $50,000 from a Debenture purchase on December 3, 2009. After taking into account a few payments – including Debenture interest payments – and some small deposits, the balance was approximately $329,500 on December 13, 2009. Espoir loaned FairWest $200,000 on December 14, 2009, taking the bank balance to just over $129,500. Various Debenture interest payments followed.

- On May 23, 2012, the deposit of $300,000 from RT's Secured Debenture purchase brought Espoir's bank balance from a deficit to just under $218,000. A number of payments followed – including payments to other investors such as Royalty LP, which received over $200,000 to redeem and pay interest on two of its Secured Debentures prior to maturity. This brought Espoir's bank balance to just over $5500 on June 5, 2012.

- On June 6, 2012, $1 million from a Secured Debenture purchased by HM's company brought Espoir's bank balance to just over $1,005,000. On June 7, 2012, $12,000 was loaned to Fauth, and on June 12, 2012, $650,000 was loaned to FMM Capital.

[307] In short, we have no doubt that Fauth did not give investors all of the relevant information with respect to Espoir's intended – and actual – use of their funds.

(ii) Awareness that Omissions Were Misleading and Would Affect Market Price or Value

[308] We are also satisfied that Fauth knew or reasonably ought to have known that these omissions were misleading, and that they would reasonably be expected to have a significant effect on the market price or value of Espoir's securities. Given their close relationship in this context and our preceding analysis of the first group of alleged misrepresentations, we considered these two elements of the legal test together when we assessed the impact the omissions had on Espoir investors and prospective investors.

[309] As discussed, the investor witnesses were clear that they wanted the funds they invested in Espoir to be used in a manner that would not expose them to risk of loss. Moreover, they were given ample grounds to expect that their funds would be used in such a manner, based on what they read in materials they received from Fauth, and what Fauth told them. If they discussed FairWest or the oil and gas LPs with Fauth in the Espoir context, it was to tell him they specifically did not want the funds they intended for secure investment to be risked on something quite so speculative.

[310] It is therefore evident that Espoir investors were misled by the information they did not receive about use of their funds just as they were misled by the information they did receive. Those who gave testimony in this proceeding left little question that accurate disclosure in this regard would have been important to them in deciding whether or not to invest in Espoir, as such disclosure "is among the most important information an investor can and should be given" (*Aitkens* at para. 140).

[311] Finally, as with respect to the other misrepresentations, we are of the view that Fauth not only knew the importance of this information, he consciously withheld it – likely because he knew it would impact his ability to raise capital for Espoir. Otherwise, he could easily have updated the written materials given to investors and discussed his actual intended use of their investment funds. He chose not to.

(c) Summary of Conclusion

[312] Accordingly, we find that Fauth breached s. 92(4.1) of the Act as alleged.

D. Fraud

1. The Law

[313] Throughout the period relevant to this matter, s. 93(b) of the Act prohibited anyone from "directly or indirectly, engag[ing] or participat[ing] in any act, practice or course of conduct relating to a security . . . that the person or company knows or reasonably ought to know will . . . perpetrate a fraud on any person or company". As was pointed out in the Staff Argument, this section of the Act was amended to include somewhat different wording in 2014. However, since that amendment did not come into effect until after the time relevant to this allegation in the NOH, it is not necessary for us to address its effect (if any) in this matter.

[314] In *Capital Alternatives* (at paras. 308-309), the ASC adopted for application in the securities context the test for fraud set out by the Supreme Court of Canada (**SCC**) in *R. v. Théroux*, [1993] 2 S.C.R. 5 (at para. 27). That test has been applied in ASC decisions with respect to allegations of fraud ever since, and requires Staff to prove:

- the *actus reus*, which is established by proof of:
    - a "prohibited act, be it an act of deceit, a falsehood or some other fraudulent means"; and
    - "deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim's pecuniary interests at risk";

  and

- the *mens rea*, which is established by proof of:
    - "subjective knowledge of the prohibited act"; and
    - "subjective knowledge that the prohibited act could have as a consequence the deprivation of another".

