

ALBERTA SECURITIES COMMISSION

DECISION

Citation: Re Kitts, 2019 ABASC 91

Date: 20190603

Brian Arthur Kitts and Vesta Capcorp Inc.

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|-------------------------------|--------------------------------------------------------------------------------------------------|
| Panel: | Tom Cotter James Oosterbaan Maryse Saint-Laurent |
| Representation: | Peter Verschoote Carson Pillar for Commission Staff Brian Kitts self-represented |
| Submissions Completed: | November 15, 2018 |
| Decision: | June 3, 2019 |

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I. INTRODUCTION

[1] Alberta Securities Commission (**ASC**) staff (**Staff**) alleged that Brian Arthur Kitts (**Kitts**) and Vesta Capcorp Inc. (**Vesta**, and together with Kitts, the **Respondents**) contravened section 93(b) of the *Securities Act* (Alberta) (the **Act**) by directly or indirectly engaging or participating in an act, practice or course of conduct relating to securities that they knew or ought to have known perpetrated a fraud on investors. Staff's allegations were set out in a notice of hearing dated August 2, 2017.

[2] Our findings and analysis in respect of these allegations are set out below. Stated briefly, we find that the Respondents engaged in a course of conduct relating to securities that they knew perpetrated a fraud on investors. This proceeding will now move into a second phase for the determination of what, if any, orders ought to be made against the Respondents.

II. HEARING BACKGROUND

[3] We began a hearing on July 9, 2018 into the merits of Staff's allegations. That hearing continued over seven days, during which we received witness testimony, documentary evidence and submissions from Staff.

[4] Kitts, who we understood to be located in the province of British Columbia, sporadically participated in the hearing by telephone. He was not present at the outset of the hearing when Staff made their opening statement, and he chose not to appear during the testimony of certain witnesses, including one of Staff's investigators. Staff provided "rough transcripts" of the investigator's testimony to allow Kitts the ability to consider cross-examining the witness – an option that he later declined.

[5] When he participated in the hearing, Kitts was able to view documentary evidence from electronic copies previously disclosed to him by Staff. This became necessary because Kitts did not provide a current address where hard copies of Staff's proposed documentary evidence could be delivered. After the hearing began, and with Kitts's agreement, Staff delivered their proposed documentary evidence to the British Columbia Securities Commission so that Kitts or his agent could pick it up, however he failed to do so.

[6] In his opening remarks to the panel, Kitts complained that "[t]his is a very biased hearing", apparently based on his previous (and unsuccessful) requests to postpone the hearing so he could "choose . . . the appropriate attorney for this case". He indicated that he was not a lawyer, that the hearing potentially affected "constitutional rights" and that he was unable to arrange for his "out-of-town witnesses" to attend the hearing. Kitts renewed his request for an adjournment of the hearing until "[l]ate September, early October" so that he could retain a lawyer. He also indicated that his former lawyer withheld Staff's disclosure for months and that much of the disclosure had been redacted. Staff opposed the adjournment request based on the lack of evidence regarding Kitts's efforts to retain a lawyer who could be available in September or October. Staff also pointed out that Kitts had received Staff's prehearing disclosure at least six months prior to the hearing and he had not made a formal application to address his disclosure concerns. For the reasons given in the hearing, we denied Kitts's adjournment application.

[7] Kitts did not present any evidence in his defence. He indicated that his witnesses were not "available on such short notice" and that he was advised not to testify as a witness. In response to Kitts's inquiry as to whether he could "introduce evidence via email", he was told to make an

application outlining his proposal to present evidence by "an alternative means" (including by Skype), which would be considered by the panel. He did not make an application despite being provided additional time to seek advice on his options.

[8] After hearing the evidence, we established a schedule for the parties to make written and oral submissions. Staff and the Respondents each received an extension of their deadlines for written submissions. Kitts, after being granted an additional extension, said that he had prepared written submissions but was advised by his legal counsel not to provide those submissions to the panel but to instead make oral submissions. Kitts's request for another adjournment shortly before the date for oral submissions was denied, and he was told that he and his counsel could attend, either in person or by telephone, to make oral submissions to the panel. Neither Kitts nor his counsel attended to make oral submissions.

III. PRELIMINARY MATTERS

A. Standard of Proof

[9] The applicable standard of proof in ASC enforcement hearings is proof on a balance of probabilities, which requires a determination of "whether it is more likely than not that an alleged event occurred" (*F.H. v. McDougall*, 2008 SCC 53 at para. 49). Evidence must be sufficiently clear, convincing and cogent to satisfy this standard of proof (*McDougall* at para. 46).

