ALBERTA SECURITIES COMMISSION

DECISION

Citation: Re Fauth, 2019 ABASC 102 **Date: 20190624**

Vernon Ray Fauth

Panel:	Maryse Saint-Laurent Ian Beddis Webster Macdonald, QC
Representation:	Adam Karbani and Garner Groome for Commission Staff Jeffrey Thom, QC for the Respondent
Submissions Completed:	December 20, 2018
Decision:	June 24, 2019

TABLE OF CONTENTS

I. INTRODUCTION

[1] After the conclusion of the hearing into the merits of the allegations made by staff (**Staff**) of the Alberta Securities Commission (**ASC**) in May 2018 (the **Merits Hearing**), this panel found that the respondent, Vernon Ray Fauth (**Fauth**), breached ss. 75, 92(4.1) and 93(b) (now s. 93(1)(b)) of the *Securities Act* (Alberta) (the **Act**) in connection with the securities of Espoir Capital Corporation (**Espoir**). Specifically, we held 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 Espoir 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 with respect to Espoir securities he knew or reasonably ought to have known were materially misleading, untrue, or omitted 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 Espoir securities; and

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

[2] The background facts and a detailed discussion of the applicable law and reasoning behind these findings were set out in a written decision dated November 8, 2018 (the **Merits Decision**). The Merits Decision is cited as *Re Fauth*, 2018 ABASC 175.

[3] This proceeding then moved into its second phase, for determination as to what (if any) orders should be issued against Fauth as a result of our findings. An oral hearing was conducted on December 20, 2018 (the **Sanction Hearing**), at which the parties made submissions and Staff entered into evidence a summary of their claim for costs related to their investigation and the Merits Hearing, along with supporting documentation (the **Staff Bill of Costs**). Prior to the Sanction Hearing, the parties also filed written submissions: Staff's on November 29, 2018 (the **Staff Submissions**), and Fauth's on December 5, 2018 (the **Fauth Submissions**). Although given an opportunity to do so, Staff elected not to file any further submissions in reply to the Fauth Submissions.

[4] For the reasons outlined below, we are permanently banning Fauth from participating in the Alberta capital market in certain capacities, and ordering that he pay disgorgement and an administrative penalty. We are also issuing a cost-recovery order against him.

II. BACKGROUND

[5] Further details with respect to this matter are outlined in the Merits Decision and should be read together with this decision. For ease of reference, we summarize the most significant points and findings here. Unless otherwise indicated, quotations are from the Merits Decision or evidence cited in the Merits Decision.

[6] Fauth has a background in insurance sales and financial planning. Although he was once registered with the Mutual Fund Dealers Association, he has not been registered with the ASC in any capacity since December 31, 2003. He was the founder of Fauth Financial Group Ltd. (**Fauth Financial**), which offered financial and estate planning services, as well as investment advice and opportunities for clients to make various investments, including investments in insurance and mutual funds. Although Fauth stated that he stepped back from his role as president and controlling shareholder of Fauth Financial in order to take on a temporary role as interim chief executive officer (**CEO**) of FairWest Energy Corporation (**FairWest**) in late 2009, the evidence led at the Merits Hearing did not indicate any formal change in control.

[7] Fauth was also the founder and sole director, officer and voting shareholder of Espoir, which he used to raise funds from the public. Those funds were to be pooled and re-invested in other opportunities to generate investment returns. He was the only person involved in raising funds for Espoir, and the only one who dealt with its investors.

[8] FairWest was a publicly-traded, Calgary-based oil and gas company listed on the TSX Venture Exchange. Fauth and one of his adult sons were two of its six directors, and Fauth was its second-largest shareholder. Ultimately, FairWest was unsuccessful, and had to make an application under the *Companies' Creditors Arrangement Act* in December 2012. Fauth resigned as its interim CEO and as a director in early 2013.

[9] Fauth also had interests in and control over a number of other entities involved with FairWest and the oil and gas business. This included several limited partnerships and their incorporated general partners. Fauth was a director, officer and shareholder of the general partners, either directly or indirectly.

[10] Over a period of approximately 10 years, Espoir raised in excess of $15.5 million from investors who either purchased three-year debentures (**Debentures**) or advanced loans under promissory notes (**Espoir Notes**). Early Debentures were generally issued as "unsecured subordinated debentures" (**Unsecured Debentures**), while later Debentures were generally issued as "Series II Secured" Debentures (**Secured Debentures**).

[11] Despite the differing nomenclature, the Unsecured Debentures and the Secured Debentures had virtually the same terms and were evidenced by virtually the same set of documentation. The primary difference between them was the interest rate offered: initially, Unsecured Debentures paid 10.5% per annum on a semi-annual basis, while Secured Debentures paid 8% per annum quarterly. However, by late March 2009, Espoir's finances were such that the last few Unsecured Debentures issued offered a reduced interest rate of 8%. By 2010, existing Unsecured Debenture holders were asked to enter into amending agreements which also reduced the interest rate to 8%.

[12] Again, despite their nomenclature (and the sometimes contradictory statements within the associated documentation), Fauth indicated that apart from the interest rate and the date of issue, the Unsecured Debentures and the Secured Debentures were essentially the same. Both were secured by "the same" security: "the assets that were in . . . Espoir". During an investigative interview, Staff asked Fauth how Espoir's assets were secured for the Debenture holders' benefit,

and he replied that ". . . they weren't. They were just -- they were just assets." The assets had not been secured by agreement or registration.

[13] Eight Espoir investors testified at the Merits Hearing, and we received the evidence of two others in the form of transcripts of their Staff investigative interviews. Some of these witnesses had purchased Unsecured Debentures, some had purchased Secured Debentures, and one had purchased both. Two had loaned money to Espoir under Espoir Notes, either in addition to or instead of investments in Debentures.

[14] All of the investor witnesses relayed a consistent story with respect to what Fauth told them about Espoir and what they understood about the Espoir opportunity: an investment in Espoir was "safe" and "secure", as funds were or would be "invested in real estate" and mortgages, and secured by that real estate. One witness said Fauth explained that the only difference between Unsecured and Secured Debentures (other than the interest rate payable) was that Secured Debentures were "tied to one secured asset", while funds invested in Unsecured Debentures were pooled and attached to "more than one asset".

[15] The investors also consistently indicated that at the time of their investments, they had not wished to risk losing their funds – they invested in Espoir on the assurance and their express understanding that it was safe and secure, and that there was either no risk or else a very low risk anyone would suffer a loss. Some mentioned that they specifically did not want to invest in FairWest or the oil and gas sector given the risk and unpredictability, and some said they told Fauth as much prior to providing him their funds.

[16] The foregoing was confirmed and reinforced by the written documents and communications the investors received from Fauth. Promotional and informational materials described the Espoir opportunity, and referred to it as a secured investment. Some materials indicated that Espoir would only use investor funds to make secured investments – including first and second mortgages, government and corporate bonds, secured debentures and promissory notes, guaranteed investment certificates, and others of a similar nature. Another document provided to investors purported to set out the proportion of funds raised to date by Espoir that had been invested in one of four categories, including over 70% in mortgages, nearly 12% in leases, and over 15% in "Other Secured" investments.

[17] Written correspondence to investors similarly referred to Espoir Debentures as "secured by the assets of Espoir" or "securitized by assets (i.e. mortgages)", and represented that Espoir would put the funds raised into secured investments and instruments. At the time Espoir sought to reduce the interest rate payable on its Unsecured Debentures, investors received letters or were told by Fauth that the reduction was necessary because the real estate market had fallen and the mortgages in which Espoir had invested were at risk of default unless the interest burden was reduced; Espoir did not wish to foreclose on the mortgages because it did not want to find itself the owner of impaired assets it could not sell.

[18] However, a former Staff investigative accountant testified at the Merits Hearing that based on his review of Espoir's financial records, he saw no uses of Espoir funds during the period from January 1, 2009 through September 30, 2014 which would correspond with the representations

made to investors. To the contrary, Espoir had only held a handful of small third-party mortgages in its earliest years. Its funds were primarily invested in and loaned to Fauth, members of the Fauth family, FairWest, the associated limited partnerships, and other entities controlled by Fauth and his family, including Fauth Financial. Though $1.73 million in mortgages in favour of Espoir were registered on the titles of two properties Fauth and his spouse owned in Edmonton and Calgary, the mortgages had little to no underlying value. Fauth acknowledged that they had been placed on the titles simply to "put some more security for Espoir on its balance sheet".