[315] The Court in *Théroux* explained that the *actus reus* of fraud is established if it is proved that a "prohibited act" was perpetrated which caused the "deprivation" of another party. The "prohibited act" may be an "act of deceit, a falsehood or some other fraudulent means". An act of deceit or a falsehood has occurred if someone has "represented that a situation was of a certain character, when, in reality, it was not" (at para. 18). A prohibited act of "other fraudulent means" refers to dishonest acts which are not necessarily deceit or falsehood; examples cited in *Théroux* included "the use of corporate funds for personal purposes, non-disclosure of important facts, . . . unauthorized diversion of funds, and unauthorized arrogation of funds or property" (at para. 18).

[316] The mental element or *mens rea* of fraud is established if it is proved that the accused party had "subjective awareness" of both undertaking a prohibited act and the possibility that the prohibited act could cause another to suffer actual or potential economic loss (*Théroux* at para. 24). It is not necessary to prove that the accused knew that what he was doing was wrong or that he intended to cause someone else to incur a financial loss – only that he "intentionally committed the prohibited acts" knowing that the consequence could be "deprivation, including the risk of deprivation" (at para. 24; see also para. 28). As the SCC explained (at para. 36):

> A person who deprives another person of what the latter has should not escape criminal responsibility merely because, according to his moral or her personal code, he or she was doing nothing wrong or because of a sanguine belief that all will come out right in the end. Many frauds are perpetrated by people who think there is nothing wrong in what they are doing or who sincerely believe that their act of placing other people's property at risk will not ultimately result in actual loss to those persons. If the offence of fraud is to catch those who actually practise fraud, its mens rea cannot be cast so narrowly as this.

[317] Similarly, it is not necessary for Staff to prove that the perpetrator personally benefited from his fraudulent conduct (*Théroux* at para. 19; *Arbour* at para. 981). In *Re Kostelecky*, 2017ABASC 42, for example, the panel found no evidence indicating how or if the respondent profited from his fraud in any manner – financial or otherwise – but still concluded he had breached s. 93(b) of the Act (at para. 134).

[318] As stated in *Théroux* (at para. 23): "In certain cases, subjective awareness of the consequences can be inferred from the act itself, barring some explanation casting doubt on such inference. The fact that such an inference is made does not detract from the subjectivity of the test." As stated in *Arbour* (at para. 983): ". . . subjective knowledge can be inferred from the prohibited act and surrounding circumstances" (see also *Brost* at para. 48).

2. Staff's Position

[319] In the NOH, Staff alleged that between approximately January 1, 2009 and September 30, 2014, Fauth breached s. 93(b) of the Act by directly or indirectly engaging or participating in an act, practice or course of conduct relating to a security that he knew or reasonably ought to have known perpetrated a fraud on investors.

[320] The NOH set out the following particulars of fraudulent conduct by Fauth:

- "[d]eceiving investors as to the security or safety of [investments in the Debentures and Espoir Notes]";
- "[d]eceiving at least one investor to believe that investment funds would not be invested in FairWest"; and
- "converting investment funds for use by businesses owned, controlled, and/or managed by [Fauth] or using investment funds to pay interest and/or principal to other investors".

[321] In addition to the above particulars, the Staff Argument referenced Fauth's direction of Espoir investment funds to himself and members of his family. However, as personal use of funds was not alleged in the NOH, we did not consider it in making our decision with respect to whether Fauth breached s. 93(b) of the Act.

[322] In both oral and written argument, Staff relied on the test in *Théroux*. They argued that the *actus reus* of fraud had been proved with proof that Fauth deceived investors both verbally and in writing, the consequence of which was "real, devastating[. . .] financial loss" to Espoir investors. He told them that Espoir only invested in secured investments – such as loans to developers for real estate which were backed by assets and registered on title – when that was not, in fact, the case. Instead, he made unsecured investments in or loans to businesses he owned, controlled or managed (including businesses involved in the oil and gas industry), used investment funds to pay interest and principal to other investors (as in a Ponzi scheme), and used investment funds for personal purposes. Since those uses were not disclosed to Espoir investors and were not in line with what investors had been told, he "represented that Espoir was of a certain character when in reality it was not".

