

ALBERTA SECURITIES COMMISSION
DECISION

Citation: Re Breitkreutz, 2018 ABASC 37

Date: 20180302

**Arnold Breitkreutz, Base Finance Ltd., Base Mortgage & Investments Ltd. and
Susan Elizabeth Way**

Panel: Bradley G. Nemetz, Q.C.
Ian Beddis
Maryse Saint-Laurent

Representation: Tom McCartney
Janet McCready
for Commission Staff

Arnold Breitkreutz
Susan Way
self-represented

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I. INTRODUCTION

[1] Alberta Securities Commission (**ASC**) staff (**Staff**) alleged that four respondents (the **Respondents**) – Arnold Breitkreutz (**Breitkreutz**), Susan Elizabeth Way (**Way**), Base Finance Ltd. (**Base Finance**) and Base Mortgage & Investments Ltd. (**Base Mortgage**) – contravened s. 93(b) of the *Securities Act* (Alberta) (the **Act**) when they engaged or participated in acts, practices or conduct relating to Base Finance's securities that they knew or reasonably ought to have known perpetrated a fraud on investors. Staff also alleged that such misconduct was contrary to the public interest.

[2] At the outset of the 11-day hearing into the merits of the allegations, Staff withdrew allegations that Breitkreutz made misleading or untrue statements to Staff. We heard testimony from witnesses called by Staff and by Breitkreutz, and we received numerous exhibits into evidence. We received written submissions from Staff and from Breitkreutz and Way, and we heard their oral submissions on July 13, 2017.

[3] Having reviewed the evidence and submissions, and for the reasons set out below, we find that Base Finance, Breitkreutz and Way contravened s. 93(b) of the Act.

II. THE ALLEGATIONS

[4] In a notice of hearing dated August 22, 2016, Staff alleged that Breitkreutz, Way and Base Finance told investors that their funds "would be lent by Base Finance to borrowers, and secured by first mortgages on real estate in Alberta", but that Base Finance and Base Mortgage instead "used new investors' funds to pay interest and principal owing to existing investors in a manner consistent with a Ponzi scheme".

[5] According to the notice of hearing, Base Finance raised approximately \$137,211,801 from "at least 261 investors" between August 1, 2006 and September 24, 2015, at which point the company owed about 240 investors approximately \$122 million but was unable to pay those investors their principal or returns.

[6] Staff alleged that Breitkreutz was the founder and guiding mind of Base Finance and Base Mortgage and that he authorized, permitted or acquiesced in the impugned corporate acts, practices and conduct. Staff alleged that Way, as the office manager and administrator for both companies, directly or indirectly engaged or participated in the impugned corporate acts, practices or conduct.

III. PROCEDURAL BACKGROUND

[7] On September 24, 2015, a representative from the Royal Bank of Canada (**RBC**) contacted the ASC to raise concerns following an internal investigation into suspicious activities in an RBC account belonging to Base Finance. From its review, RBC considered such activities to be consistent with a Ponzi scheme, as there were many account transactions with individual investors (with some references to principal and interest payments) without any apparent corresponding lending activities from the company (with perhaps one exception, as further explained below).

[8] Based on this information, the ASC began an investigation on September 24, 2015. Staff investigators gathered documents from various sources, conducted corporate and land titles searches, obtained bank records and interviewed numerous individuals, including Breitkreutz (on

January 7 and 28, 2016) and Way (on January 6, 2016). Both Breitkreutz's and Way's interviews were under oath or affirmation and they were each represented by legal counsel.

[9] On September 29, 2015, the ASC's Executive Director issued an order freezing Base Finance's RBC account. A subsequent court order authorized the payment of funds in Base Finance's account, totaling \$1,084,604, to some Base Finance investors.

[10] On October 15, 2015, BDO Canada Limited (the **Receiver**) was appointed receiver over Base Finance and Base Mortgage. Breitkreutz and Way were also named respondents in the receivership proceedings. The Receiver seized Base Finance's and Base Mortgage's records and conducted an extensive review of those records (including the banking records, which were not complete and had some months and periods missing, as the Receiver indicated in its reports to the court). The Receiver also held discussions with the companies' management, interested parties and the companies' stakeholders, culminating in a number of reports that were presented to the court as part of the receivership proceedings.

[11] On November 5, 2015, the ASC issued an interim order requiring, among other things, that all trading in securities of Base Finance cease. This order was later extended until this proceeding "is finally determined or otherwise concluded".

[12] As mentioned, Staff issued its notice of hearing on August 22, 2016.

IV. HEARING AND WITNESSES

[13] None of the Respondents were represented in the hearing by legal counsel. Breitkreutz principally conducted the defence on behalf of himself and Way, although she assisted Breitkreutz, cross-examined some witnesses (including Breitkreutz) and addressed the panel on occasion.

[14] Staff's witnesses included two ASC investigators, six Base Finance investors and Craig Fryzuk – a partner and senior vice president of the Receiver. Breitkreutz testified and called four witnesses: three Base Finance investors and his former lawyer. Way chose not to testify and did not call any witnesses.

A. Conflicting Evidence and Credibility

[15] During the course of our deliberations we assess the credibility of witnesses who testified before us, particularly given the Respondents' defence that they were engaged in a normal financing business, not operating a fraudulent scheme, and were not misleading investors.

[16] In considering the credibility of the witnesses, we are mindful of the principles set out in *R. v. Boyle*, 2001 ABPC 152 at para. 107, citing *Faryna v. Chorny*, [1952] 2 D.L.R. 354 (B.C.C.A.) at 357, that:

The credibility of interested witnesses, 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 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.

[17] As well we have regard for the words of O'Halloran J.A. of the British Columbia Court of Appeal in *R. v. Pressley*, 1948 CarswellBC 123 at para. 13 (referenced in *Springer v. Aird & Berlis LLP*, 2009 CarswellOnt 1832 (S.C.J.) at para. 14 and in [Re Suman (2012), 35 OSCB 2809] at para. 315), that:

... The Judge is not given a divine insight into the hearts and minds of the witnesses appearing before him. Justice does not descend automatically upon the best actor in the witness box. The most satisfactory judicial test of truth lies in its harmony or lack of harmony with the preponderance of probabilities disclosed by the facts and circumstances in the conditions of the particular case.

[18] We took into account the above principles in analyzing the evidence and reaching our conclusions. We generally found the testimony of all witnesses, with the exception of Breitkreutz, to be generally consistent with or supported by documentary evidence, and we therefore considered their evidence to be credible.

[19] Breitkreutz's testimony on key points often conflicted with other testimony (including his own) and with documentary evidence. When cross-examined by Staff, he was argumentative and evasive. For example, Breitkreutz (previously a mortgage broker) was asked about the meaning of "demised premises" as used in a Base Finance document. He acknowledged that the term indicates "a property" and said "[a]n oil well in Texas is property". When asked if he agreed that the term "premises" does not imply an oil and gas lease, he said "I don't believe it has to" and that he did not know what it implied.

[20] In respect of certain topics, Breitkreutz asserted that he had documentary proof to support his testimony but he was unable to provide such evidence to the panel because Base Finance's records had been seized by, and were in the possession of, the Receiver. Breitkreutz proclaimed to having limited (and at times no) access to such documents. However, he acknowledged having obtained documents in the possession of the Receiver by April 2017, and the Receiver's evidence indicated that on at least five prior occasions Breitkreutz or his agents had been provided access to review and obtain copies of records in the Receiver's possession. Breitkreutz also was in receipt of Staff's prehearing disclosure. In the circumstances, we consider that Breitkreutz was provided a fair opportunity to access and obtain documents to make full answer and defence to Staff's allegations. Breitkreutz also indicated that he "didn't think of bringing" certain documents to the hearing to support his assertions. Breitkreutz's cross-examination was adjourned and he was provided an opportunity over a weekend to locate documentary evidence to support his testimony. Breitkreutz then provided additional documents to support some of his testimony on certain topics but not others.