[19] Moreover, by Fauth's own admission during his investigative interview, the vast majority of Espoir's transactions with non-arm's length parties were not only unsecured – or, at best, greatly under-secured – they were undocumented. For most (if not all) of Espoir's existence, the value of its assets was nowhere near sufficient to secure its obligations to its investors. Many of the loans were never repaid to Espoir, and most of the investments ultimately lost all value. Loans to Fauth and other members of his family – the total of which exceeded $2.1 million at one point – were offset by invoices Fauth, his spouse and one of his sons issued to Espoir in January 2014 for cumulative "services rendered" over the previous 10 years. Outstanding loans to Fauth Financial reached as high as $4.2 million, and by the end of 2013, nearly $6 million in principal and interest owed to Espoir by Fauth Financial was written off as uncollectible.

[20] Espoir also used investor money to repay principal and make interest payments to other Espoir investors, in the manner of a Ponzi scheme. This was necessary because its investments and loans did not generate sufficient income for it to keep up with payments due.

[21] While some Debentures and Espoir Notes were paid out over the years and calculated interest was generally paid until approximately mid-2013, most investors – including those who testified at the Merits Hearing – lost their money. As of the end of 2014, Espoir owed investors over $12.3 million, and there is little to no prospect that it will ever be paid.

III. SANCTIONS

A. Law, Rationale and General Principles

[22] The type and extent of the sanctioning orders an ASC hearing panel may make in the public interest are set out in ss. 198 and 199 of the Act. The orders available under s. 198 are generally directed toward curtailing participation in the capital market in various capacities, but the section also provides for orders such as reprimand and disgorgement. Section 199 provides a hearing panel with the authority to impose administrative penalties of up to $1 million per contravention of Alberta securities laws. It has thus been observed by the Alberta Court of Appeal (the **ABCA**) that the Act "reflects a legislative intent that [administrative] penalties ought not to be so low that they amount to nothing more than another cost of doing business", and that "the [ASC] should fit the sanction to the circumstances, including the magnitude of the illegality and the need to encourage lawful conduct by those involved with securities" (*Alberta Securities Commission v. Brost*, 2008 ABCA 326 at para. 54).

[23] As is invariably noted in ASC sanction decisions, the purpose of sanction orders under the Act is not to punish respondents who breach securities laws or to remediate wrongs done to particular parties; rather, the purpose is to protect Alberta investors and the Alberta capital market, and to prevent or deter future misconduct (*Committee for the Equal Treatment of Asbestos*

Minority Shareholders v. Ontario (Securities Commission), 2001 SCC 37 at paras. 41-43). "Specific" deterrence is directed at the particular respondent then before a panel, and "general" deterrence is directed at others who might be tempted to undertake similar misconduct (*Re Cartaway Resources Corp.*, 2004 SCC 26 at paras. 52-62). Sanction orders are thus "preventive in nature and prospective in orientation" (*Asbestos* at para. 45; see also *Cartaway* at para. 52).

[24] While we have a wide discretion to determine which orders are in the public interest given the particulars of each case (*Asbestos* at paras. 39-40, 45), the ABCA has cautioned that sanctions "must be proportionate and reasonable" for the respondent (*Walton v. Alberta (Securities Commission)*, 2014 ABCA 273 at para. 154). Sanctions should address the actual misconduct at issue, but must also take into account the specific circumstances of the respondent and the risk of future misconduct posed by him, not just the risk posed by others who might seek to emulate him (*Walton* at para. 156; *Re Homerun International Inc.*, 2016 ABASC 95 at para. 14). Administrative penalties in particular must not over-emphasize "general deterrence of an unidentified and amorphous sector of the public" (*Walton* at paras. 156).

[25] To guide our determination as to whether and what degree of deterrence is required in a particular case, we have reference to a set of sanctioning factors which focus the analysis on the misconduct under consideration and the circumstances of the perpetrator. Although ASC hearing panels have in the past relied on the factors enunciated in *Re Lamoureux*, [2002] A.S.C.D. No. 125 and later refined in *Re Workum and Hennig*, 2008 ABASC 719 (aff'd. 2010 ABCA 405), panels now prefer to rely on the factors as further refined and restated in *Homerun* (at para. 20). Those factors are discussed and applied later in these reasons. We also adopt (without citing in its entirety) the comprehensive examination of the factors set out in *Homerun* (at paras. 22 *et seq.*).

[26] Lastly, in reaching a sanction decision, we have reference to the sanctions imposed in previous decisions and settlements involving similar conditions to the matter before us (*Homerun* at para. 16). The circumstances underlying those decisions and settlements will not be identical to those here, but such cases still help to inform our determination as to the package of sanctions which is "proportionate to the offence, and fit and proper for the individual offender" (*Walton* at para. 156).

B. Positions of the Parties

1. Staff

[27] Staff seek the following orders against Fauth:

(a) market-access bans

(i) permanently prohibiting Fauth from trading in or purchasing any security or derivative, and from relying on any exemptions contained in Alberta securities laws;

(ii) directing Fauth to resign from any positions he holds as a director or officer (or both) of any issuer or other person or company that is authorized to issue securities, registrant, investment fund manager, recognized exchange,

recognized self-regulatory organization, recognized clearing agency, recognized trade repository or recognized quotation and trade reporting system, and permanently prohibiting him from assuming any such positions in the future; and

(iii) permanently prohibiting Fauth from acting in a management or consultative capacity in connection with activities in the securities market;

(b) disgorgement in the amount of $2,585,414.87 (said to represent the sum of the payments from Espoir to non-arm's length parties between January 1, 2009 and September 30, 2014, as calculated by the former Staff investigative accountant who testified at the Merits Hearing); and

(c) an administrative penalty of $750,000.

[28] In both the Staff Submissions and oral submissions at the Sanction Hearing, Staff emphasized the seriousness of the misconduct perpetrated by Fauth, especially considering the multiple contraventions of the Act, the finding of fraud, and the dollar amounts and number of investors involved, most of whom are unlikely to recoup their financial losses. Staff suggested that Fauth "demonstrated reckless disregard for securities regulation" despite his experience in the financial sector, and pointed out that he was the only individual responsible for Espoir and its activities. They argued that Fauth exhibited "a high degree of deceit and dishonesty" over an extended period, and "deliberately and knowingly used investor funds for his own purposes".

[29] Overall, Staff submitted that Fauth's misconduct and the personal benefit he derived therefrom call for very significant sanctions. They stressed the extensive harm Fauth caused to Espoir's investors, both in terms of their finances and in terms of their physical and mental well-being. In that regard, the Staff Submissions referenced at some length the evidence the investor witnesses gave at the Merits Hearing with respect to the impact the experience with Espoir had on them.

[30] Staff argued that Fauth poses a "grave risk to the investing public", and should thus be removed permanently from participation in the Alberta capital market. They argued for strong messages of specific and general deterrence, concluding that there are no mitigating considerations in Fauth's favour. At the Sanction Hearing, they commented on the absence of evidence in support of Fauth's representations regarding the state of his health and finances, and were skeptical about his remorse and acceptance of responsibility.

[31] Finally, Staff cited eight past ASC decisions which they submitted provide guidance as to the type and scope of sanction orders appropriate in matters of this nature – those which involve, as Staff described it, "large-scale fraud". Staff submitted that these decisions support the orders they seek against Fauth, since they generally resulted in orders imposing comprehensive, permanent market-access bans and large administrative penalties, as well as, in some cases, orders to disgorge amounts obtained as a result of the respective respondents' non-compliance with the Act.

2. Fauth

[32] The brief Fauth Submissions did not include a proposal with respect to the sanction orders Fauth felt would be in the public interest in the circumstances. However, in oral submissions at the Sanction Hearing, his counsel made a few comments with respect to Staff's proposal.

[33] First, Fauth's counsel argued that disgorgement could not be ordered in this case because there are no funds remaining in Espoir and Fauth is impecunious, such that there is "nothing left to disgorge". Instead, he pointed to the $3 million Staff had referred to as the maximum administrative penalty allowed under the Act for the breaches of the three sections found in the Merits Decision (i.e., $1 million per section breached, multiplied by three). While he submitted that this was not the most serious of cases and thus did not warrant the maximum penalty, Fauth's counsel suggested that instead of disgorgement, we could impose a higher administrative penalty, which might fall anywhere between Staff's $750,000 proposal and the $3 million maximum. He indicated that he did not take issue with the $750,000 figure, but there should be no disgorgement order.

[34] Second, Fauth's counsel argued that any cease-trade order imposed should include an exception or "carve-out" to allow Fauth's trustee in bankruptcy and "pension managers" to administer any securities in Fauth's name. He suggested such a carve-out is "standard", and often included in ASC sanction orders.

[35] In the unsworn Fauth Submissions, Fauth apologized for causing harm to Espoir's investors, and echoed the evidence he gave during his investigative interview to the effect that he had not intended to lose any investor funds – including his own – and wished that he had the ability to "somehow make it right". He suggested that he had relied on professional advice in "making operational and investment decisions" for Espoir, and said that "[t]his outcome was not what [he] envisioned".