[323] Staff further argued that the *mens rea* had also been proved, because Fauth, as the sole shareholder, director, guiding mind and signing authority of Espoir, "had objective and subjective knowledge of his deceit" with respect to the purported and actual use of investment funds. He knew or ought to have known that it "placed investors' economic interests at risk".

[324] Finally, Staff noted that as per the *Théroux* decision, "the fact that Fauth may have hoped that the deprivation would not take place or felt that there was nothing wrong with what he was doing provides no defence". They argued that even an absence of intent to defraud would not assist him, because "intention does not negate subjective knowledge in fraud". In other words, intent is not the same thing as subjective knowledge, and it is the latter the *Théroux* test requires.

3. Fauth's Position

[325] Again, while Fauth stated that he was not advancing an affirmative defence to Staff's allegation, he took the position that based on the evidence led at the Hearing, fraud had not been proved on a balance of probabilities. His counsel acknowledged the *actus reus* ("[t]here's no question, at the end of the day, that there was a prohibited act"), but argued that the *mens rea* had not been established.

[326] *Mens rea* was therefore the focus of Fauth's submissions on the fraud allegation. Although he agreed with Staff that *Théroux* sets out the governing law on fraud in Canada, he suggested that Staff's summary of the law was "incomplete". He relied on the B.C. Court of Appeal's (**BCCA**) decision in *Anderson v. British Columbia Securities Commission*, 2004 BCCA 7, which in turn cited the companion case to *Théroux*, *R. v. Zlatic*, [1993] 2 S.C.R. 29. In particular, Fauth highlighted the following statement from *Zlatic* (at para. 33), wherein the SCC referenced one of its previous fraud decisions:

> The critical question was whether the transfer of investment vehicles could be considered within the bona fides business interest of the target company, or was more appropriately seen as a transfer designed to serve the personal ends of the parties who effected the transfer, bearing no relation to bona fides business purposes.

[327] Fauth also cited the following statements from *Théroux* – the first from the concurring minority decision delivered by Sopinka J. (at para. 3), and the last three from the majority decision (at paras. 20-22):

> **3** . . . If the risk of deprivation is dependent on some future event not happening but the accused honestly believes that the future event will happen and there will be no deprivation, a trial judge who accepts this evidence should acquit. . . .
>
> . . .
>
> **20** . . . Mens rea . . . refers to the guilty mind, the wrongful intention, of the accused. Its function in criminal law is to prevent the conviction of the morally innocent -- those who do not understand or intend the consequences of their acts. . . .
>
> **21** . . . the test for mens rea is subjective. The test is not whether a reasonable person would have foreseen the consequences of the prohibited act, but whether the accused subjectively appreciated those consequences at least as a possibility. In applying the subjective test, the court looks to the accused's intention and the facts as the accused believed them to be . . .
>
> **22** . . . The question is whether the accused subjectively appreciated that certain consequences would follow from his or her acts, not whether the accused believed the acts or their consequences to be moral. . . .

[328] Based on these statements of law, Fauth argued that his "subjective state of mind" and "the history of the Espoir business" must be considered when applying the *mens rea* portion of the test

in *Théroux*. In further support of this contention, Fauth relied on the Ontario Securities Commission's (**OSC**) lengthy decision in *Re Sino-Forest Corporation*, 2017 ONSEC 27. The OSC panel cited *Anderson* – in which the BCCA had said fraud requires a "'guilty state of mind as well as an act'" – and said that as a result, "the subjective knowledge of the respondent" must be taken into account (at para. 1030).

[329] Fauth also noted the distinction the SCC had drawn in *Zlatic* between unwise business practices and fraud (at para. 37):

> The distinction is the same as the distinction between a corporate officer using corporate funds for unwise business purposes, which is not fraud, and the diversion of corporate funds to private purposes having nothing to do with business. Unwise business practices are not fraudulent.