[21] Breitkreutz's evidence on his use of computers is also relevant to our decision, as certain of the emails in evidence provided insight into what he might have known about what investors were being told or what they believed about the nature of the mortgages that they were investing in. At one point he stated that "I don't do emails myself, and I don't know how to send one, and I don't know how to retrieve one". Another time he said that he did not "send personal emails to very many people because I don't know how to do that", and that Way would, from time to time, send emails to investors "on my behalf". Yet many documents (including some which he put into evidence) showed Way and other individuals closely associated with Base Finance sending emails

to Breitkreutz at his email address. Thus, people close to Breitkreutz in this investment scheme used his email address to communicate with him. Moreover, Breitkreutz acknowledged that he was able to receive and read emails sent to him.

[22] To summarize, we generally neither believed nor accepted Breitkreutz's testimony on key points. Where his evidence conflicted with that of other witnesses, we preferred and accepted those witnesses' evidence.

V. EVIDENCE

A. Parties

1. Breitkreutz

[23] Breitkreutz was hired by a finance company in the late 1960s, where he gained experience in lending and collections. He worked in the lending business for various companies until he created Base Mortgage in 1978. He brokered mortgages until 1984, when he created Base Finance as a private investment company. The evidence before us confirmed that Breitkreutz became a licenced mortgage broker with the Real Estate Council of Alberta in October 1997, an accreditation he held until May 2013 when he gave up his licence with plans of retiring.

[24] Breitkreutz was, at all times material to this proceeding, the founder, sole director and shareholder of Base Finance and Base Mortgage, and had signing authority for both companies' bank accounts. We find that Breitkreutz was the guiding mind of Base Finance and Base Mortgage at all relevant times.

2. Way

[25] According to Breitkreutz, he and Way "ran a two-man shop". She worked for Breitkreutz prior to Base Finance's incorporation and was Base Finance's and Base Mortgage's office manager and sole employee. Way had signing authority for the corporate bank accounts, signed the majority of company cheques and was responsible for the companies' bookkeeping and banking. She also managed the accounting records and maintained an organized ledger detailing investor contributions and payments.

[26] Way made an assignment into bankruptcy on May 5, 2016.

3. Base Finance

[27] Breitkreutz incorporated Base Finance in Alberta in February 1984, with the intent that it be a "private mortgage investment company". Its primary operating bank account was held with the Bank of Montreal until Base Finance was asked to "make alternate banking arrangements". Base Finance then opened an operating account with RBC in May 2014, which it continued to use until frozen by the September 29, 2015 ASC Order.

[28] Base Finance is currently in receivership. At the time of receivership, Base Finance reportedly owed approximately \$122 million to about 240 investors (including \$1,125,000 to Breitkreutz and his wife, and \$10,000 to Way).

4. Base Mortgage

[29] Base Mortgage was incorporated in Alberta in August 1978, with the intent that it be a mortgage broker. In response to an ASC inquiry in April 2012, Breitkreutz advised that Base Mortgage had "been brokering all types of mortgages for the past thirty-five years", but that very little brokering had been done since 2009, "and for the past two years none at all as we have been winding down to retirement".

[30] At all times material to this proceeding, Base Mortgage operated as administrator for Base Finance. It received a monthly payment from Base Finance and paid the operating expenses for both companies. According to Breitkreutz, Base Mortgage was not directly involved in any lending or "gathering of investors", although the Receiver determined that one of Base Mortgage's accounts received deposits from investors that were "subsequently transferred to" Base Finance.

[31] Base Mortgage is currently in receivership.

B. Base Finance Investments

[32] Investments in Base Finance were essentially loans, in which investors provided money to Base Finance in exchange for a mortgage assignment (or a portion thereof) held by Base Finance. Investors received a document entitled "Irrevocable Assignment of Mortgage Interest" (**Assignments or Assignment**), which were typically signed by Way for Base Finance. The Assignment documents were structured the same; each provided that Base Finance was irrevocably assigning a mortgage interest to the lender (i.e., the investor) against "1st mortgages" held by Base Finance and that Base Finance "shall direct from the borrowers . . . to the lender, interest payments" at the stipulated rate with the principal balance (plus any applicable bonus) due and payable at the end of the term. Unique to each Assignment was the identity of the investor, the date and principal amount of each loan, the applicable interest rate (generally between 9 and 14% per annum), whether any bonus was payable and the amount of the bonus, and the term of the loan (typically six or twelve months).

[33] Assignments required written notice to be provided by the investor if he or she did not wish to extend the term of the Assignment, failing which it would be "renewed at the borrower's option". An additional provision absolved Base Finance from any liability associated with default and limited the investor's remedies to "the demised premises and the borrowers".

[34] Base Finance maintained a good record of making payments to investors, who often allowed their principal to rollover, in which case the investor would be issued a new Assignment.

[35] Marketing of Base Finance investments occurred primarily by word of mouth and the company did not issue any marketing materials or rely on a prospectus. Investors generally understood that their investments were secured by a mortgage over real estate located in Alberta. However, aside from two exceptions, we received no evidence of any Alberta-based mortgages, or in fact any first mortgages, held by Base Finance for the period in question. Instead, Breitkreutz produced a deed of trust (the **Deed of Trust**) dated October 3, 2014, which purported to secure certain oil and gas interests in the state of Texas. The Deed of Trust was signed by Brian Fox (**Fox**) as director of Saddle Lake LLC (**Saddle Lake**), and stated that it was "given to secure payment and performance" of indebtedness evidenced by a \$30 million promissory note payable

by Saddle Lake to Base Finance. In evidence was a December 2, 2014 promissory note, in the amount of \$30 million with a three-year term payable to Base Finance from Saddle Lake. This note was described as "security for a Line of Credit and is secured as well by way of Deed of Trust for all funds advanced to Saddle Lake Energy, LLC" by Base Finance.

[36] Breitkreutz asserted that Base Finance loaned money to Fox and his companies over the course of 35 years to produce oil and gas properties, including those secured by the Deed of Trust. Since at least 2004, most of the investors' money was used to make interest payments and principal repayments to other Base Finance investors.

C. Investor Evidence

[37] Several investors testified, but a brief description of the evidence of three of them will suffice to provide their perspective and their understanding of their investment in Base Finance.

[38] One investor was introduced to Base Finance by his cousin Way in 2000 when she was helping his father with financial affairs. He said that Way presented to him an opportunity to invest \$150,000 through Base Mortgage in "a first mortgage on some property or house" and have interest paid monthly to his father. Way set up a meeting between her cousin and Breitkreutz, who discussed the opportunity in similar terms, albeit without reference to the house or property that was the subject of the investment. Breitkreutz reiterated the terms of the investment and pointed out that if the borrower failed to pay, the investor's recourse would be against the borrower and not Base Finance or Breitkreutz. Breitkreutz also advised the investor that there had been only one foreclosure in 12 or 15 years of operations.

[39] The investor continued to invest with Base Finance, contributing both his and his wife's money. When Base Finance went into receivership, they had \$7.1 million in outstanding investments with Base Finance.

[40] Way's cousin understood that he was investing "in the Alberta real estate market" and considered his Base Finance investment to be "medium-risk". He said that he had no reason to think he was investing in the oil and gas business, Breitkreutz did not tell him that his funds were invested as such, and he would not have invested with Base Finance had he known that fact. When he asked about the identity of the homes or real estate that was the subject of his Assignments, Breitkreutz told him that it was none of his business. The investor said that he continued to do business with Base Finance "because of Susan [Way]".

[41] Another investor learned about Base Finance in the early 1990s through a childhood friend, Lyle Hogaboam (**Hogaboam**), who held himself out as being in the mortgage investment business with Base Finance. His initial investment in Base Finance was made through Hogaboam's company. He had understood from Hogaboam that he was receiving an assignment of a first mortgage registered on Calgary real estate.

[42] This investor met Breitkreutz in the late 1990s or early 2000s, and by the mid-2000s he communicated with either Breitkreutz (by telephone) or Hogaboam (by email) about his Base Finance investments. He was primarily interested in knowing whether the underlying property was located in Calgary and that the loan-to-value ratio was reasonable. He said that Breitkreutz

provided limited information about the investments and he did not recall Breitkreutz telling him that the underlying mortgages were on Alberta property. However, Breitkreutz's interactions with this investor show that Breitkreutz knew communications were presented in a manner that suggested that mortgages were on Calgary properties. For example, in a September 2015 email exchange involving a Base Finance investment of \$500,000 between Breitkreutz, Hogaboam and the investor (as well as two of his friends who also invested with Base Finance), Hogaboam stated:

Further to our telephone discussion Saturday, Arnold's main appraiser is out of town until Monday so the appraisal update will be in his hands [a] week this Tuesday. The property is in Windsor Park as is Base's office so he's very familiar with values there . . . and thinks the update will be close to the \$750,000.