[36] The Fauth Submissions also emphasized Fauth's cooperation with Staff's investigation, in that he provided the documentation and information requested and "answered all their questions honestly". Fauth reiterated that he is 71 years of age, has health issues, and is retired, currently living on his pension and Old Age Security benefits. He said he is in the midst of the bankruptcy process and has no assets.

[37] In addition, Fauth noted his objection to certain inflammatory comments made about him and his character in the Staff Submissions. We will not repeat those comments here. We agree that such intemperate language was unnecessary, and we disregarded the comments in reaching our decision herein.

C. Analysis

1. Application of Sanctioning Principles and Factors

[38] We now apply the law and principles discussed above to the facts of this case, and further consider the submissions made by the parties.

(a) Seriousness of the Misconduct

[39] The first sanctioning factor described in *Homerun* is the seriousness of the misconduct at issue. We consider the nature of the misconduct, the intention behind it (i.e., whether it was "planned and deliberate, not deliberate but attributable to recklessness, or simply inadvertent"), and the harm it caused, both to the specific investors involved and to the capital market at large (*Homerun* at para. 22). Generally, the more serious the misconduct, the greater the future risk of harm presented and the greater the need for deterrent measures (*Homerun* at para. 26).

[40] Although Fauth argued in the Merits Hearing that his breach of s. 75(1)(a) was only "a technical breach", we consider it a serious contravention of a fundamental provision of the Act. The section is intended to ensure that investors have the benefit of a qualified registrant's involvement in their investment decisions, and is key in addressing the goal of investor protection. The importance of being able to rely on a knowledgeable professional was demonstrated by the trust many of the investor witnesses placed in Fauth, at least in part because of his long experience as a financial advisor.

[41] The fraud – based on the deceit of misrepresentations made to numerous investors over an extended period – was more serious, and deprived the investors of the ability to make fully informed investment decisions. Fauth also made unauthorized use of investment funds, including by paying earlier investors with funds from later investors, in the manner of a Ponzi scheme. He deliberately misled those he knew were in search of a secure way to generate a return on their money, exposing them to unanticipated risk despite the fact that he knew some investors were using the life savings they had set aside for their retirement.

[42] Even if Fauth were truthful initially and intended to follow the investment plan he described to early Espoir investors, it was not long before he became deliberately deceptive. He then continued to deceive people over the ensuing months and years. As we noted in the Merits Decision, he relied on the enticement of a low-risk investment secured by assets that could be liquidated if necessary, and never corrected or updated the promotional information he gave to investors. He also distributed materials which were not accurate at any point, and sent correspondence with claims about Espoir's mortgage holdings when he knew full well Espoir was no longer investing in mortgages.

[43] Fauth's misrepresentations went to the heart of what Espoir investors specifically wanted: safety and minimal risk. The actual uses to which he put their funds were not only undisclosed, they were unsafe and high-risk – the opposite of what these investors had been led to believe. He failed to tell them what was really happening with Espoir, and instead purposely fed them false information about where their money was being invested. This encouraged them to maintain their investments as they matured and to make further investments. Since he was in sole control of Espoir and the only person who dealt with its investors, Fauth knew exactly what they were and were not told, and he knew the reality of how investment funds were and would be used.

[44] There was no disclosure that even hinted at the actual use that was being made of investor money. Fauth purposely withheld that information, likely because he knew it would negatively impact his ability to raise further funds. Moreover, while the majority of Espoir investors will never see repayment of their principal, he made sure that the limited partnership he controlled was

fully paid on its Debentures, even before they matured. He also created the aforementioned invoices to net out the millions of dollars in debt he and members of his family owed to Espoir.

[45] The impact on many investors – both financial and emotional – was devastating, especially for those who were retired or close to retirement, and those who lost their life savings. Even when Fauth knew FairWest was failing and that he was being dishonest about Espoir's use of funds, he accepted investments from people like TB and WC, whom he knew could not afford to lose their money. We considered this particularly egregious, given that the evidence led at the Merits Hearing showed how clear TB and WC made it to Fauth that they were entrusting him with their life savings and could not tolerate any risk of loss.

[46] Fauth also caused harm to the Alberta capital market itself. Investor witnesses testified to their lost confidence in the Alberta market, and said that the experience soured them on investing in the future. Others not involved in Espoir may hear of what happened in this case and find themselves similarly dissuaded from investing, even with law-abiding issuers.

[47] In short, Fauth's capital-market misconduct was among the most serious. It was deliberate, self-serving, and caused substantial harm. We agree with the ASC panel in *Re Arbour Energy Inc.*, 2012 ABASC 416, which said (at para. 80):

> Investment fraud is reprehensible and completely unacceptable capital-market misconduct; instances of fraud in the capital market severely threaten the public's confidence and sense of fairness in the whole of our capital market. A high level of both specific and general deterrence is required against each Respondent on the basis of our fraud findings alone.

(b) Characteristics and History

[48] As described in *Homerun* (at para. 27), a respondent's individual characteristics and history may be relevant to both the degree of future risk posed (and thus the extent of the deterrent measures required) and the proportionality of any proposed package of sanctions. Relevant personal characteristics can include educational background, work experience, capital-market experience, and disciplinary history, each of which may be indicative of the extent to which a respondent was or should have been aware of the requirements of the regulated financial sector (*Homerun* at paras. 28-29). Such awareness may in turn be indicative of the extent to which the misconduct was deliberate rather than inadvertent, which speaks to its seriousness and the risk of recurrence (*Homerun* at para. 29).

[49] Fauth is a resident of Calgary, married, and has three adult sons. As of the date of the Fauth Submissions, he was 71 years old. We noted earlier in these reasons that his background is in insurance sales and financial planning, and that he was once registered with the Mutual Fund Dealers Association. He has held various financial designations throughout his career, including designations as a chartered life insurance underwriter, a certified financial planner, an elder planning counsellor and a trust and estate practitioner. Prior to Fauth Financial, he was a branch manager at a Manulife Financial office in Calgary, and through Fauth Financial, he provided financial and estate planning services, including investment advice and opportunities. He has no prior sanctioning history.

[50] We are satisfied that given Fauth's extensive capital-market experience, he was familiar with the regulatory environment in which he was operating, and knew that there were requirements under securities laws which could affect his fundraising activities on behalf of Espoir. We observed in the Merits Decision that he even indicated that he had legal counsel at one time for advice on securities matters. Moreover, as is often noted in ASC sanction decisions, no special knowledge or experience is required to know that deceit and fraud are wrong. That Fauth conducted himself as he did despite this knowledge and the apparent availability of legal advice suggests an enhanced need for deterrence, especially with respect to any future activity in the capital market. The absence of a sanctioning history is not mitigating in these circumstances.

[51] In some situations, a respondent's financial circumstances may also be relevant, as impecuniosity or constrained finances may go to the proportionality of a proposed administrative penalty (*Homerun* at paras. 17, 28, 34). As described earlier, the Fauth Submissions indicated that Fauth has "health issues", is now both retired and bankrupt, has no assets and is living on pension benefits.

[52] Staff is correct that there was no evidence before us at the Sanction Hearing to support these unsworn representations. However, the representations are consistent with the evidence led at the Merits Hearing with respect to Fauth's filings under the *Bankruptcy and Insolvency Act*. The fact that he is in his seventies may have a limiting effect on his ability to earn income in the future. In accordance with the ruling of the ABCA in *Walton*, this suggests a need for moderation of any administrative penalty imposed (see paras. 154, 156, 165).

(c) Benefit Sought or Obtained

[53] This factor focuses on the extent to which a respondent benefitted or sought to benefit from the misconduct at issue, whether in a financial capacity or otherwise. It, too, may be an indication of future risk, and thus of the need for deterrent measures directed at both the respondent and others who might see the potential benefit as an incentive to repeat or emulate the misconduct (*Homerun* at paras. 35-38).

[54] In this case, while Fauth may not have enjoyed an enduring financial benefit from his activities with Espoir, the evidence at the Merits Hearing was clear that over a sustained period, he sought and obtained such a benefit, both directly and indirectly. He received millions of dollars in proceeds from the investments he solicited, and then used those funds in whatever manner he saw fit at the time. This included millions of dollars in loans made to himself and to members of his family (some of which was used to purchase real estate held in their names), and in loans to Fauth Financial (some of which, by Fauth's own admission, may then have been paid to him personally). As we mentioned earlier in these reasons, the family loans were not repaid to Espoir, but were instead offset against *ex post facto* invoices issued "for services rendered", and millions in loans to Fauth Financial were written off as uncollectible.

[55] In addition, Fauth realized the indirect benefit of the funding Espoir investors unwittingly provided for the other business entities under his ownership or control.

[56] This factor calls for significant deterrent measures in order to mitigate the risk that either Fauth or others might be tempted to replicate the misconduct so they can realize either a direct or

indirect personal benefit. It must be made readily apparent that contravening Alberta securities laws does not pay.