[330] In view of all of the foregoing, Fauth argued that his "intentions in this case are critical", particularly with respect to the fraud allegation. He pointed to the following as indicative of his "good intentions" and his absence of intent to defraud:

- Espoir did invest in mortgages in its early years;
- ". . . until the burst of the bubble in early 2013, Espoir always paid all of its interest obligations on time and in full" – and some of the investors who testified at the Hearing "received large amounts of interest";
- he fully disclosed to the ASC at an early juncture that he, members of his family and various non-arm's length parties owed money to Espoir, some of which was later set off against the invoices they rendered, and all such debts were properly reflected in Espoir's accounting documents;
- he did not plan Espoir as a scheme to enrich himself and his family; in fact, he and Sherri also invested heavily in FairWest and ended up losing everything, such that they both had to make proposals under the Canada *Bankruptcy and Insolvency Act* in 2015;
- while he "took . . . money out of Espoir early", more went in than was taken out during the Financial Review Period;
- the Espoir Investor Capital Breakdown showed he had "invested $1,589,319 of his <u>own</u> money in Espoir" (Fauth's emphasis) and certain investor witnesses testified they knew Fauth had invested personally – this was "not consistent with an attempt to defraud" but rather was consistent with an "intent . . . to earn money for investors through Espoir";
- his clients made money on their other investments; and
- "post-2013", he "scrambl[ed] to salvage some recovery for some of his most needy clients", such as TB and WC.

[331] Fundamentally, Fauth argued, he directed Espoir funds to FairWest and the oil and gas LPs in the best interests of Espoir's investors: "The idea, and the hope, was that the FairWest shares would vastly increase in value, perhaps up to $3 per share, so all Espoir investors and also Vern Fauth would make large profits on the shares and units held in FairWest and the LP's [sic]." He took the position as FairWest's CEO in order to help save the company, and "protect Espoir and its investments from loss as best he could". Unfortunately, there was an economic downturn that was beyond his control and led to FairWest's failure. If FairWest had increased in value as he had hoped and expected, there would have been no deprivation and therefore no *actus reus* and no fraud.

[332] In short, Fauth argued that he did not intend to perpetrate a fraud or cause deprivation to the Espoir investors by losing their money – to the contrary, he wanted "to make them money". Accordingly, he submitted that the necessary *mens rea* had not been established.

4. Discussion and Conclusion on Fraud

(a) *Actus reus*

[333] Even apart from the concession on the point made by Fauth's counsel, there is little doubt that the evidence led at the Hearing established the *actus reus* of the fraud alleged in the NOH.

[334] As discussed with respect to the misrepresentation allegations, both verbally and in writing, Fauth led investors to believe that investments in Espoir were safe and secure because Espoir, in turn, would only use the funds it raised to make certain types of safe and secure investments. In reality, Fauth caused Espoir to use those funds in a variety of ways which had not been disclosed to investors and were neither safe nor secure. These acts of deceit and falsehood created an immediate risk of deprivation, and later resulted in actual deprivation.

[335] The second particular for fraud alleged in the NOH was not specifically argued by Staff. It was thus not clear which "one investor" they had in mind when they alleged that Fauth deceived "at least one investor to believe that investment funds would not be invested in FairWest". However, the evidence from several investor witnesses was to that effect.

[336] HM, for example, testified that he specifically told Fauth he did not want the money his numbered company paid for its two Secured Debentures to go to FairWest, as he had had other business dealings with that company, had trouble getting paid for services, and did not wish to risk additional funds by investing in FairWest. Fauth assured him funds would not be invested in FairWest, but later acknowledged that they had been. Likewise, RT testified that while Fauth encouraged him to invest in FairWest directly, he was not interested in an unsecured investment and therefore specifically declined to invest in FairWest and bought a Secured Debenture instead. He was not told that his money might go to FairWest anyway, or he would not have invested in Espoir.