[43] He advanced \$500,000 to Base Finance on September 23, 2015. This deposit into Base Finance's account (shortly before the account was frozen) nearly doubled the balance in that account.

[44] The investor said that Breitkreutz never suggested to him that his investments involved properties other than real estate in Calgary, and Breitkreutz never told him that Base Finance was investing in oil and gas interests located in the United States (**US**). He considered such investments to present a "very high" risk and he felt that a mortgage investment allowed him to diversify his investment portfolio. He testified about a lunch that he (along with another Base Finance investor) had with Breitkreutz in 2012, at which time Breitkreutz "talked about oil and gas investment in the US", particularly in relation to a venture that he was considering. The investor told Breitkreutz during the meeting that "any investment in oil and gas is extremely risky, particularly in the US" and that he had "no interest" in such investments.

[45] Ultimately, the investor's principal investments in Base Finance (and that of his wife) exceeded \$2.1 million by the time Base Finance was in receivership (not including his \$500,000 advance in September 2015, for which he received about \$482,000 from the Receiver). He said that he received payments from Base Finance – "[i]nterest only" – but he never withdrew any principal as he allowed his investments to be reinvested into new assignments.

[46] A third investor witness testified that she and her husband were introduced to Base Finance by friends who had been investing with Base Finance for years. She received Hogaboam's email address, and the couple contacted him about investment opportunities. She and her husband began investing with Base Finance in 2005 or 2006.

[47] The couple regularly received investment opportunities by way of email from Hogaboam, and understood from him that the mortgage assignments related to mortgages on either commercial or residential property in the Calgary area that would be arranged and registered on title by Base Finance. Hogaboam also told them that the mortgage was always a first mortgage and would not be more than 65% of the value of the property, which "seemed quite secure".

[48] In 2014, the couple sold their Calgary residence with plans to build a house in British Columbia. Her husband contacted Hogaboam by email to indicate that they were interested in temporarily investing an additional \$100,000. When Hogaboam learned that the couple had additional funds to invest, he aggressively persuaded them to invest \$400,000 with Base Finance.

His email to the couple on July 21, 2014 (copied to Breitkreutz) indicated that they could invest \$400,000 for a period of six months. The couple advanced \$400,000 to Base Finance on August 11, 2014.

[49] At the end of 2014, the couple discovered that their funds had been locked in for a year (rather than for six months as initially discussed), and they expressed concern to Hogaboam about the risks involved "and the potential for an economic downturn from the low oil prices". In his response, Hogaboam stated:

... as with all of our . . . first mortgages, the loan to value will be under 65% especially for this amount of money. We are not oil price speculators. We are strictly high equity lenders which allows for market fluctuations very well.

[50] The couple also asked whether they could access some of their invested funds to pay their house construction costs. Hogaboam said that he would forward their request to Breitkreutz and get back to them on their options. In February 2015, the couple were told that they might be able to receive some funds in March. When no payout was received, they gave written notice to Base Finance to have their investment paid out at the end of the one-year term.

[51] On August 13, 2015, Hogaboam emailed the couple (with a copy to both Breitkreutz and Way) stating:

Arnold advised me this afternoon that your borrower apparently left the refinancing too late and now cannot meet the payout deadline of August 15th. This despite telling Arnold that there would be no glitches.

...

The borrower will bring your interest payment into Base and a cheque will be mailed to you shortly.

[52] The couple, concerned about this development, arranged a telephone call with Breitkreutz on August 17, 2015. In evidence is a transcript of that telephone conversation, along with a file of the audio recording. In that conversation, Breitkreutz affirmed the couple's understanding that the underlying property for this investment was on a residential property:

INVESTOR: Now, is he still secured on this mortgage (INAUDIBLE) –

ARNOLD BREITKREUTZ: The mortgage has – yes. Our – our mortgage security hasn't changed at all.

...

INVESTOR: Okay. Is the security still 500,000 on the first mortgage on his personal residence that's valued at 2 million?

ARNOLD BREITKREUTZ: Oh, yeah. M-hm. That has – nothing has changed in that regard. I've been carrying the mortgage on this fellow, and I've had a mortgage on his property for the last 15, 20 years, and, you know, he uses us like a line of credit.

[53] At another point in the conversation, the following exchange occurred:

INVESTOR: . . . when we entered this with [Hogaboam], we were looking for a short-term commitment because we were planning on building and needed money for, you know, building advances, and [Hogaboam] had – had advised [her husband] that the borrower was using the funds on a spec home that had been basically pre-sold and that – that we may not even be looking at six months, that the money might be in for three or four months and then we'd get paid out.

ARNOLD BREITKREUTZ: Exactly. Had everything worked out.

[54] The witness testified that the telephone conversation reassured her (and her husband) "that there was still truly a mortgage". The panel received no evidence indicating that Base Finance held a \$500,000 first mortgage on a personal residence or that it lent money to a borrower for a pre-sold "spec home".

[55] She subsequently inquired about the "interest payment" that Hogaboam had said would be left by the borrower with Base Finance. In a September 11, 2015 email to her, Way said that she would contact the borrower "to get the interest cheque". On September 17, Way wrote another email telling her that the interest payment had been received and that she would be paid later that day. Base Finance's banking records revealed that Base Finance received no payment on that date, and that the most recent deposit into Base Finance's account occurred on September 4, 2015 (we understood this to be from another investor). In her interview with Staff, Way stated that the payment to the couple "[e]ither came out of the bank or from another investor, money that had been sitting there in the bank".

[56] The couple lost all their invested money (\$600,000) and were unable to build the house as they had planned. Instead, they were forced to sell another property in order to purchase a house, and the witness had to postpone her retirement.

D. Evidence from ASC Investigators and the Receiver

[57] In his interviews with ASC Staff, Breitkreutz said that Fox borrowed \$122 million from Base Finance on behalf of companies controlled by Fox. When asked what had happened to the \$122 million, Breitkreutz said:

It was monies that Mr. Fox borrowed over time. Most of the money – he borrowed money to capitalize his companies in between when he was making money and wasn't making money, he borrowed money in order to make his payments.

[58] Breitkreutz indicated to Staff that Base Finance provided money to Saddle Lake and Goliad Phoenix Energy LLC (**Goliad**), a company related to Fox. He also told Staff that he provided money to a number of different companies related to Fox prior to 2000 – primarily to Powder River Basin Gas Corp. (later known as Powder River Petroleum International Inc.) (**Powder River**). Fox was, at times, Powder River's sole director, president and chief executive officer. We were not provided any Base Finance ledger recording payments between Base Finance and Fox and his companies.

[59] A Staff investigator reviewed Base Finance's banking records for the period of January 1, 2011 to September 24, 2015 in an attempt to trace the source of deposits made to Base

Finance's accounts and to determine how those funds were used. In the review period, the Staff investigator testified that more than \$62 million of the deposits into Base Finance's primary operating accounts derived from identifiable Base Finance investors (nearly 75% of all deposits). During that same time frame, more than \$66 million (almost 80%) of withdrawals were paid to Base Finance investors. From his review, the investigator determined that there was no significant source of business revenue contributing to investment returns and investors' funds were pooled into Base Finance's accounts with returns on new or renewed investments largely paid from other investors' contributions. He also found "very little evidence of mortgage-lending business", other than a series of transactions between July 2013 and April 2015 involving two related companies that was "inconsistent amongst the rest of the account activity". In this series of transactions, Base Finance acted as an intermediary in flowing funds between the two related companies. The Staff investigator concluded that "all the proceeds went in and out just to those related parties" without the involvement of other Base Finance investors' funds, and that these transactions "appeared to be a different arrangement than that of other investors". (This was the only indication found by RBC that suggested any lending activity on the part of Base Finance.)