B. Witness Credibility

[10] Staff called eight witnesses – two staff investigators and six investor witnesses. We generally found Staff's witnesses to be credible and we attributed any inconsistency or lack of clarity in a witness's recollection primarily to the passage of time. We accepted their evidence.

[11] We paid particular attention to the testimony of Robert Morris (**Morris**), a Staff witness who received significant compensation from the Respondents for his role as a referral agent. Having carefully assessed his evidence and the record as a whole, we accept that Morris's only involvement with the Respondents was in his professed role as a referral agent and an investor; he was not an officer, director or shareholder of Vesta, he had no apparent control over the purported investment opportunities offered by the Respondents and he did not exercise any control over Vesta's bank accounts. Despite attempts by Kitts to discredit Morris in cross-examination, his testimony was not seriously challenged nor was his testimony on relevant matters inconsistent with other evidence. Accordingly, we found Morris to be a credible witness and generally accepted his evidence, particularly where it was corroborated by other evidence.

IV. FACTUAL BACKGROUND

A. The Respondents

1. Vesta

[12] Vesta was a federally incorporated company throughout the relevant time period – from February 20, 2014 through to June 30, 2015 (**Relevant Period**). Vesta was registered in Alberta as an extra-provincial corporation in September 2014. The company was struck from Alberta's corporate registry on March 2, 2017.

2. Kitts

[13] Kitts was Vesta's president and secretary, and he signed Vesta's incorporating documents as the company's sole director. Kitts appeared to sign all documents on behalf of Vesta, including promissory notes issued to investors. Evidence established that he was Vesta's sole director, that

Vesta had not appointed any other officer, and that his knowledge was also that of Vesta. It was clear from the evidence as a whole, and we find, that Kitts was Vesta's guiding mind.

B. Vesta's Capital-Raising Activities

1. Vesta's Banking Records

[14] Kitts (as Vesta's president and secretary) opened two bank accounts with the Canadian Imperial Bank of Commerce – a Canadian dollar account (the **CDN Account**) opened on February 27, 2014 and a US dollar account (the **US Account**) opened on August 29, 2014. Kitts had sole signing authority for both accounts.

[15] In this decision, amounts not specified to be in a particular currency refer Canadian dollars, either because the evidence clearly indicated Canadian dollars as the relevant currency or because that was assumed when no currency was specified; amounts known to be in US currency are specified as such.

[16] We received into evidence numerous records from the CDN Account and the US Account, dated from the opening of each account through June 30, 2015. These records showed that Vesta raised approximately \$4.3 million and US\$850,000 from approximately 38 confirmed investors, all during the Relevant Period. Vesta also received more than \$1.26 million and US\$87,000, from an additional 27 sources identified by Staff as "Possible Investors" – a category that included transactions involving "even dollar drafts that were very similar to known investors", as well as transactions involving "names . . . from supporting documents who [Staff] weren't able to identify definitively if they were an investor or not".

[17] Vesta's bank records disclosed that Vesta investors received approximately \$2.8 million from the CDN Account and an additional US\$450,102 from the US Account, and "possible investors" received approximately \$767,000 from the CDN Account and an additional US\$15,075 from the US Account. Additionally, about \$700,000 was transferred from the CDN Account to the US Account, and approximately US\$300,000 was transferred from the US Account to the CDN Account.

[18] Some of the Respondents' transactions with Vesta investors were made using a US dollar account with the Bank of Montreal in the name of "Vesta Equity Partners". Staff advised that no allegations were made in respect of this entity and we were not provided bank records for this account, aside from isolated transaction records and wire transfer instructions in relation to this account.

2. Vesta's Promissory Notes

[19] Vesta raised money from investors by issuing short-term promissory notes (**Notes**) – each with a term typically ranging from 15 to 90 days – in which Vesta promised to repay "the principle [sic] sum" along with either "fees and profit sharing" or "profit sharing" at a 20% monthly rate of return. Repayment schedules for most Notes contemplated a single payment at the end of the term, although some Notes provided for repayment in two or more instalments.

[20] Many of the Notes indicated the manner in which it was funded, and generally involved a payment of funds from the investor to Vesta or by the investor agreeing to "roll over" funds – either the principal amounts or the supposed "profits" (or both) from a maturing Note. It was also common for Notes to be funded by some combination of new capital along with "rolled over"

funds, and some Notes were apparently funded in whole or in part by referral fees or commissions owed by Vesta for introducing others to the company.

3. Vesta Communications

[21] Prospective investors learned about Vesta through referrals by an agent or other Vesta investors. Kitts may also have directly solicited two investors to invest with Vesta.