[337] In reality, as Fauth acknowledged both in his Interview and to some investor witnesses, funds invested in Espoir were advanced to FairWest, both directly and indirectly (the latter through loans to other parties who in turn invested the proceeds in FairWest). This was confirmed by the financial records in evidence.

[338] It is true that during the Financial Review Period, FairWest repaid slightly more to Espoir than it received. However, we consider that irrelevant to the fraud allegation, which properly focused on the deceit involved rather than the net effect of payments in and out at any given point in time. Investors were misled, their funds were exposed to the risk of loss, and then, ultimately, they suffered actual loss.

[339] The final particular alleged in the NOH constituted both an act of deceit by non-disclosure and an "unauthorized diversion of funds". Investors testified they were not told the money they invested in Espoir would be loaned to or invested in other Fauth-owned, controlled or managed entities, or used to pay principal and interest to other investors. In reality, such uses were common. During his Interview, Fauth acknowledged as much, and this was confirmed by the financial records. A few examples were set out previously in these reasons, but there were a number of others, including instances where an Espoir investor made an investment and some of those very funds were used to pay the same investor interest on an earlier investment. Again, investors were not informed, their funds were exposed to a risk of loss they did not anticipate, and, ultimately, were lost.

[340] On the issue of *actus reus*, one further point to be addressed was the suggestion during oral argument that if FairWest had succeeded as Fauth hoped, there would have been no deprivation to Espoir investors and therefore no *actus reus* and no fraud. This is incorrect in law based on *Théroux*, because the test contemplates both actual loss and the risk of loss. Funds loaned to or invested in FairWest and the oil and gas LPs without full security would have been at risk of loss until they were repaid. This point was made by Sopinka J. in *Théroux* (at para. 3), and was the reason he concurred with the majority of the SCC in the result of the appeal.

(b) *Mens rea*

[341] We are also satisfied that the evidence led at the Hearing established the *mens rea* of fraud as alleged in the NOH.

[342] First, it is clear that Fauth had subjective knowledge of his prohibited acts. As the only person who dealt with Espoir investors, Fauth knew what they had been told (and not told) about the safety and security of an investment in Espoir and the uses to which investment funds would be put. Further, as its sole guiding mind and its sole signing authority, he also knew how Espoir actually used its investment funds. He knew that the vast majority of those uses were neither safe nor secure, and that they did not fall within the investment categories listed on the Espoir Summaries and other documents. He knew that funds had been used to make payments to other investors, and he knew that funds had been advanced to businesses he owned, controlled or managed – including FairWest.

[343] In other words, Fauth knew that he deceived Espoir investors. He also knew that he caused Espoir to use funds in ways that were undisclosed to and unauthorized by those investors. Whether or not Espoir started out making the kinds of investments represented, it did not continue that way, including during the relevant period. Fauth knew it, and admitted it both during his Interview, and during conversations with certain investors – such as MT in July 2013.

[344] Second, we are satisfied that Fauth also had subjective knowledge of the consequences and potential consequences of his prohibited acts. He knew that using investment funds in ways which

were not only unsecured but, in some cases, undocumented, placed the Espoir investors' pecuniary interests at risk, as did using such funds to pay other investors rather than to generate actual returns. Satisfying investor obligations in that manner – the manner of a Ponzi scheme – is unsustainable, and experienced financial planning professionals like Fauth know that to be the case.

[345] Moreover, we are of the view that Fauth's awareness of the prospect of financial loss was the reason he did not disclose the actual use of funds or change the content of investor materials like the Espoir Summaries. He wanted to raise money and knew prospective investors were more likely to invest if they had specific assurances their money would be safe. Since he knew that unsecured loans to and investments in non-arm's length entities – especially those involved in the unpredictable oil and gas industry – did not fit the bill, he did not disclose them.