[60] As noted earlier, marketing to Base Finance investors occurred largely through word of mouth. Some individuals, notably Hogaboam, were paid for referring investors to Base Finance. In evidence was an email exchange between a Staff investigator and Hogaboam, who indicated that he met Breitkreutz in the early 1980's, that he and his wife invested "many times and in varying amounts" with Base Finance, and that he had referred friends and business acquaintances to Base Finance since 1987, for which he was paid referral fees. In response to an inquiry as to the training he received to solicit investors, Hogaboam stated:

... there was no training provided. Breitkreutz would simply phone and say he had a loan under contract, give me the amount, rate, term and a basic description of the property (i.e., a house in south-west Calgary with an appraised value of \$x). If I thought my friends or business acquaintances might be interested, I would simply pass that information on to them and tell them to contact [Base Finance] or get back to me if they were interested. If they got back to me and expressed interest I then provided them with contact information for [Base Finance].

[61] Many of the documents from the receivership were placed into evidence, including three of the Receiver's reports to the court (plus a supplementary report to its third report) that summarized the Receiver's review and findings. The Receiver's testimony, including documents admitted into evidence, provided significant insight into the operations of Base Finance, Base Mortgage, Fox and his related companies, and into the activities of Breitkreutz and Way.

[62] The Receiver determined that Base Finance raised about \$137 million from Base Finance investors between August 2004 and September 2015, that investors were owed approximately \$122 million at the time of Base Finance's receivership, and that investors had been paid approximately \$125,422,752 during the review period. The Receiver did not identify any Alberta-based mortgages held by Base Finance for the benefit of its investors, although a single mortgage (for a one-year term) was found to have been issued by Base Finance and discharged in 2008.

[63] The Receiver's evidence (including testimony, reports and appendices to the reports such as the transcript of oral questioning of Breitkreutz on an affidavit he had filed in the receivership proceedings) indicated the following:

- Breitkreutz maintained that Base Finance had lent money to Fox, through various companies he controlled, most of which had been advanced prior to 2000.
- Breitkreutz told the Receiver that he did not know "how much has been invested in Mr. Fox and his related companies" and estimated the amount to be in the range of \$30 million to \$80 million. The Receiver said that Fox "oppose[d] this position". When questioned under oath, Breitkreutz said that Fox had borrowed approximately \$120 million from Base Finance over a 35-year span, and Powder River assumed "all of the liabilities of Mr. Fox and his companies".
- The Receiver found no evidence showing the transfer of funds from Base Finance to Powder River during the period covered by the Receiver's review, although Fox was directly provided \$462,297 from Base Finance or Base Mortgage. The Receiver acknowledged that this figure did not include cash withdrawals (approximately \$1.7 million), which the Receiver could not trace.
- Powder River paid \$1,738,451 to Base Finance between August 1, 2004 and August 31, 2007.
- Breitkreutz told the Receiver that Base Finance's "investment" was "lost when [Powder River] . . . filed for bankruptcy protection under Chapter 7 of the US Bankruptcy Code" (on November 2, 2010), that "no significant income was earned" by Base Finance or Base Mortgage after Powder River's liquidation, and that Breitkreutz was "soliciting new investments in order to keep up with the interest and principal amounts" owing to Base Finance investors.

[64] The Receiver interviewed both Breitkreutz and Fox and said that they agreed on certain facts, including that Fox attempted to reacquire Powder River's oil and gas leases after its liquidation. Initially, Goliad (incorporated September 24, 2013) entered into an agreement with a third party to acquire the leases at a price of \$1.5 million. Base Finance paid the initial down payment of \$30,000 on the leases, and the purchase was secured by "a \$50 million deed of trust note". However, that deed of trust was apparently not valid as the third party was not the legal owner of the leases.

[65] The Receiver understood from Fox and Breitkreutz that they then incorporated Saddle Lake in October 2014 "to repurchase these same leases". Base Finance paid for the purchase of these leases, retained legal counsel to secure Saddle Lake's registrations, and solicited funds to start production. One of the six leases was able to "briefly" achieve production and generate about US\$5,000 to US\$10,000 in revenue over a one-month period. Fox was "actively pursuing a Chinese-based investor" who was purportedly interested in investing approximately \$50 million into Saddle Lake, with the deal set to close in June 2015.

[66] According to the Receiver, Breitkreutz and Fox both claimed that Base Finance paid Saddle Lake no more than US\$300,000, although the Receiver could only account for less than \$20,000 of those funds.

[67] The Receiver's review of Base Finance's and Base Mortgage's bank accounts suggested that Breitkreutz and Way both withdrew funds from Base Finance to acquire local real estate properties. In particular, Breitkreutz or his wife (or both) acquired several houses using Base

Finance's funds, while Base Finance acquired a property that was subsequently transferred to Way, who repaid Base Finance \$200,000 of the \$385,000 purchase price.

[68] The Receiver also determined that Breitkreutz received a net of approximately \$1.15 million from Base Finance's and Base Mortgage's accounts from August 2006 to October 2015 (almost \$870,000 of this was characterized as employment compensation and reimbursement of expenses), and Way received a net of more than \$700,000 from Base Finance's and Base Mortgage's accounts from June 2007 to October 2015 (more than \$400,000 of this was characterized as employment compensation and reimbursement of expenses).

[69] The Receiver also reviewed Breitkreutz's personal bank account records, which suggested "that many of the payments or drafts paid from [Base Finance and Base Mortgage] to [Breitkreutz] were received into" his primary personal account, that the companies also received deposits from his personal account, and that "many of the deposits into [Base Finance and Base Mortgage] were immediately directed back to" his personal account "within days". The Receiver was unable to determine "the purpose of running the monies through" the companies' accounts. The Receiver went on to note in the supplemental report to the court:

For the most part, over the period provided, there are many untraceable deposits made in round numbers that are not traceable to their source. These deposits ranged from the tens of thousands to the hundreds of thousands. Given the quantum of the deposits and the inability to trace them to the Base accounts, it is not known if some investor funds were being directed to the personal account rather than through Base, or if there were other unrelated investments or income sources that Mr. Breitkreutz was managing personally.

The bulk of withdrawals out of [Breitkreutz's] personal account relate to regular living expenses such as utilities, what appears to be an allowance or regular cash advances made available for Mrs. Breitkreutz, and regular cash withdrawals for Mr. Breitkreutz. We also note, that regular withdrawals were made from a specific Calgary casino as evidenced on the bank statements; these transactions increased substantially in 2014 through 2015.

[70] Regarding Way's personal bank records, the Receiver found that Way's income tax filings showed that her annual employment income from Base Finance (believed to be her sole source of income) was \$42,000 per year from 2011 through 2014. From a review of Way's personal bank statements, the Receiver stated in the supplemental report to the court:

An analysis of the statements reveals that deposits increased substantially beginning in 2013 with some monthly deposits as high as \$40,000. In reviewing the withdrawals from her account, which effectively equaled deposits into her account each month, it appears that Ms. Way withdrew significant amounts of money at a particular Calgary casino. As much as \$10,000 per month was being withdrawn from this casino as evidenced from the bank statements. She also appears to have been supporting, in part, some family members. The Receiver also notes that the deposits into Ms. Way's accounts ceased, with [one] exception . . . , after the Base account was frozen.

[71] According to the Receiver, Hogaboam and his company were investors in Base Finance and received "interest and principal repayments" from Base Finance, as well as finder's fees for introducing investors to Base Finance. In its third report to the court, the Receiver commented on Hogaboam's relationship with Base Finance and Base Mortgage:

.... Mr. Hogaboam had a working relationship with the Companies as far back as 1995. Hand written notes referring to "our staff" referring to Base's staff, and Mr. Hogaboam's signature has been found on Company letterhead during the Receiver's review of books and records.

In the Oral Questioning, on page 37 line 26, Mr. Breitkreutz confirmed that Mr. Hogaboam received referral fees. It is our understanding that Mr. Hogaboam was a promoter or agent of the Companies as evidenced in investor correspondence and the issuance of T4A CRA income reporting slips issued by the Companies to Mr. Hogaboam.

E. Breitkreutz's Testimony

[72] Breitkreutz testified over the course of three days.