(d) Mitigating and Aggravating Considerations

[57] According to the panel in *Homerun*, sanctioning decisions should take into account all other relevant circumstances which may not fall within any of the preceding factors (at para. 39). Some circumstances may be aggravating and militate in favour of significant sanctions to address an enhanced risk, while others may be mitigating and suggest that because the risk of future misconduct is reduced, sanctions of lesser severity will suffice.

[58] Other than as discussed in the previous sections of these reasons, we see no mitigating circumstances in this matter. *Homerun* states that "[p]ersuasive indications that a respondent appreciates the wrong done, and its seriousness" may be mitigating in that such indications can be suggestive of a diminished risk of recurrence (at paras. 41-42). Fauth apologized in the Fauth Submissions, but his apology and expression of regret were undermined by the fact that in the same paragraph, he continued to deflect responsibility by citing reliance on professional advice. Since there was no evidence of such advice or reliance (see Merits Decision at paras. 251, 293), we considered these statements in the Fauth Submissions indicative of a continued failure to accept full responsibility for the misconduct. Pursuant to *Homerun*, this is therefore a "neutral consideration" (at para. 41).

[59] The Fauth Submissions also reiterated that Fauth did not deliberately set out to create a fraudulent enterprise and lose everyone's money. At the Merits Hearing, he pointed out that before Espoir's collapse, he tried to return some money to the investors most in need. However, any mitigating effect this might have had (see *Homerun* at para. 40) is offset by the fact that Fauth engaged in active deceit to obtain money from those investors in the first place. He deliberately chose not to disclose the actual use of Espoir investment funds when he knew that use was not what investors expected and involved risk they were not prepared to take. If he had been as confident as he said he was with his plan to make money for everyone through FairWest and the oil and gas limited partnerships, he could have disclosed the plan to those he solicited for investment.

[60] Moreover, we consider the fact that Fauth ensured repayment in full to one particular Espoir investor in the latter part of 2012 to be an aggravating circumstance. As alluded to earlier, a limited partnership under Fauth's sole control was paid out in full on its $400,000 in Secured Debentures prior to their maturity date, using funds obtained from other Espoir investors. While this does not necessarily rise to the level of "belligerent contempt" for Espoir's other investors as described in *Homerun* (at para. 46), it is indicative of a conscious choice to prefer the limited partnership's interest – and thus Fauth's personal interest – over the interest of any other investor. It in turn suggests a need for heightened deterrence.

2. Outcomes in Other Proceedings

[61] We referenced above Staff's reliance on eight prior ASC sanction decisions for comparison with the facts in this case. No cases were cited by Fauth. We reviewed the decisions provided by Staff, and found them of assistance to us in assessing the proportionality and appropriateness of

Staff's proposed sanctions, and in devising sanction orders we consider suitable in the present circumstances. The decisions are summarized as follows:

- *Re Cloutier*, 2014 ABASC 170: Among other misconduct, the individual respondent was found to have illegally traded and distributed securities, made misrepresentations and perpetrated a fraud. Over $10.6 million was raised over a span of several years, and the respondent personally benefitted from it through a generous annual salary, payment of expenses, and some personal use of funds. He had sufficient prior capital-market experience to have been aware there were regulatory requirements applicable to his activities. The panel imposed permanent market-access bans, and ordered the respondent to pay an administrative penalty of $1 million.

- *Re Optam Holdings Inc.*, 2015 ABASC 996: The individual respondent admitted to illegally trading and distributing approximately $10.8 million in securities over a period of approximately four years, as well as perpetrating a fraud. Investors understood they were investing in a mortgage lending business and that their funds would be secured by real estate. In reality, the funds were unsecured and diverted to unauthorized uses – including over half paid as returns to other investors and at least $800,000 converted to the respondent's own use. He later declared bankruptcy, and almost all of the principal owed to investors remained outstanding. The respondent had prior capital-market experience, including as a registered mutual fund salesman. The parties jointly proposed – and the panel accepted – sanctions that included permanent market-access bans and a $1 million administrative penalty.

- *Re Reeves*, 2011 ABASC 107: The respondent admitted that he illegally distributed securities, made a misrepresentation to at least one investor and perpetrated a fraud, converting at least $500,000 in investor funds to his own use. He had no sanctioning history, but had extensive prior capital-market experience. He was ordered to pay an administrative penalty of $650,000, and was permanently banned from market access. However, he was granted a limited carve-out for certain personal trading and purchasing.

- *Re Narayan*, 2016 ABASC 228: The individual respondent admitted to fraud and to authorizing, permitting or acquiescing in various misconduct by the corporate respondents, including illegally dealing in and distributing securities and making misrepresentations. Over $5.8 million had been raised, but the money was not used to fund secured mortgages or develop a recreational park as represented. Instead, funds were used for other purposes including payments to earlier investors and to the respondent and his family. The respondent had capital-market experience and a history of discipline by another regulator. He was made subject to permanent market-access bans (with a limited carve-out for certain personal trading and purchasing), and was ordered to pay a $300,000 administrative penalty plus $880,951 in disgorgement.

- *Re Magee*, 2015 ABASC 846: One of the three individual respondents admitted illegally dealing in and distributing securities, making misrepresentations and fraud. Over $2 million was raised over a three-and-a-half-year period, a significant portion of which was diverted to uses that were not authorized by investors. This included at least $893,837 used personally by the respondents or by companies in which they had interests. They were ordered to disgorge this sum on a joint and several basis, and the respondent liable for misrepresentation and fraud was permanently banned from market access and ordered to pay a $200,000 administrative penalty.

- *Re Mandyland Inc.*, 2013 ABASC 69: Among other misconduct, the three individual respondents – all members of the same family – illegally traded and distributed $2.9 million in securities and perpetrated a fraud. Two of the three were also found to have made misrepresentations to investors. All three were permanently banned from market access and ordered to pay administrative penalties of $150,000 each. On a joint and several basis, they were also ordered to pay $1,716,647.20 in disgorgement, representing the amount that the panel found had been fraudulently converted to their personal use.

- *Re DeLaet*, 2013 ABASC 228: Although there were two individual respondents in this matter, only one is comparable to Fauth. That respondent was the directing mind behind the activities in question, made misrepresentations, and engaged in fraud. $47 million was raised "over several years" for investments that were touted as "lucrative and safe" but turned out to be neither. The panel found that the respondent was experienced in the capital market, yet blamed others and took no responsibility for his conduct. The panel also found that he had benefitted financially from the scheme, even though he claimed financial destitution at the time of the hearing. He was ordered to pay a $1.5 million administrative penalty, and permanently banned from participating in the Alberta capital market in various capacities.

- *Re Schmidt*, 2013 ABASC 320: The individual respondent made admissions and was found to have illegally traded and distributed securities, made misrepresentations and perpetrated a fraud. He raised approximately $5 million over approximately five years, and received approximately $700,000 of that amount in undisclosed fees, either directly or indirectly. He was in his seventies at the time of the hearing, and had a prior disciplinary history (two settlement agreements with the ASC in the 1990s). The panel imposed permanent market-access bans against him and considered his impecuniosity claim, but in the interest of deterrence (especially general deterrence – the decision is pre-*Walton*), ordered him to disgorge the $700,000 and pay a $200,000 administrative penalty.

[62] These decisions all suggest that cases involving significant misconduct (especially misrepresentation and fraud) which causes significant harm will attract substantial sanctions. Orders aimed at deterring recidivism and sending the message that wrongdoers will not be permitted to benefit from breaching the Act are appropriate in such circumstances.

[63] Permanent market-access bans were ordered in each of these cases against those liable for fraud. In addition, an administrative penalty was imposed, sometimes in conjunction with a disgorgement order.

[64] Administrative penalties ranged from $150,000 to $1.5 million, with those at the lower end of the range accompanied by disgorgement orders. The administrative penalties at the lower end of the range also tended to be imposed in the cases that involved a lesser amount of money raised from investors ($5.8 million or less). The size of the disgorgement orders varied depending on the sum the panel in the case found had been misappropriated by the relevant respondents.

3. Sanctions Ordered

[65] Based on our application of the factors set out in *Homerun* to the facts of this case, we are satisfied that a package of sanctions including market-access bans, a disgorgement order and an administrative penalty is necessary and appropriate to effect the specific and general deterrence required. This is particularly so in view of our finding of fraud, which is completely incompatible with a capital market in which investors can have trust and confidence. As noted by the panel in *Reeves* (at para. 20), ". . . capital market participants must appreciate that findings of fraud will attract the most severe sanctions".

[66] We are also satisfied that such a package is proportionate, as it takes into account Fauth's personal circumstances as well as the seriousness of his misconduct, and is consistent with the sanctions suggested by the comparable past decisions discussed above.