[346] Our conclusion in that regard is reinforced by certain communications Fauth sent to investors. Even if we were to assume that his failure to mention certain uses of funds and his failure to update the Espoir Summaries were inadvertent, inadvertence would not explain the falsehoods in the Espoir Investor Capital Breakdown, the September 2010 Update Letter, or Fauth's January 8, 2012 e-mail to HM. Among other things, each of those documents contained references to mortgages and secured investments which, by Fauth's own admission, did not exist.

[347] In light of the foregoing, we conclude that Fauth was aware of the risk to which he had subjected funds invested in Espoir, and that he consciously chose not to disclose that risk. If he were as confident in a positive outcome for FairWest and the oil and gas LPs as he claimed in argument, there would have been no reason not to tell Espoir investors expecting safe and secure investments that that was how their funds had been and would be used. As stated in *Théroux* (at para. 29): ". . . in cases like the present one, where the accused tells a lie knowing others will act on it and thereby puts their property at risk, the inference of subjective knowledge that the property of another would be put at risk is clear".

[348] Thus, both elements of *mens rea* enunciated in the *Théroux* test were established.

[349] With respect to the issue of Fauth's supposed "good intentions", it is not necessary for us to decide whether or not he intended to defraud in the colloquial sense that he deliberately set out to lose or steal people's money for his own benefit. The governing case law is clear that the intent referenced is not intent to defraud in that sense; rather, it is the intent to commit the prohibited acts – here, the deliberate falsehoods and the deliberate, unauthorized uses of funds despiterepresentations to the contrary – knowing the potential consequences (*Théroux* at paras. 24, 40).

[350] Similarly, it is not necessary for us to decide on the wisdom or legitimacy of Fauth's business decision to use Espoir funds as he did, or the authenticity of his hopes for FairWest and the LPs. We are mindful of the SCC's observation in *Théroux* that, "[m]any frauds are perpetrated by people who think there is nothing wrong in what they are doing or who sincerely believe that their act of placing other people's property at risk will not ultimately result in actual loss to those persons" (at para. 36). Whether or not investments in and loans to FairWest and the other entities were a reasonable choice in some other context, the crucial point here is that investors were deliberately deceived, and their funds were exposed to risks to which they did not agree.

[351] In other words, we reject Fauth's interpretation of intention in the context of *Théroux*. In that case, the accused (appellant) was the directing mind of a company involved in residential construction. House purchasers were told that their deposits on new homes to be constructed were insured. This was false, and when the builder became insolvent and thus unable to complete the housing project, most of the depositors lost their money (at paras. 5-9).

[352] The issue squarely before the SCC was "whether the fact that [Théroux] honestly believed that the projects would be completed negates the guilty mind or mens rea of the offence" (at para. 13) – or, as stated elsewhere in the decision, "whether a belief that, in the end, a dishonest practice will not result in loss to the victims of that practice, negates the guilty mind necessary to establish the offence of fraud" (at para. 4).

[353] The majority of the SCC analyzed this question as follows (at paras. 41-43):

> The trial judge found that the appellant deliberately lied to his customers, by means of verbal misrepresentations, a certificate of participation in the insurance scheme, and brochures advising that the scheme protected all deposits. The lies were told in order to induce potential customers to enter into contracts for the homes the appellant was selling and to induce them to give him their money as deposits on the purchase of these homes. The trial judge also found that the appellant knew at the time he made these falsehoods that the insurance for the deposits was not in place. Finally, he found that the appellant genuinely believed that the homes would be built and hence that there was no risk to the depositors. "No risk" used in this sense is the equivalent of saying the appellant believed the risk would not materialize.
>
> Applying the principles discussed above, these findings establish that the appellant was guilty of fraud. The actus reus of the offence is clearly established. The appellant committed deliberate falsehoods. Those falsehoods caused or gave rise to deprivation. First, the depositors did not get the insurance protection they were told they would get. That, in itself, is a deprivation sufficient to establish the actus reus [of] fraud. Second, the money they gave to the appellant's company was put at risk, a risk which in most cases materialized. Again, this suffices to establish deprivation.
>
> The mens rea too is established. The appellant told the depositors they had insurance protection when he knew that they did not have that protection. He knew this to be false. He knew that by this act he was depriving the depositors of something they thought they had, insurance protection. It may also be inferred from his possession of this knowledge that the appellant knew that he was placing the depositors' money at risk. That established, his mens rea is proved. The fact that he sincerely believed that in the end the houses would be built and that the risk would not materialize cannot save him.