[73] Breitkreutz asserted that Base Finance had "mortgage security in Texas" in relation to "a viable oil and gas operation" that had been "appraised at over a hundred million dollars", and it was this security that he had in mind when talking to investors about investing in Base Finance.

[74] According to Breitkreutz, Base Finance had advanced money to Fox and his various companies over the years – Breitkreutz estimated approximately \$50 to \$60 million – and both Fox and Powder River assumed the debt from Fox's previous companies. Fox repaid some funds (Breitkreutz estimated between \$3 to \$5 million) to Base Finance while he was operating Powder River but that Base Finance's debt was "expunged" through Powder River's bankruptcy. Breitkreutz believed that "we still had our security . . . until that matter was resolved". Breitkreutz also mentioned prior mortgages on "properties" located in Oklahoma and Louisiana that "he had never discharged".

[75] Breitkreutz testified that Base Finance continued to fund Fox and his attempts to re-acquire properties previously owned by Powder River by continuing to solicit funds from investors. He stated that Base Finance raised funds from investors for Fox, who "used those funds to pay what he had to pay" including "operational, business, and investors". According to Breitkreutz, interest payments and principal repayments to Base Finance investors were notionally added to Fox's "line of credit" in accordance with Fox's instructions.

[76] Breitkreutz also explained that all cash withdrawals were provided to Fox, which was necessary as "most of the employees that [Fox] had . . . wouldn't accept [a] cheque, and if you paid them by cash, you got a better deal". Breitkreutz said that it was difficult to withdraw large amounts of cash from the bank, so he and Way regularly withdrew and accumulated smaller cash amounts and provided them to Fox when he required additional cash. Breitkreutz had Fox sign promissory notes from time to time, which represented debt owed for cash payments made to Fox "to operate the leases". Breitkreutz tendered into evidence four promissory notes purportedly signed by Fox. Particulars of the four promissory notes are set out below:

Date	Amount	Due
May 1, 2006	\$1,500,000	Demand
November 24, 2008	\$275,000	Demand
No Date, 2015	No Amount	Demand
No Date, 2015	No Amount	Demand

[77] Breitkreutz said that Fox was "able to obtain [Powder River's] properties back shortly after" Powder River's bankruptcy by contracting directly with the landowners. He provided a letter from

a US lawyer (dated October 15, 2015) stating that the Deed of Trust "does appear to be a proper 'deed of trust' and is secured by various properties" (as listed on an exhibit attached to the Deed of Trust) and that Saddle Lake "remains a viable entity able to operate in the State of Texas". Breitkreutz relied on this letter as evidence "that we had a viable mortgage registered and that Saddle Lake, the borrower, was able to operate and produce those oil and gas leases in the state of Texas as they were licenced to do so with funds that were borrowed from Base Finance in order to get to that position".

[78] Breitkreutz asserted that a deed of trust (as it was called in the US) is the "equivalent" of a mortgage in Canada but has "much greater powers" because it encompasses all of the borrower's assets until fully repaid. He relied on a document he found on the internet that explained the deed of trust concept, which Breitkreutz said clarified his understanding of that term.

[79] Breitkreutz indicated that the security for Fox's debt – the Deed of Trust over oil and gas leases in Texas – had been appraised in July 2013 at more than US\$100 million. When cross-examined by Staff, Breitkreutz admitted that the appraisal pertained to 27 different leases and that the Deed of Trust only covered six of those leases, one of which had produced for about a month, resulting in revenue of approximately US\$10,000.

[80] Breitkreutz testified that in June 2015, he anticipated a "large payout of our mortgage" from Fox, who had arranged financing to pay most, if not all, of the amounts owing to Base Finance. Although that payout "never happened", Breitkreutz said that he had Fox attend Base Finance's office to acknowledge "all of the mortgage assignments that I had issued to my investors". Breitkreutz said that Fox signed approximately 482 Assignments, each containing a stamp, prepared by Way, that read:

This Mortgage Assignment is hereby
duly acknowledged
and accepted by the Borrower
[Signature]
Brian D. Fox

[81] Breitkreutz said that he discovered these Assignment documents next to a filing cabinet after the Receiver's search of Base Finance's office, and assumed that "these were on top, fell down, and no one bothered to retrieve them". The one sample in evidence was an unsigned Assignment dated September 1, 2011, and did not indicate the date that it was signed by Fox. Of note is the fact that this evidence conflicts with other evidence given by Breitkreutz that the Receiver "took filing cabinets", and that "all of our documents . . . were gone. We had nothing left."

[82] Breitkreutz denied that he was operating a Ponzi scheme, and said that he "never . . . lied to my investors or attempted to deceive them in any way". He said that he would tell Base Finance investors that he "had a first mortgage investment, this is the return, and if you're interested in investing, you will get a first mortgage assignment from me, and you will get a piece of my mortgage that I'm investing in". He also told investors that they were investing in Base Finance mortgages with other investors, their money would be lent to a borrower and their security would be a first mortgage held by Base Finance. Investors were not told the location of the mortgage

security unless they funded the entire mortgage. He also did not tell investors that: (1) Base Finance's "1st mortgages" was a reference to the Deed of Trust; (2) they were investing in oil and gas properties in the US; or (3) that their funds would be used to make interest payments and principal repayments to other investors.

[83] As with the set of Assignments supposedly acknowledged by Fox and "left behind" by the Receiver, we disbelieve Breitkreutz's evidence of never lying or misleading investors based on the evidence presented to the panel, including the transcript of the telephone conversation with the couple (as set out earlier in this decision).

[84] Breitkreutz testified that there were other mortgages registered on Alberta properties within the past ten years, but he was only able to point to two specific instances where Base Finance mortgages were supported by documentary evidence. One instance (which had been identified by the Receiver) involved a mortgage that had been discharged in 2008. The other mortgage (which had been identified by the ASC Staff investigator as "a different arrangement") involved two related companies. One of the companies provided funds to Base Finance beginning in July 2013, which were then lent out to fund a mortgage on the related companies' commercial property. In April 2015, the mortgage was paid out in full, including interest. Breitkreutz said that he had agreed to administer this transaction for a relatively small fee "as a favour", and Base Finance did not otherwise earn interest on this transaction.

[85] Again, we disbelieve Breitkreutz on this point given the absence of any significant mortgage files identified by the Receiver or produced by Breitkreutz and the evidence of both the Receiver and Staff indicating that Base Finance's banking activities reflected little, if any, evidence of a legitimate mortgage-lending business.

[86] Breitkreutz acknowledged that he worked closely with Hogaboam, who referred "a lot of business" to Base Finance. Breitkreutz said they would discuss investment opportunities before Hogaboam solicited investments on behalf of Base Finance – he would tell Hogaboam about a deal and Hogaboam "would go and see what money he could arrange". Breitkreutz professed not to know "all the time" what Hogaboam told investors (such as Hogaboam representing to investors that he was Breitkreutz's partner) although he said he was aware of some of the things Hogaboam was saying and that he would talk to Hogaboam if investors were being given incorrect information.

[87] Breitkreutz testified that he personally invested a substantial amount of money in Base Finance – "over a million dollars" – some of which he withdrew to acquire local properties. He also asserted that he did not take out more money than he had invested, and that all of his personal investments in Base Finance were documented by Assignments, which he would redeem when he received a payment from Base Finance. He offered some documentation relating to his purchases of local properties in support of his testimony.

[88] Breitkreutz provided details on Way's acquisition of her home, stating that she had previously invested in Base Finance, and that Base Finance "took back a caveatable interest on that property" for the balance (\$185,000) owing on her home. It was agreed that Base Finance would carry the debt owed by Way until Base Finance's operations could be wrapped up, at which

point an accounting would be done to settle the amounts. Breitkreutz acknowledged that she "hadn't paid that at the time of [Base Finance's] receivership". He also said that Way was still owed a balance on her investment in Base Finance at the time of the receivership and that she had been taking out increments to slowly pay back her investment.

F. Witnesses Called by Breitkreutz

[89] One of the investor witnesses called by Breitkreutz had invested about \$660,000 with Base Finance. He understood that his investments were being loaned to borrowers and that Base Finance secured investors' contributions through first mortgages. He was never told about a particular property or mortgage that was the subject of his investment. He also understood that his interest payments came from payments made by the borrower whose mortgage was used to secure the invested funds. When cross-examined by Staff, the investor confirmed that he was not told that his investments were in oil and gas interests or that his money was being used to pay interest to other Base Finance investors. He said that he had received less than \$5,000 from the receivership.