(a) Market-Access Bans

[67] In *Re Planned Legacies Inc.*, 2011 ABASC 278 (at para. 42; see also para. 63), the hearing panel made the following remarks with respect to sanction orders, and, in particular, the imposition of market-access bans under s. 198(1) of the Act:

> As [the ASC] has noted in many other cases, participation in the Alberta capital market is a privilege not a right. Those who exercise the privilege of access to the Alberta capital market are to adhere scrupulously to all requirements of Alberta securities laws. Those who do not do so are subject to losing that privilege and facing other consequences.

[68] Different bans addressing different types of activity in the Alberta capital market are available under s. 198(1). They may be temporary or permanent, and subject to exceptions (the aforementioned "carve-outs") or not. Such orders prohibit those who contravene Alberta securities laws from future participation in the market, and make it apparent to others that they risk losing the privilege of participation if they undertake similar misconduct (see *Planned Legacies* at para. 63 and *Mandyland* at para. 51).

[69] We agree with Staff that market-access bans are appropriate in this case, and necessary to achieve the requisite levels of specific and general deterrence. We also agree that the specific bans ordered should be directed at "the variety of ways in which the investing public is at risk". In other words, the particular orders made should be directed at the capacities in which Fauth acted when he breached ss. 75(1)(a), 92(4.1) and 93(b) of the Act.

[70] In cases of misconduct as serious as that here, involving a large-scale fraud that caused significant harm to investors over a lengthy period, we are of the view that permanent bans are in the public interest. Given the extent of Fauth's deceit (despite his knowledge of regulatory requirements and his awareness that Espoir's investors were relying on him and his representations), we do not believe that he can be trusted to comply with Alberta securities laws in the future. He should be prohibited from raising money from the public ever again. Further, we do not believe that he is fit to act as a director or officer or in any other management or consultative capacity in connection with the securities market, now or in the future.

[71] Accordingly, we are imposing the market-access bans against Fauth which were proposed by Staff, although our orders will use the current language of s. 198 of the Act (as amended in November 2018). We are satisfied that Fauth's future participation in the Alberta capital market "would pose a very real and significant threat to Alberta investors and to the integrity of and confidence in that market" (*Planned Legacies* at para. 69). Permanent orders of the kind sought by Staff are appropriate on the facts of this case, proportionate to both the seriousness of the misconduct and the circumstances of the respondent, and consistent with the bans imposed in comparable cases.

[72] Earlier we referenced the argument made at the Sanction Hearing by Fauth's counsel that any cease-trade order we impose should include a "carve-out" to allow Fauth's trustee in bankruptcy and "pension managers" to administer any securities held in Fauth's name. While we disagree with counsel's suggestion that a carve-out is "standard", we acknowledge that such a concession is sometimes included in ASC sanction orders where it is considered appropriate in the circumstances and does not threaten the public interest.

[73] Staff acknowledged that carve-outs are within our discretion, but argued that one should only be granted where there is justification for it. Here, we have no evidence with respect to Fauth's current securities holdings, and therefore no evidence as to what sort of concession is necessary to allow his trustee in bankruptcy or his "pension managers" to administer them. Moreover, Fauth made no submissions with respect to the exact nature of the carve-out sought.

[74] Accordingly, we decline to include a carve-out in our market-access prohibition. However, it will remain open to Fauth to bring an application under s. 214 of the Act in the future, provide evidence, and seek variation of our order at that time (see *Walton* at para. 159).

(b) Monetary Sanctions

[75] We are satisfied that to achieve the necessary specific and general deterrence, this matter calls for monetary sanctions in addition to market-access bans. Disgorgement orders are different from administrative penalties and different considerations apply to each of them. We are of the view that both are required in this case.

(i) Disgorgement

[76] Section 198(1)(i) of the Act provides that "if a person or company has not complied with Alberta securities laws" and the ASC "considers that it is in the public interest to do so", it may order "that the person or company pay to the [ASC] any amounts obtained or payments or losses

avoided as a result of the non-compliance". This is what is commonly known and referred to in these reasons as a disgorgement order.

[77] In *Planned Legacies*, the panel explained that a disgorgement order "reflects the equitable policy designed to remove all money unlawfully obtained by a respondent so that the respondent does not retain any financial benefit from breaching the Act" (at para. 71). As the sum ordered is paid to the ASC and not to wronged investors, "[i]t is not a compensation mechanism" (at para. 71). Rather, it "provides a further element of specific and general deterrence" by removing the incentive to profit from misconduct (at para. 71; see also *Re Pro-Financial Asset Management Inc.*, 2018 ONSEC 18 at para. 48). While disgorgement is thus like an administrative penalty in that both are aimed at deterrence, they have different purposes.

[78] To determine whether disgorgement should be ordered in a particular case, we agree with the two-step approach developed in British Columbia (**B.C.**) Securities Commission (**BCSC**) jurisprudence and recently approved and adopted by the B.C. Court of Appeal. First, the adjudicator should "'determine whether a respondent, directly or indirectly, obtained amounts arising from his or her contraventions of the Act'" in order to establish whether a disgorgement order can be made at all (*Poonian v. British Columbia Securities Commission*, 2017 BCCA 207 at para. 144, citing *Re SPYru Inc.*, 2015 BCSECCOM 452 at para. 131). Second, the adjudicator should "'determine if it is in the public interest to make such an order'", including by considering the goals of specific and general deterrence (*Poonian* at para. 144, citing *SPYru* at para. 132).

[79] With respect to the first step, the "amounts obtained" by individual respondents as a result of the misconduct at issue includes amounts obtained by corporate entities under their direction and control: see, e.g., *Schmidt* (at paras. 8, 12, 18, 77). As stated by the Ontario Securities Commission (**OSC**), "[i]n our view, individuals should not be protected or sheltered from administrative sanctions by the fact that the illegal actions they orchestrated were carried out through a corporation which they directed and controlled" (*Re Limelight Entertainment Inc.* (2008), 31 OSCB 12030 at para. 59).

[80] In *Pro-Financial*, despite the fact that there was no evidence the individual respondent received any direct financial benefit from the misconduct at issue, the OSC ordered him and the corporate respondent – of which he was directing mind – to disgorge the sum obtained by the corporation on a joint and several basis (see paras. 55, 60-61, 117-118, 121). In *Phillips v. Ontario (Securities Commission)*, 2016 ONSC 7901, the Ontario court upheld the OSC's decision to order individual respondents to disgorge amounts they had not received personally, but were instead received by entities under their control that were not named as respondents in the proceeding (see paras. 65-80).

[81] Staff have the initial burden to prove on a balance of probabilities the amount they say a respondent obtained as a result of the misconduct; the burden then shifts to the respondent to disprove the reasonableness of that amount (*Planned Legacies* at para. 72; see also *Arbour* at para. 37 and *Poonian* at para. 129). Further, it has been accepted that "any risk of uncertainty in calculating disgorgement should fall on the wrongdoer whose non-compliance with the Act gave rise to the uncertainty" (*Limelight* at para. 53; see also *Poonian* at paras. 101, 129, 140).

[82] It is important to note that s. 198(1)(i) of the Act – like the equivalent sections contained in the B.C. and Ontario securities acts – stipulates that a disgorgement order may be directed at "**any** amounts **obtained** . . . as a result of the non-compliance" (emphasis added). The section is not limited to "the amount **retained**, the profit, or any other amount calculated by considering expenses or other possible deductions" (*Arbour* at para. 37, emphasis added; see also *Limelight* at para. 49, *Pro-Financial* at para. 49, and *Poonian* at para. 85). As discussed in D. Johnston, K. Rockwell and C. Ford, *Canadian Securities Regulation*, 5th ed. (Markham: LexisNexis Canada Inc., 2014 at para. 14.32), ". . . the relevant amount is what a respondent obtained through misconduct, not what the respondent retained or spent inappropriately". The B.C. Court of Appeal explained the rationale for this in *Poonian* (at para. 88):

> One way to deter is to remove the incentive for non-compliance. However, if the disgorgement amount is based on profits, then wrongdoers would not be deterred from contravening, or attempting to contravene. They would only face the risk of having to disgorge amounts *if their schemes succeeded*. However, the public is still harmed. A profit-oriented interpretation would undermine the statute's remedial and protective purpose. The failure to "turn a profit" on the wrongdoing should not prevent the regulator from requiring the wrongdoer to give up money received from the wrongdoing. [Original emphasis.]

[83] In *North American Financial Group Inc. v. Ontario (Securities Commission)*, 2018 ONSC 136, the Ontario court similarly explained (at para. 218):

> If the aim is to preserve confidence in the capital markets by ensuring that fraudulent behaviour does not occur as opposed to punishing those who commit fraud, there is less reason to focus on whether the fraudsters pocketed the money for themselves. What they did with the money does not lessen the seriousness of the effect of the behaviour when looked at through the framework of restoring confidence in the market.