[354] If one reads "security" in place of "insurance" and belief that "FairWest and the oil and gas LPs would succeed" in place of belief that "the homes would be built", the application of this analysis to Fauth and Espoir leads to the conclusion we have drawn and explained above, just as it led to the dismissal of Théroux's appeal to the SCC.

[355] The same is also true of the following passage from the minority decision in *Théroux*, delivered by Sopinka J. (at para. 3) and relied on in part by Fauth:

> In this case, the trial judge's finding that the appellant deliberately lied to his customers that their deposits were insured determines both the actus reus and mens rea of deceit which is the first element in the definition of fraud. That leaves for consideration the issue of deprivation or risk thereof which is the second element. The trial judge found that there was no insurance in place but that the appellant believed that there was no risk to the depositors because the project would be completed

> and the depositors would obtain the homes in respect of which the deposits were placed. If the sole issue were whether the conduct of the appellant created a risk of deprivation to the depositors of their deposits by reason of the non-completion of the project, I would have allowed the appeal. If the risk of deprivation is dependent on some future event not happening but the accused honestly believes that the future event will happen and there will be no deprivation, a trial judge who accepts this evidence should acquit. The Crown will not have proved mens rea with respect to deprivation. **In this case, however, the trial judge found there was no insurance in place and, therefore, even if the project were eventually completed, there would have been a deprivation or risk of deprivation during the uninsured period.** [all emphasis added]

[356] While the underlined portion of this paragraph is one of the points on which the minority of the SCC disagreed with the majority, it was relied on by Fauth in argument as noted previously. It was cited in support of his contention that *mens rea* was not proved because he did not intend for anyone to lose their money – he intended for everyone to make money, through the success of FairWest. However, Fauth's argument ignored the effect of the final, bolded sentence in the paragraph, which drew an important distinction based on the facts of the case: Théroux had falsely told his home purchasers their deposits were insured. Even if the homes had been built, the risk of deprivation in the interim satisfied the deprivation portion of the test.

[357] Sopinka J. reiterated this point in dissent in *Zlatic* (at para. 11):

> In Théroux, my colleague properly points out that with respect to deprivation or risk thereof, either knowledge or recklessness must be proved. In the latter case, "knowledge of the likelihood" of the deprivation or risk is required. If the accused honestly believes there is no risk, this aspect of mens rea is not made out. . . . If the actus reus has resulted in a deprivation or risk thereof, an intention to make good the loss or to remove the risk is not a defence. The offence is complete and a good intention will not save the accused. That is the situation in Théroux. The accused had subjected the deposits of his customers to a risk by his false representation. He did so knowingly, and his honest belief that the risk would not result in an eventual loss was to no avail. It is quite a different situation where, as here [i.e., in *Zlatic*], in respect of the very activity relied on as creating the risk, the accused states that he honestly believed no risk was created.

[358] In this case, while Fauth's counsel directed us to evidence from the Interview concerning Fauth's hopes and expectations for FairWest and the related entities, we were not directed to any evidence suggesting that Fauth believed Espoir's use of funds was without risk. To the contrary, there was evidence (as described above) suggesting Fauth knew there was risk in what he was doing and chose to conceal it in order to induce risk-averse investors to continue to make their investments.