[90] Another investor witness called by Breitkreutz was a widow who began investing with Breitkreutz in 2009 after being introduced to Base Finance by a friend. She started with a \$25,000 investment and was pleased when she was paid a good rate of return on time every six months. She did not care where Base Finance invested her funds, and did not think that Base Finance was trading in securities. She thought her funds were invested in a first mortgage but did not know that they were being used for an oil and gas development in Texas. She believed that the payments she received came from the income from her investments and she was not told that such payments might have been redirected from investments made by other investors.

[91] Another investor witness called by Breitkreutz testified to similar effect and confirmed she lost \$30,000.

[92] Breitkreutz's lawyer's testimony was primarily about Breitkreutz's acquisition of local properties and the position taken by Breitkreutz in the receivership proceedings – including that the Receiver should be attempting to obtain value from the US oil and gas property and not from Breitkreutz's Alberta assets. The lawyer acknowledged that he did not undertake an investigation into how Breitkreutz was able to acquire his properties, that he had not reviewed Breitkreutz's, Base Finance's or Base Mortgage's bank statements, and that he relied on Breitkreutz's assertion that Base Finance's funds were not used to acquire local properties for Breitkreutz.

G. Way

[93] Way chose not to testify or call any witnesses.

VI. ANALYSIS AND DISCUSSION

A. Standard of Proof

[94] We apply the standard of proof set out in the Supreme Court of Canada's decision in *F.H. v. McDougall*, 2008 SCC 53 at paragraph 46, which requires that facts must be proven with evidence "sufficiently clear, convincing and cogent to satisfy the balance of probabilities test". That test is met where the existence or occurrence of an alleged fact required to be proven is more probable than its non-existence or non-occurrence.

B. Preliminary Issues

[95] Two preliminary issues must first be addressed before we consider whether the Respondents breached s. 93(b) of the Act: (1) whether the Assignments were "securities", as defined under the Act; and (2) whether the fraud allegations are statute barred because of the limitation period in s. 201 of the Act.

1. "Security"

[96] The alleged fraud must be in relation to a "security" within the meaning of the Act. The term is broadly defined in s. 1(ggg), and includes "any bond, debenture, note or other evidence of indebtedness . . ." (s. 1(ggg)(v)) or "any investment contract" (s. 1(ggg)(xiv)).

[97] We find that the investments offered by Base Finance, as evidenced by the Assignments, constituted "evidence of indebtedness" within the meaning of the Act. Base Finance investors – referred to as "lenders" – provided money to Base Finance in exchange for an interest in Base Finance's "1st mortgages", with the expectation that Base Finance would periodically "direct from the borrowers" interest payments at the stipulated rate, with investors' principal returned at the end of the term or rolled over into a further investment.

[98] We also find that the investments at issue were "investment contracts" under s. 1(ggg)(xiv) of the Act, which is defined by the jurisprudence to require an investment of money in a common enterprise with the expectation of profits arising significantly from the effort of others (*Pacific Coast Coin Exchange of Canada Limited v. Ontario (Securities Commission)*, [1978] 2 S.C.R. 112). Base Finance investors provided money to Base Finance, which was pooled with other investors' funds. Investors were not expected to do anything more to earn profits, in the form of interest payments from "1st mortgages" secured by Base Finance.

[99] Accordingly, we find that the investments offered by Base Finance were securities within the meaning of the Act.

2. Limitation Period

[100] Section 201 of the Act currently states: "No proceeding under this Part shall be commenced . . . before the [ASC] more than 6 years from the day of the occurrence of the last event on which the proceeding is based".

[101] Although the Respondents did not raise a limitations issue, Staff addressed it in their submissions.

[102] The fraud as alleged by Staff was that the Respondents orchestrated a deceitful scheme – one that led investors to understand that they were investing in mortgages on property located in Alberta rather than in oil and gas interests in the US – and implemented a Ponzi scheme. A Ponzi scheme, by its nature, involves continuing activity. As stated in *Re Williams*, 2016 BCSECCOM 18 at para. 229:

By its nature, those perpetrating a Ponzi scheme must keep up the appearance that it is a successful investment scheme in order to attract new investors and continue the scheme. To keep up appearances, perpetrators continue their deceit against investors, by making payments or issuing

account statements, for example. These acts of deceit continue the fraud beyond an investor's initial investment.

[103] On this theory of the case, the alleged fraud was an ongoing scheme and misuse of funds. Therefore, we consider the fraud, as alleged by Staff, to have continued from 2006 until stopped by a combination of the actions of RBC, the ASC's freezing of Base Finance's account, and the receivership. We consider this to be a continuing course of conduct in the period from 2006 to September 2015.

[104] The "last event" that gave rise to these proceedings, and on which this proceeding was grounded, occurred on September 22, 2015 when the last deposit of investor funds was made into Base Finance's primary operating account.

[105] We therefore find that the allegations in the notice of hearing are not statute barred pursuant to the current wording of s. 201 of the Act.

[106] The section previously stated (until amended in 2014) that no proceeding could be commenced "more than 6 years from the day of the occurrence of the event that gave rise to the proceedings". The alleged misconduct began as early as August 2006, which would be more than 6 years before the August 2016 notice of hearing.

[107] The previous wording of the section does not change our analysis, or our conclusion that the allegations in the notice of hearing are not statute barred. We consider that "the day of the occurrence of the event" means, in respect of an ongoing and continuous course of conduct, the last day of the occurrence of the event (see *Re Dennis*, 2005 BCSECCOM 65).

[108] Accordingly, we are persuaded that under either the current or the previous wording of the limitation section, these proceedings are not statute barred.

C. Fraud

[109] Section 93(b) of the Act was amended in 2014. Prior to the amendment, the provision stated:

No person or company shall, directly or indirectly, engage or participate in any act, practice or course of conduct relating to a security . . . that the person or company knows or reasonably ought to know will

(b) perpetrate a fraud on any person or company.

[110] The current wording of the section states:

No person or company shall, directly or indirectly, engage or participate or attempt to engage or participate in any act, practice or course of conduct relating to a security . . . that the person or company knows or reasonably ought to know may

(b) perpetrate a fraud on any person or company. [Emphasis added.]

[111] The parties did not address these changes in their submissions. We do not consider the amendment to substantively alter the required analysis in the circumstances, as we find that the evidence in this proceeding demonstrates more than an "attempt" and that the knowledge of the parties went beyond the possibility that their conduct would perpetrate a fraud to the level of knowing that their conduct was perpetrating a fraud.

[112] The Act does not define "fraud" but the ASC has adopted the elements of fraud enunciated by the Supreme Court of Canada in *R. v. Thérioux*, [1993] 2 S.C.R. 5. This requires proof of a guilty act (*actus reus*) and a corresponding guilty mind (*mens rea*).

[113] In *Thérioux* (at 20), the Court stated, concerning the *actus reus*, that:

These doctrinal observations suggest that the *actus reus* of the offence of fraud will be established by proof of:

1. the prohibited act, be it an act of deceit, a falsehood or other fraudulent means; and
2. deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim's pecuniary interests at risk.

[114] The Court further stated that the *mens rea* of fraud is established by proof of:

1. subjective knowledge of the prohibited act; and
2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim's pecuniary interests are put at risk).

Where the conduct and knowledge required by these definitions are established, the accused is guilty whether he actually intended the prohibited consequence or was reckless as to whether it would occur.

[115] Regarding the nature of a prohibited act within the meaning of *Thérioux* (as stated in *Re Arbour Energy Inc.*, 2012 ABASC 131 at paras. 979-80):

"Deceit" or "falsehood" is established when it is proved that the person represented a certain situation was something other than what it really was (*Thérioux* at 17).

"Other fraudulent means" is the catch-all concept, designed to capture a wide range of dishonest commercial acts which appear to be neither deceit nor falsehoods but, when viewed objectively, would be considered dishonest acts by a reasonable person. Examples of conduct found to constitute "other fraudulent means" include personal use of corporate money, failure to disclose important facts, unauthorized diversion or taking of money or property, and the unauthorized use of investor money (*Thérioux* at 16-17; and *R. v. Currie*, [1984] O.J. No. 147 (C.A.)).