[84] It therefore does not matter that there are no funds remaining in Espoir and that Fauth is impecunious. Disgorgement may still be ordered. The panel in *Magee* stated (at para. 191):

> We are mindful of what was said about a respondent's ability to pay in *Walton* . . . , but it would seem inapplicable to disgorgement orders. Indeed, it would seem perverse that disgorgement could be ordered against a respondent who has retained amounts illegally obtained, but not against a respondent who has squandered such amounts.

[85] We agree. A contrary approach could conceivably encourage wrongdoers to spend funds raised as soon as possible, and would in effect reward them for doing so by removing the consequent possibility that they could be held liable for those funds in the future. Obviously, that is not in the public interest. Moreover, we observe that in *Walton*, the ABCA's comments with respect to proportionality and a respondent's ability to pay were focused on the assessment of appropriate administrative penalties (as discussed later in these reasons), rather than on the disgorgement orders made by the ASC panel below. The panel charged with reconsidering sanction following the successful appeal to the ABCA noted that the disgorgement orders were not in issue: *Re Holtby*, 2015 ABASC 891 (at para. 18).

[86] That said, there may be other reasons for a panel to order disgorgement of a sum less than the full amount obtained by a respondent as a result of his non-compliance with Alberta securities laws. Like other sanction orders, disgorgement orders are discretionary, and s. 198(1)(i) provides

that an order may be made with respect to "any amounts obtained", rather than *all* amounts obtained (*Re Sino-Forest Corporation*, 2018 ONSEC 37 at paras. 201-202; see also *Poonian* at paras. 92, 138 and *Pro-Financial* at para. 50).

[87] Some adjudicators, for example, have considered it appropriate to deduct amounts that were repaid to victim investors: see *Planned Legacies* (at paras. 73-75) and *Poonian* (at para. 91). Others have chosen to deduct the amount of funds raised which were actually used for the benefit of the investors, in the manner investors were told their funds would be used: see *Re 509802 BC Ltd. (c.o.b. Michaels Wealth Management Group)*, 2014 BCSECCOM 457 (at para. 46; aff'd. *Michaels v. British Columbia (Securities Commission)*, 2016 BCCA 144), *Poonian* (at para. 139, citing *Re Streamline Properties Inc.*, 2015 BCSECCOM 66 at para. 100), and *Mandyland* (at paras. 31, 59-60).

[88] In the Merits Decision, we found that from 2002 through 2012, Espoir raised over $15 million from its Debentures and another $545,000 from Espoir Notes. However, the allegations made by Staff in the notice of hearing – and thus our findings on the contraventions of the Act alleged – concerned the period from October 6, 2006 through September 30, 2014. Staff's formal source and use of funds analysis (referred to in the Merits Decision as the **Source and Use Analysis**) concentrated on the period relevant to the fraud allegation, from approximately January 1, 2009 to September 30, 2014 (referred to in the Merits Decision as the **Financial Review Period**). Staff's submissions on disgorgement in turn focused on the funds that flowed into and out of Espoir's bank account during that same period.

[89] Based on the evidence led at the Merits Hearing, we are satisfied on a balance of probabilities that during the Financial Review Period, Espoir received $4,707,000 from investors: $4,162,000 from Debentures, plus $545,000 from loans made under Espoir Notes. Since Espoir was under Fauth's sole direction and control, we are also satisfied on a balance of probabilities that Fauth obtained at least the amount of $4,707,000 as a result of his non-compliance with the Act during the same period.

[90] It is true that the Source and Use Analysis indicated that during the Financial Review Period, Espoir made payments of principal and interest to its investors in excess of $4,707,000. However, this included payments made on Debentures that were already outstanding as of January 1, 2009. It would therefore be incorrect to conclude that all of those from whom Fauth obtained the $4,707,000 during the Financial Review Period were subsequently made whole. To the contrary – and as we observed earlier – by the end of 2014, Espoir's records showed that it still owed Debenture holders over $12.3 million. That amount remained outstanding at the time of the Merits Hearing, and it is unlikely it will ever be paid.

[91] Accordingly, in assessing the appropriate amount for a disgorgement order in these circumstances, we find that it would detract from the sanctioning goals of specific and general deterrence and the promotion of public confidence in the Alberta capital market to give Fauth "credit" for the sums repaid to Espoir investors during the Financial Review Period. Nor is there any basis on which to give Fauth "credit" for funds used by Espoir in ways consistent with the expectations of its investors during the Financial Review Period – there were none. Other than the payments to investors and some relatively minor amounts paid for business expenses, virtually all

of Espoir's funds during the Financial Review Period were paid to non-arm's length parties, including Fauth personally.

[92] Staff's proposed disgorgement figure of $2,585,414.87 – which they characterized as "conservative" in the circumstances – is, according to the Source and Use Analysis, the sum paid by Espoir to Fauth and other non-arm's length parties during the Financial Review Period. Again, it is true that the Source and Use Analysis indicated that during that period, Fauth and other non-arm's length parties paid more than $2,585,414.87 to Espoir. However, some of the payments related to transactions that were outstanding as of January 1, 2009 (before the Financial Review Period), and the non-arm's length payors were not all the same parties as the non-arm's length payees. As discussed in the Merits Decision, over $7.1 million in debt owed to Espoir by non-arm's length parties and nearly $1 million in investments made by Espoir in non-arm's length parties was written off by the end of 2013. We have already mentioned that approximately $2 million owed to Espoir by Fauth, his spouse and his son personally was set off against invoices the three issued in January 2014 for ostensible services rendered over the years, back as far as 2002.

[93] It was not possible based on the evidence before us to calculate precisely the flow of funds among Espoir, Fauth, and the other non-arm's length parties. In part this was due to the absence of financial records in evidence for most of those parties, but it was also due to the fact that, as Fauth acknowledged, not all such transactions were even documented (see Merits Decision at para. 197). Overall, we were left with the impression that once investment funds were received by Espoir – and despite what he told the investors – Fauth considered himself at liberty to move those funds wherever and whenever he saw fit, whether for his own benefit, the benefit of his family, or the benefit of other entities under his direction and control. It is irrelevant to disgorgement that the benefits were not ultimately enduring.

[94] Since we are satisfied that through Espoir, Fauth obtained at least $4,707,000 as a result of his contraventions of the Act during the Financial Review Period, Staff have met their burden of proof in that regard. They have submitted that Fauth should be ordered to disgorge $2,585,414.87 of that amount "at a minimum". Fauth did not meet his burden to then disprove the reasonableness of that amount, and any risk of uncertainty with respect to its calculation falls on him. In fact, the only information provided to us by Fauth on disgorgement was that given by his counsel, who submitted that due to his impecuniosity, no disgorgement order should be made against Fauth. In our view – and in accordance with the law discussed above – impecuniosity, even if proved, does not preclude the imposition of a disgorgement order.

[95] We are thus satisfied that it is in the public interest to order Fauth to disgorge $2,585,414.87. Such an order furthers the aims of specific and general deterrence by making it clear to Fauth and any others who might be of a similar mind that they will not be permitted to benefit from breaching Alberta securities laws, especially in cases of deliberate deceit and protracted fraud. This serves the Act's remedial and protective purposes as well as the goal of promoting public confidence in the Alberta capital market. Moreover, we are satisfied that the order is reasonable in the circumstances given the amounts raised in breach of the Act, and that it is proportionate with the outcomes in similar proceedings involving misconduct of comparable severity.

(ii) Administrative Penalty

[96] As we stated above, disgorgement orders and administrative penalties have different purposes. This was explained in *Re Currey*, 2018 ABASC 34, as follows (at para. 44):

> While disgorgement is intended to remove any profit incentive behind securities misconduct and addresses the calculable financial benefit a respondent may have gained, the addition of an administrative penalty is meant to ensure that the respondent does not view a sanction as merely a cost of doing business. The panel in [*Holtby*], while noting that both are "aimed at protecting through deterrence", described the difference as follows (at para. 65): ". . . a disgorgement order is directed at ensuring that a respondent does not retain any financial benefit from breaching Alberta securities laws, whereas an administrative penalty imposes a direct financial cost on a respondent for the respondent's breach of Alberta securities laws."

[97] Thus, a combination of monetary orders may be necessary to achieve the requisite levels of protection through deterrence. In the context of insider trading, the ABCA held in *Walton* (at para. 156) that it is not unreasonable to impose both a disgorgement order and an administrative penalty, ". . . because if the maximum financial consequence of insider trading was a disgorgement of the profits realized, there would be no true deterrent. Anyone caught would at worst 'break even'." The same rationale applies to other contraventions of the Act. As observed in *Narayan* (at para. 66), ". . . the return of misappropriated money is not a sufficient deterrent to prevent others from raising money by breaking securities laws. If promoters who raise money by breaches of securities laws only risk returning money taken, there is little downside to taking that risk." The addition of an administrative penalty ". . . send[s] a message that such violations of securities laws are serious and will result in serious personal and financial consequences" (*Narayan* at para. 67).