[359] Nothing in *Anderson* or *Sino-Forest* (citing *Anderson*) alters these conclusions or assists Fauth. Both decisions rejected the notion that the fraud provisions in the *Securities Act* of B.C. and Ontario, respectively, created an objective rather than a subjective standard for assessing *mens rea* (*Anderson* at paras. 23-24; *Sino-Forest* at para. 1030). Thus, the BCCA in *Anderson* overturned the finding of fraud that had been made by the BCSC, as the BCSC had based its decision "on what the appellants ought to have known . . . rather than what they actually knew". The BCCA found "no evidence that the appellants made any intentionally false statements to investors", and to the contrary, found that the appellants were actually unaware of their company's perilous financial condition – information the BCSC faulted them for not disclosing (at paras. 20, 23, 28, 30-32). That was not the situation in the case before us.

[360] The BCCA also overturned the BCSC's conclusion that Anderson and his co-appellant perpetrated a fraud because they "did not disclose to investors that they were using investors' funds for their own purposes and not for the proper conduct of the Company's business" (at para. 20). As pointed out by Fauth, the BCCA found that the BCSC had "ignored the subjective state of mind of the appellants and the history of the business", and referenced a passage from the majority decision in *Zlatic* with respect to whether a transfer of investment vehicles was fraudulent or "within the bona fides business interest of the . . . company" (at para. 33, citing *Zlatic* at para. 33).

[361] However, this is not helpful to Fauth, either, because there was no finding in *Anderson* that investors were deceived about the use of their funds. The appellants' business was "making loans to individuals and small businesses in and around Burns Lake, British Columbia" (at para. 3), and making such loans to themselves and parties related to them was not found to be inconsistent with that business (at para. 33). By contrast, Espoir's investors were led to believe that its business was making secured loans and investments. Fauth deviated from that and betrayed investors' expectations by making unsecured, risky loans and investments – whether to parties he owned, controlled or managed, or to others at arm's length.

[362] In view of that fundamental deceit, the other matters Fauth cited in his favour – that his clients made money on their other investments and received their interest payments from Espoir until 2013, that he and his spouse also lost their money, that he did his best to get money to the most desperate Espoir investors even after all other payments ceased – simply do not answer the test in *Théroux*. Nor do we attach any significance to the amount of funds that Fauth and related parties paid to Espoir during the Financial Review Period versus the amount paid out by Espoir. As we stated previously, that is not determinative, as the crucial point was not the net balance at a given moment in time. It was that between January 1, 2009 and September 30, 2014, Fauth consciously misled investors and knowingly put their money at risk.

[363] Thus we find that Fauth breached s. 93(b) of the Act as alleged.

VI. CONCLUSION

[364] We have found that Fauth breached Alberta securities laws as discussed above. This proceeding now moves into a second phase to determine what, if any, sanction or cost-recovery orders should be made against him.

[365] To that end, we make the following directions:

- Staff shall provide their written submissions on the subject of appropriate orders to the panel (through the ASC Registrar) and to Fauth **by 4:00 p.m. on November 29, 2018**;

- Fauth may respond in writing to Staff's written submissions by providing his submissions to the panel (through the ASC Registrar) and to Staff **by 4:00 p.m. on December 6, 2018**; and

- Staff may reply in writing to Fauth's written submissions by providing their reply submissions to the panel (through the ASC Registrar) and to Fauth **by 4:00 p.m. on December 13, 2018**.

[366] A further in-person hearing session will be held on **December 20, 2018, commencing at 9:00 a.m**. If either Staff or Fauth wish to lead evidence with respect to the issue of appropriate orders, they must advise the ASC Registrar **by 4:00 p.m. on December 6, 2018**, and indicate the amount of hearing time that party requires.

[367] In accordance with s. 2.3 of Rule 15-501 *Rules of Practice and Procedure for Commission Proceedings*, if a party proposes to lead evidence, that party must provide the other party the following information **at least ten business days before the in-person hearing session**: (i) the names of any proposed witnesses; (ii) summaries of those witnesses' expected evidence; and (iii) copies of any documents intended to be entered as evidence.

November 8, 2018

For the Commission:

"original signed by"
Maryse Saint-Laurent

"original signed by"
Ian Beddis

"original signed by"
Webster Macdonald, QC