[116] The *mens rea* element requires proof that the person involved "had subjective awareness of the person's prohibited act and that such act placed another's or others' economic interests at risk" (*Arbour* at para. 982). This subjective awareness can be inferred from the totality of the evidence (*Alberta Securities Commission v. Brost*, 2008 ABCA 326 at para. 48). In the case of a corporation, "it need only be proved that the corporation's directing minds knew or reasonably ought to have known that the acts of the corporation perpetrated a fraud" (*Arbour* at para. 985).

[117] It is not necessary to show that a respondent accused of fraud personally profited from the wrongdoing (*Thérioux* at 17, *Arbour* at para. 981).

1. *Actus Reus*

(a) Prohibited Acts

[118] We find that Base Finance, Breitkreutz and Way engaged in at least two prohibited acts: (1) they deceived Base Finance investors into thinking that they were investing in traditional mortgage securities when they were actually investing in US oil and gas operations; and (2) they operated a Ponzi scheme, in which the purported returns paid to investors derived from other investors' funds.

(i) Deception of Base Finance Investors

[119] The first prohibited act, the deception of Base Finance investors, caused investors to think that they were investing in mortgages held by Base Finance in real estate rather than in a loan to an undisclosed entrepreneur focused on oil and gas developments in the US. This deception involved express representations made to investors, as well as the omission of important information regarding the nature of the Base Finance investments.

[120] Investor witnesses understood that they were loaning money to borrowers and that their investments were secured by first mortgages. Some understood that the mortgages were registered against residential or commercial properties located in Alberta, while others were uncertain as to details of the subject property or the terms of the underlying mortgages beyond what was represented in the Assignments.

[121] Hogaboam referred many of his business and personal acquaintances to Base Finance. In so doing, he provided prospective investors with pertinent details that often described Base Finance mortgages as pertaining to Alberta-based properties or residential properties (or both). Hogaboam told Staff that he had received such details from Breitkreutz, which is consistent with Breitkreutz's evidence that he provided Hogaboam with details about an investment. Although Breitkreutz denied providing information about the location of a property, he knew that Hogaboam was (at least on some occasions) telling investors that mortgages were on personal residences and said that he would have talked with Hogaboam if the information was incorrect. Investor evidence showed that Breitkreutz affirmed (or did not deny) Hogaboam's representations that Base Finance investments involved either residential properties or properties located in Alberta (or both) and that Breitkreutz made no attempt to correct this misinformation. In the circumstances, we find that Breitkreutz provided Hogaboam with misleading details – that Base Finance mortgages were on residential properties or that they were Alberta-based properties (or both) – knowing that Hogaboam would pass along these details to prospective investors.

[122] The careful deception of Base Mortgage investors was not limited to the making of misleading statements but also involved the withholding of information critical to their investments. Breitkreutz said that investors were generally not told of the location of the properties unless a single investor financed the entire mortgage. None of the investor witnesses were told that the "1st mortgages" underlying their investment was actually the Deed of Trust on oil and gas

leases in the US. Some investor witnesses told us that they would not have invested had they known that their investment was in oil and gas properties in the US.

[123] Indeed, one investor testified that he specifically told Breitkreutz that he would not invest in US oil and gas assets. In face of this statement, Breitkreutz did not tell the investor that that was precisely where his money was being invested. Further, Breitkreutz renewed the investor such that, at the time of the receivership, the investor and his wife were owed in excess of \$2 million.

[124] At a minimum, proper disclosure as to the true nature of the underlying mortgage security would have affected investors' understandings of the risks of their investments and influenced their decisions whether to invest in the securities offered by Base Finance. We find that the failure to divulge such information to prospective or existing investors was objectively dishonest and constitutes a prohibited act within the meaning of *Théroux*.

[125] Considering the evidence as a whole, we consider the pattern of communications with investors to have been carefully tailored to maintain a façade that they were investing in first mortgages in real estate and not in oil and gas plays in the US. This is evident in the careful wording adopted by Breitkreutz and Way when communicating with investors, as well as by the terms used in Assignments provided to Base Finance investors.

[126] To provide a few examples, the Assignments stated that Base Finance would assign "an Irrevocable Mortgage interest . . . against 1st mortgages held by" Base Finance and would "direct from the borrowers . . . to the lender, interest payments . . .". This gave the impression that Base Finance would use invested funds to provide mortgages to facilitate a real estate transaction, and that the investment would be registered on title in priority to all other interests. This terminology also conveyed the impression that the borrower would be required to make interest payments, which would be redirected by Base Finance to the investor. Instead, Base Finance was providing a line of credit to Fox to acquire and develop oil and gas leases. Fox was making virtually no payments to Base Finance, so there was no directing of interest payments to investors. Rather, Base Finance was notionally increasing Fox's line of credit and using investors' capital to make purported interest payments and principal repayments to other investors.

[127] Even the term "1st mortgages" was misleading, as it conveyed a significantly different understanding in the minds of investors as to the nature of their investments and reinforced the deception that the security pertained to a conventional real estate mortgage rather than a deed of trust in relation to oil and gas leases. Breitkreutz acknowledged that a deed of trust was not "a familiar term" in Canada, yet he (and Way) avoided any use of the term when communicating with investors. We find that their avoidance of such terminology was a deliberate attempt to avoid raising questions from investors as to the true nature of their investment.

[128] We also considered the reference to "demised premises" in the third paragraph of the Assignment to be part of the deception of Base Finance investors. The term "premises" in plain English connotes land with buildings, and reasonably conveyed the impression that the mortgage security pertained to real estate, rather than oil and gas leases. We are confident that Breitkreutz, with his background as a mortgage broker, knew this and we note his evasive answers when questioned on this point and disbelieve his statement that he did not know what "premises" implies.

[129] Way actively participated in the deception of Base Finance investors. She was involved in all facets of Base Finance's business and operations, including communicating with investors. She told Staff in her investigative interview that she conveyed to investors that Base Finance investments pertained to a "first-mortgage interest", she did not disclose that the mortgage security was in reference to the Deed of Trust "on the oil wells down in Texas", and that investors were never told the location of the underlying properties. Way's (and Breitkreutz's) interaction with Way's cousin led him to understand that he was investing in Alberta real estate and he had no reason to think that his investment was in oil and gas leases. Further, she was intimately involved in the preparation, execution, and delivery of the deceptive Assignments to investors.

[130] In all of the circumstances we find that Way engaged in the prohibited act of deceiving Base Finance investors as to their investment.

[131] Breitkreutz's actions, as guiding mind of Base Finance, are attributable to it. We therefore find that Base Finance was also responsible for the deception of Base Finance investors.

[132] Breitkreutz was also the guiding mind of Base Mortgage, although it is unclear whether he was acting in any capacity in respect of Base Mortgage while orchestrating the deception of Base Finance investors. Indeed, we received little evidence as to Base Mortgage's involvement in Base Finance's investments, other than it had received a monthly fee from Base Finance, which was used to pay operating expenses of Base Mortgage and Base Finance. Base Mortgage was not party to the Assignments, nor did those documents refer to Base Mortgage. There is no indication that communications with Base Finance investors occurred through, or on behalf of, Base Mortgage. The Receiver determined that in respect of one of Base Mortgage's bank accounts, "[a]ll deposits into the account were made by investors and subsequently transferred to" Base Finance. However, we were not provided statements from Base Mortgage's account or accounts, nor any particulars in relation to such activity (including the amounts of such deposits, the dates of the transactions or the investors who purportedly made the deposits). In the circumstances, we lack sufficiently clear, convincing and cogent evidence to find that Base Mortgage deceived Base Finance investors as to the nature of their investment.

(ii) Ponzi Scheme

[133] We consider a second prohibited act that involved the payment of promised returns to Base Finance investors under the guise of interest payments directed from an undisclosed borrower. In reality, such payments were merely the re-circulation of funds received from other investors. We find that such a course of conduct constituted a Ponzi scheme, and was objectively dishonest.