[98] The decision as to the size of administrative penalty which is appropriate in a given situation is not simply "a mathematical exercise": *Fiorillo v. Ontario (Securities Commission)*, 2016 ONSC 6559 (at para. 296). An administrative penalty must be large enough to act as a deterrent, but, like other sanction orders, it must also be proportionate to the circumstances. This includes, as cited previously, the "magnitude of the illegality" (*Brost* at para. 54). In *Maitland Capital Ltd. v. Alberta (Securities Commission)*, 2009 ABCA 186 (at para. 21), the ABCA stated: "If sanctions under this legislation are so low as to communicate too mild a rebuke to the misconduct, or perhaps a licensing fee for its occurrence, the opposite to deterrence may result" (see also *Walton* at para. 165).

[99] In addition (and as discussed above), consideration of what may be proportionate in the circumstances involves consideration of the range of administrative penalties imposed in comparable cases, and consideration of a respondent's finances. Following the ABCA decision in *Walton*, the panel in *Holtby* noted that evidence of reduced financial circumstances is a "moderating consideration" with respect to the amount of an administrative penalty (at para. 55). The *Walton* decision cautioned against relying on the principle of general deterrence to justify imposing administrative penalties which are "crushing or unfit" and "beyond the capacity of the individual offender" (at paras. 154, 165).

[100] However, we also agree with the reasoning of the panel in *Homerun*, which observed that ". . . a monetary sanction almost inevitably involves . . . a burden on a respondent. This does not in itself demonstrate disproportion or unreasonableness in the *Walton* sense; an order with no real

effect on the recipient may be no sanction at all" (at para. 18). Balancing is involved so that general deterrence is not over-emphasized and individual circumstances are not overlooked, but the administrative penalty should still be sufficient to have a deterrent effect (*Guindon v. Canada*, 2015 SCC 41 at paras. 77, 80). We agree with Staff's submission that an administrative penalty that is too low – especially in cases like this one, involving the most serious sort of capital-market misconduct – could erode public confidence.

[101] Although the Staff Submissions did not directly address the effect of Fauth's apparent bankruptcy on their position with respect to the appropriate administrative penalty in this matter, they argued at the Sanction Hearing that their $750,000 proposal was "proportionate and reasonable" in the circumstances, including Fauth's filings under the *Bankruptcy and Insolvency Act* a few years ago and the fact that in Staff's view, the maximum administrative penalty which could be imposed in this case is $3 million. We noted earlier that Fauth's counsel similarly referenced a $3 million maximum, did "not tak[e] issue with" Staff's $750,000 number, and suggested that the appropriate figure might be "[s]omewhere between [$]750,000 and [$]3 million" – albeit without a disgorgement order. He further argued that the total of the monetary sanctions sought by Staff – the $750,000 administrative penalty plus the $2,585,414.87 in disgorgement – cannot be ordered because the total would exceed the purported $3 million maximum.

[102] Section 199 of the Act provides:

> (1) If the [ASC], after a hearing,
>
> (a) determines that
>
> (i) a person or company has contravened or failed to comply with any provision of Alberta securities laws, or
>
> (ii) a person or company authorized, permitted or acquiesced in a contravention or failure to comply with any provision of Alberta securities laws by another person or company,
>
> and
>
> (b) considers it to be in the public interest to make the order,
>
> the [ASC] may order the person or company to pay an administrative penalty of not more than $1 000 000 for each contravention or failure to comply.
>
> (2) The [ASC] may make an order pursuant to this section notwithstanding the imposition of any other penalty or sanction on the person or company or the making of any other order by the [ASC] related to the same matter.

[103] The maximum set out by s. 199(1) is $1 million "for <u>each</u> contravention" of Alberta securities laws (emphasis added), not $1 million for each section of the Act contravened. As the BCSC explained with respect to the similarly-worded provision in the B.C. *Securities Act* (*Re Manna Trading Corp. Ltd.*, 2009 BCSECCOM 595 at para. 49):

> Section 162 allows us to order payment of the maximum administrative penalty for each contravention. We found that each of the respondents contravened four sections of the Act (treating

> the two fraud sections, 57(b) and 57.1(b) as one). The respondents contravened all of those sections in their dealings with hundreds of clients. They also contravened those sections multiple times in their dealings with many clients. There are therefore hundreds, if not thousands, of contraventions for which we could order an administrative penalty.

[104] Similarly, the ASC panel in *Arbour* said (at para. 91):

> Brost contravened six sections of the Act, Sorenson one section of the Act and Morice four sections of the Act, and they did so over and over again each time one of the hundreds of investors was defrauded when illegally sold Arbour securities. Thus, the maximum administrative penalty we could order would be in the hundreds of millions of dollars, if we were to consider separately each of the Respondents' contraventions.

[105] However, for the purpose of sanction, ASC hearing panels typically consider a respondent's contraventions on a global basis rather than individually. We have done so in this case.

[106] With respect to the effect of a combination of monetary orders, s. 199(2) of the Act is clear that an administrative penalty may be imposed "notwithstanding . . . any other penalty or sanction". Section 199 provides the authority for the imposition of administrative penalties, and is separate from s. 198(1)(i), which provides the authority for the imposition of disgorgement orders. Fauth's submission conflates two distinct concepts which, as we have discussed, serve two distinct purposes.

[107] Fauth's counsel submitted that Fauth is currently experiencing constrained financial circumstances. We note that he was largely the architect of that state of affairs through his own actions and decisions around Espoir, FairWest and the other entities under his control. That said, he is approximately 71 years old and, based on his counsel's submissions, he is hampered by health issues and living on retirement benefits.

[108] However, for the reasons discussed, this does not preclude the imposition of an administrative penalty, as long as we are mindful not to overemphasize general deterrence nor to overlook Fauth's personal circumstances (*Re Bennett*, 2017 ABASC 177 at para. 56).

[109] The comparable cases discussed previously suggest a range for administrative penalties in matters such as this from the aforementioned low of $150,000 to a high of $1.5 million. In those decisions, the administrative penalties ordered on the higher end of the range were not accompanied by disgorgement, while those on the lower end of the range included a disgorgement order. A lower administrative penalty in combination with a disgorgement order recognizes the deterrent effect of the latter, which attenuates the magnitude of the administrative penalty required to achieve the necessary levels of specific and general deterrence – especially when further combined with permanent market-access bans.

[110] Given the law, the other orders we are making, and the conclusions we have drawn from the law and the facts as discussed in these reasons, we conclude that an administrative penalty in the amount of $400,000 is appropriate, proportionate, and in the public interest in this case.

[111] We are satisfied that this sum appropriately reflects the nature and seriousness of Fauth's misconduct, including the amount of money raised, the harm caused to investors, the breach of

trust placed in him as an experienced financial professional, and the personal benefit he obtained for himself and his family. A lower amount would give insufficient regard to the gravity, deliberateness and magnitude of this fraud and securities-market fraud in general, and would, in our view, be insufficient to achieve meaningful deterrence – in the words of the ABCA, it would "communicate too mild a rebuke to the misconduct" (*Maitland* at para. 21) and undermine public confidence in the Alberta capital market as a place in which fraud is not tolerated, and is dealt with severely.

[112] At the same time, we are satisfied that the administrative penalty necessary for effective deterrence in this case need not be at the top end of the range, given the information available with respect to Fauth's current impecuniosity, the disgorgement order and the permanent market-access bans. In our view, the sum we are ordering is proportionate for this respondent, as it takes into consideration his personal circumstances, including his finances and age. Were it not for those circumstances, we would have ordered an administrative penalty closer to the upper end of the range.

D. Conclusion on Sanctions

[113] To conclude, we adopt the comments of the panel in *Planned Legacies* (at para. 81), which we find equally applicable here:

> We are satisfied that the imposition of these sanctions will, in the public interest, provide the necessary level of protection through specific and general deterrence. These sanctions are intended to communicate to [the respondent] and like-minded others the seriousness with which we treat such capital market misconduct – those who engage in such misconduct will be denied the privilege of access to the Alberta capital market, will not be allowed to profit from such misconduct and will find such misconduct comes at a direct and substantial financial cost to them.

IV. COSTS

A. The Law

[114] Where a contravention of Alberta securities laws or conduct contrary to the public interest has been found after a hearing, s. 202 of the Act gives an ASC panel the authority to order a respondent to pay costs of or related to the investigation or hearing, or both. Section 20 of the *Alberta Securities Commission Rules (General)* sets out the categories of costs that may be ordered, including Staff time and expenses, and expenses incurred by witnesses.