[134] The US Securities and Exchange Commission described a Ponzi scheme as follows:

Ponzi scheme is an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk. In many Ponzi schemes, the fraudsters focus on attracting new money to make promised payments to earlier-stage investors to create the false appearance that investors are profiting from a legitimate business.

[online: U.S. Securities and Exchange Commission
www.sec.gov/fast-answers/answersponzihtm.html]

[135] We find that Base Finance, Breitkreutz and Way were running such a scheme. A Staff investigator's analysis of Base Finance's banking records from January 1, 2011 to September 24, 2015 revealed little evidence of a mortgage-lending business, there was no significant source of business revenue contributing to investment returns, and investors' funds were pooled in Base Finance's accounts with returns to investors largely paid from the contributions of other investors. These conclusions were consistent with those of the Receiver, whose review of Base Finance's banking records (with some missing documents) from August 2004 to September 2015 revealed that Base Finance had raised about \$137 million, that investors had been paid approximately \$125 million and were collectively owed some \$122 million at the time of Base Finance's receivership.

[136] Breitkreutz, as the guiding mind of Base Finance, was the head of the Ponzi scheme. He created the business structure in which Base Finance obtained little, if any, revenue from its lending operations. He paid investors their promised returns – ostensibly as interest payments – using funds provided by other investors. This allowed him to maintain the façade that Base Finance was a legitimate private mortgage lender and ensured that Base Finance investors were satisfied with their investments, at least so long as timely payments were maintained.

[137] Breitkreutz submitted that he could not have been operating a Ponzi scheme because he made so little from it. The amount a promoter chooses or is able to keep from a fraudulent scheme does not change the essential nature of the scheme. Additionally, personal profit is not a necessary element to a finding of fraud.

[138] Way, as office manager, was in charge of Base Finance's banking and bookkeeping, among other things. From the evidence, it is clear that she maintained a ledger for Base Finance's investors, and she prepared and signed cheques to investors knowing that Base Finance was not generating any revenues or receiving interest payments from "borrowers". She told Staff during her interview that funds from new investors were used – "fairly often" – to pay returns to other investors. Her involvement is illustrated from her communications with the couple, who were seeking information from Way regarding a purportedly overdue interest payment. Way advised that Base Finance had received the payment and took steps to transfer the funds to them. In context, Way conveyed the false impression that the payment came from the borrower's interest payment when banking records revealed that the funds came from money already in Base Finance's account. We find that Way also committed the prohibited act of operating a Ponzi scheme.

[139] As mentioned, we received little evidence as to Base Mortgage's involvement, including in relation to the alleged Ponzi scheme. Although the Receiver reported that Base Mortgage received and transferred investor funds to Base Finance, we were not provided evidence providing details on these transactions. Accordingly, we are unable to find that Base Mortgage committed the prohibited act of operating a Ponzi scheme.

(b) Deprivation Caused by Prohibited Acts

[140] We consider the prohibited acts committed by Breitkreutz, Way and Base Finance placed investors' financial interests at risk, and we so find. Clearly, Base Finance investors sustained significant financial losses; the Receiver estimated that Base Finance owed more than \$122 million

to its investors at the time of the receivership. Evidence from investor witnesses indicated that some considered their investment risk to be lower because they (erroneously) understood that their principal was secured against Alberta-based properties. Some investor witnesses indicated that they had no interest in investing in US oil and gas properties. We accept that the risks to an investor for a loan secured by mortgage against real property is markedly different from the risks of an investment in oil and gas leases, particularly so when those leases are located in another country. The deception of Base Finance investors placed their financial interests at risk.

[141] We also find that the operation of a Ponzi scheme put investors pecuniary interests at risk. Inherent to such a scheme is the fact that some investors will lose some or all of their investment. Some Base Finance investors received payments from Base Finance, ostensibly as interest payments or principal repayments. Some investors received payment from the Receiver out of the funds frozen by the ASC. Such recovery pales in comparison to the collective loss of approximately \$122 million by Base Finance investors.

2. *Mens Rea*

[142] We are also satisfied, and we find, that Breitkreutz, Way and Base Finance had subjective knowledge of both the prohibited acts and of the fact that such acts were placing investor's financial interests at risk.

[143] Breitkreutz knew that the only purported mortgage held by Base Finance was the Deed of Trust, and he ensured that investors knew nothing about the supposed mortgage. In one instance, Breitkreutz responded to Way's cousin when he inquired about the identity of the underlying property by telling him that it was none of his business. Breitkreutz acknowledged that he did not tell any of his investors that they were investing in an oil and gas mortgage in the US, and he clearly knew that investors were under a misapprehension as to the nature of the underlying business. This is made obvious by evidence of the investor who told Breitkreutz that he had "no interest" in an investment in oil and gas, particularly in the US because it was "extremely risky". Not only did Breitkreutz not tell him that was exactly where his money had been placed, but Breitkreutz renewed those investments issuing new Assignments each time.

[144] Breitkreutz was also aware that investors' funds were being pooled in Base Finance's accounts, from which purported returns were paid to earlier investors. We find that Breitkreutz knew that:

- investor funds were being deposited into Base Finance's accounts;
- money from Base Finance's accounts was paid to investors, and characterized as either interest payments or principal repayments;
- Fox was not making payments on his debt to Base Finance (at least not since the time he had been operating Powder River);
- Base Finance would notionally increase Fox's debt to make payments promised to Base Finance investors, purportedly "[o]n Fox's instructions";
- approximately \$137 million was raised from Base Finance investors from 2004 to 2015, from which approximately \$125 million was paid out to investors as purported interest and, for certain of them, as principal, with about \$122 million owing to investors by the end of September 2015.

[145] While Way figured less prominently than Breitkreutz in the scheme, we find that she had extensive knowledge of the nature of Base Finance's business at all times material to these proceedings. She and Breitkreutz operated the business as a "two-man shop", during which time she saw most emails, managed Base Finance's bookkeeping and banking, and interacted with investors. From all of the evidence, we find Way to have been fully conversant with Base Finance's internal business activities, to the extent that she knew:

- about the relationship between Base Finance and Fox;
- that investors were told that their investments were in first-mortgage interests;
- that investors were not told the location of the properties, that the security for their loans was the Deed of Trust, or that investments were going to develop oil and gas leases in the US;
- the specific terms of the Assignments issued to investors, most (if not all) of which she signed on behalf of Base Finance;
- that Base Finance's mortgage security was the Deed of Trust, with Fox as the borrower; and
- that Fox was not making interest payments to Base Finance, and that his loan balance was notionally being increased while money raised from investors was being recirculated to other investors, ostensibly as either interest payments or principal repayments.

[146] Breitkreutz was the guiding mind of Base Finance, and his knowledge is attributable to Base Finance. We therefore find that it too knew of the prohibited acts and that such acts placed investor's financial interests at risk.

3. Conclusion on Fraud

[147] In summary we find that Breitkreutz, Way, and Base Finance contravened s. 93(b) of the Act by engaging in prohibited acts relating to securities that they knew would perpetrate a fraud on investors, including: (1) deceiving investors into thinking that they were investing in mortgages held by Base Finance rather than in a loan to an undisclosed entrepreneur involved in oil and gas developments in the US; and (2) operating a Ponzi scheme that recirculated investors' funds to pay purported returns to existing investors.

D. Conduct Contrary to the Public Interest

[148] Staff also alleged that the Respondents' misconduct was contrary to the public interest. In light of our findings above, we do not consider it necessary to make an independent finding that the contraventions of Alberta securities laws were also contrary to the public interest.

VII. CONCLUSION AND NEXT STEPS

[149] We find that the allegations of breach of s. 93(b) of the Act by Breitkreutz, Way and Base Finance have been proven on the balance of probabilities.

[150] Our findings above conclude the first part of the hearing. What remains to be decided is what, if any, orders should be made, in the public interest, against Breitkreutz, Way and Base Finance. Staff and the three Respondents are directed to contact the ASC Registrar by March 19, 2018 to set a date for the second part of the hearing, which will address the questions of sanctions and costs.

March 2, 2018

For the Commission:

"original signed by"
Bradley G. Nemetz, Q.C.

"original signed by"
Ian Beddis

"original signed by"
Maryse Saint-Laurent