[115] Costs orders are not sanctions, and do not serve the same purpose as sanction orders: *Re Marcotte*, 2011 ABASC 287 (at para. 20). Instead, they are a way for the ASC to recoup costs associated with enforcement proceedings that would otherwise have to be paid from operating funds. The panel in *Reeves* explained as follows (at para. 38; see also *Planned Legacies* at para. 86):

> An order for costs provides the [ASC] with a means of recovering costs incurred by the [ASC] in enforcing Alberta securities laws, which costs would otherwise be paid by law-abiding market participants whose fees fund the [ASC]'s operations. Generally, therefore, it is considered appropriate for a respondent who has been found to have contravened Alberta securities laws or acted contrary to the public interest to pay some or all of the costs incurred in the investigation and hearing of such allegations. Costs orders also provide the [ASC] with an effective means to encourage procedural efficiency in enforcement proceedings. Thus, in determining the quantum of a costs order, we consider any efficiency brought to an enforcement proceeding by a respondent.

[116] As discussed in *Homerun*, various considerations may lead a hearing panel to conclude that a deduction from the total amount of costs claimed by Staff in a particular matter is appropriate. These may include indications of duplicated effort on the part of Staff, prior recovery of a portion of costs from settling respondents, and the extent of a respondent's cooperation with Staff in the investigation or hearing (including by making admissions which contribute to hearing efficiency) (*Homerun* at paras. 44, 50, 52). In addition, it is generally inappropriate to assess costs against a respondent that are related to allegations that were not proved (*Homerun* at para. 49).

[117] Although they are monetary in nature, costs orders, like disgorgement orders, have not been in issue in recent ABCA decisions that have considered impecuniosity in the ASC context: *Walton*; *Spaetgens v. Alberta (Securities Commission)*, 2018 ABCA 410 (see also *Re Spaetgens*, 2017 ABASC 38 at para. 116).

B. Positions of the Parties

1. Staff

[118] Staff seek a costs order against Fauth in the amount of $295,000. As the Staff Bill of Costs indicates that $259,198.75 in Staff time and $35,250.61 in disbursements were incurred in relation to the investigation and conduct of the Merits Hearing, the order sought is slightly in excess of the Bill of Costs total of $294,449.36.

[119] Staff submitted that all of the costs claimed "were necessarily incurred to investigate and prosecute this matter". They further argued that the claim is reasonable, as it does not include all of the costs actually incurred, nor any costs related to preparing the Staff Submissions or appearing at the Sanction Hearing.

[120] Staff also submitted that their costs claim should not be reduced by the panel because all of the allegations made in the notice of hearing were proved, Fauth made no admissions and "the case was complex".

2. Fauth

[121] The Fauth Submissions did not express a position on costs, although they referenced Fauth's cooperation with Staff during their investigation.

[122] At the Sanction Hearing, Fauth's counsel argued that while this panel has the discretion to award the full amount sought by Staff, ASC hearing panels usually apply some "discount" to that total. Based on the cases cited in the Staff Submissions, Fauth's counsel suggested that panels typically award approximately 80% of the amount sought. He further suggested that a discount is warranted here given that the Staff time claimed included the cost of two Staff lawyers' attendance throughout the Merits Hearing when that may not have been warranted.

C. Analysis and Conclusion on Costs

[123] For the reasons described in *Reeves* and *Planned Legacies*, we find that it is appropriate to make a cost-recovery order in this case.

[124] As Fauth has always been the sole respondent, there is no question of allocation of costs among parties (*Homerun* at para. 51). In addition, all of the allegations made in the notice of hearing were proved (*Homerun* at para. 49).

[125] Although Fauth did not make any overt contribution to the efficiency of the Merits Hearing, neither did he detract from its efficiency. There was some concession by his counsel in closing argument following the evidence portion of the Merits Hearing that misrepresentations had been made and the *actus reus* of fraud had been established, but he made no formal admissions – even as to non-controversial matters – which might have shortened the hearing. However, we acknowledge that during the investigation, he attended his interview as required, answered Staff's questions, and provided documentation in response to Staff's requests.

[126] Generally, we are satisfied that the costs claimed by Staff were incurred as claimed, although we note that some of the descriptions in the Staff Bill of Costs concerning the tasks performed were rather unhelpful (for example, "Work on file"). We also agree with Fauth that there seems to have been some duplication of effort among some Staff.

[127] In view of all of the foregoing, we order Fauth to pay $250,000 toward the costs of the investigation and Merits Hearing.

V. NOTICE UNDER SECTION 47(7)

[128] The final few pages of the Staff Submissions addressed a notice issued by the Executive Director of the ASC (**Executive Director**) under s. 47(7) of the Act (**Notice**). Simply stated, s. 47 gives the Executive Director the authority to issue what are colloquially referred to as "freeze orders". These orders act to preserve or "freeze" assets belonging to parties that have contravened or are suspected of having contravened Alberta securities laws. Subsection 47(7) applies specifically to real estate or mining assets.

[129] As described in the ruling cited as *Re Fauth*, 2016 ABASC 70 (at paras. 6-8), on November 25, 2015, the Executive Director issued the Notice, which was registered against the title to a property in Edmonton of which Fauth was a joint owner. Fauth and the Executive Director later agreed that the Notice would be revoked to enable the sale of the property to a third party, provided that the net proceeds of sale (**Sale Proceeds**) were held by a lawyer in trust on conditions set out in a Staff letter to the lawyer dated December 17, 2015. The Executive Director refused Fauth's subsequent request to consent to release of the Sale Proceeds to Fauth's trustee in bankruptcy (and for other relief sought in the alternative). Fauth appealed the refusal to an ASC panel pursuant to s. 35 of the Act, but the panel denied the appeal for the reasons given in the ruling cited.

[130] Staff advised that the Sale Proceeds – totalling approximately $50,000 – continue to be held in the lawyer's trust account. Staff therefore asked for this panel's guidance with respect to the disposition of the Sale Proceeds.

[131] Despite this request for guidance, however, Staff:

- argued in the Staff Submissions that an ASC panel's jurisdiction with respect to orders made by the Executive Director under s. 47 of the Act is limited to hearing appeals brought pursuant to s. 35;

- pointed to comments made by the panels in *Re Holtby*, 2013 ABASC 273 (at para. 153) and *Workum* (at para. 270), which Staff submitted were an indication those panels felt orders and directions concerning s. 47 orders were properly within the purview of the Executive Director;

- suggested that s. 47 itself does not give the Executive Director the authority to vary his own decisions made under the section, but also suggested that he could revoke or vary a prior decision under s. 214(1.1) if he considered it would not be prejudicial to the public interest to do so; and

- suggested at the Sanction Hearing that this panel should remind Espoir investors that the Sale Proceeds remain in trust and they may be able to take legal steps to access them.

[132] As relayed by his counsel at the Sanction Hearing, Fauth's position was that this panel should not get involved in the collection of amounts owed by a respondent as a result of a sanctions or costs order, and that we do not have the jurisdiction to direct disposition of the Sale Proceeds. Since these issues are within the purview of the Executive Director, Fauth's counsel argued that we should not offer the "guidance" requested by Staff.

[133] We conclude that apart from hearing appeals under s. 35 of the Act, we have no jurisdiction with respect to matters under s. 47. We decline to offer the guidance sought by Staff other than to suggest that the matter be taken up with the Executive Director in accordance with the Act.

VI. CONCLUSION

[134] For the foregoing reasons, we make the following orders:

(a) pursuant to s. 198(1)(d) of the Act, Fauth must resign from any positions he holds as a director or officer (or both) of any issuer, registrant, investment fund manager, recognized exchange, recognized self-regulatory organization, recognized clearing agency, recognized trade repository, designated rating organization or designated benchmark administrator;

(b) pursuant to ss. 198(1)(b), (c), (e) and (e.3), Fauth is permanently prohibited from:

(i) trading in or purchasing any security or derivative, and from relying on any exemptions contained in Alberta securities laws;

(ii) becoming or acting as a director or officer (or both) of any issuer or other person or company that is authorized to issue securities, registrant, investment fund manager, recognized exchange, recognized self-regulatory

organization, recognized clearing agency, recognized trade repository, designated rating organization or designated benchmark administrator; and

(iii) acting in a management or consultative capacity in connection with activities in the securities market;

(c) pursuant to s. 198(1)(i), Fauth must pay to the ASC disgorgement in the amount of $2,585,414.87;

(d) pursuant to s. 199, Fauth must pay to the ASC an administrative penalty of $400,000; and

(e) pursuant to s. 202, Fauth must pay costs to the ASC in the amount of $250,000.

[135] This proceeding is now concluded.

June 24, 2019

For the Commission:

"original signed by"
Maryse Saint-Laurent

"original signed by"
Ian Beddis

"original signed by"
Webster Macdonald, QC