[22] Most of the investors interviewed by Staff said that Kitts explained how their money would be used by Vesta and how their profits would be generated. Although a few investors either did not know exactly how their invested funds would be used or had a different understanding as to such use, most understood that their funds would be used by Vesta to provide short-term financing for real estate developments or sales – the term "bridge financing" was commonly used.

[23] Information was conveyed to investors through a combination of email and telephone conversations, in-person meetings and a PowerPoint presentation. Investors interviewed by Staff said that they primarily interacted with Kitts by email, and some by telephone or in person. A number of investors also told Staff that they had ongoing communications with Morris and only spoke with Kitts by telephone "later on in the process".

[24] In most instances, Kitts sent an introductory email to prospective investors describing the Vesta investment. These emails indicated that Vesta provided financing to individuals or entities in the real estate industry and that such financing was to be funded from capital provided by Vesta investors, who would receive their principal and profit sharing once Vesta's client repaid the money on the close of a pending real estate transaction. A typical introductory email read:

We work with developers, general contractors, private individuals that are renovating and flipping properties as well as real estate agents looking for advances on commissions. As you may or may not know, the housing markets in Alberta and British Columbia are hot and have been for several years. A bad year is a 2 to 3 percent gain in housing prices. Last year many areas saw double digit gains.

Although conventional financing would be ideal for these projects, our clients need short term cash to complete projects, get their projects to the next stage or need cash while they are waiting for a property they have sold to close. We do not "lend" our clients the funds. We partner with them on a very short term basis. 30, 60 and 90 days and the exit strategy must be linked to an actual closing date, pre-approved financing that will be closing on a specific date, etc.

To finance these projects, we have a group of investors that I am currently working with. I personally invest in many of the notes. In order to keep up to the demand from clients, we are looking for additional individuals that currently have available funds in savings accounts. As you know, money in a bank account rarely earns more than 3% interest per year. Our investors are earning 10 to 20 percent profit per month.

We do not hold your money in our bank account. When we have a demand from a client, we email our investors with a list of available notes. An investor that is interested in participating in a note then wires the necessary funds to us, we disburse the funds to the client and when the note pays out, we immediately return the principle and profit to the investor. We do not keep your money for a future note unless we are given instructions to do so by the investor.

[25] Some Vesta investors also identified a PowerPoint document, which was often emailed to prospective investors or made available on Vesta's website. This nine-page document included a

page titled Vesta's "Mission Statement", which referred to "hard money financing for developers", "above average returns for investors" and "a guaranteed exit strategy". Another page of the PowerPoint document indicated that Vesta "does not loan money" but "invests along with other principals and earns a profit on each project". The apparent safety of the investment was promoted, with a statement that Vesta's financing was "backed by real estate" and included references to "Securitized collateral", "Assignment of funds" and "Lien on title". Also mentioned was Vesta's claimed operating history – no defaults to investors and average returns of 15% per month (and more recent projects providing returns of up to 20% per month). Another page of the document (titled "Investing protocol") described the investment process, by which Vesta obtained contracts for projects and circulated available Notes to investors, who would then select a Note and provide funds to Vesta in exchange for the Note "evidencing investor share of project and expected return". It was represented that investors would be repaid once proceeds of the project had been paid and cleared. The final page of the PowerPoint document urged readers to "get started" by filling out an "investor application", though Staff did not find, nor did any Vesta investor mention, such a document.

[26] After receiving an introductory email, or otherwise upon being introduced to Vesta, prospective investors would typically receive an email from Kitts (on behalf of Vesta) listing available Notes from which to choose. In the words of Vesta's referral agent, Kitts "led us to believe" that these emails – initially sent out "a couple times a week" but later "it got down to once a week" – listed "notes that he had available" and allowed investors an opportunity to "reinvest" their current investment loan into a new loan.

[27] The evidence included several emails from Kitts listing "available opportunities". The available Notes listed in these emails set out the term (typically from 15 to 90 days) and principal (generally between \$25,000 and \$100,000 but occasionally more than \$200,000). The emails often indicated that other investors had provided funds for certain Notes and that the recipient could "fund all or part" of a Note.

[28] Once an investor chose a Note, Kitts would send the investor an electronic copy of the Note with his signature. The investor was asked to countersign and return the Note to Kitts and to send the principal amount in accordance with instructions included with the email. Most investors wired their investment funds to Vesta, and in some cases payment was made by bank draft or cheque.

4. Referral Agent

[29] Vesta entered into an agreement with Morris to compensate him for referring investors to Vesta. At least one other Vesta investor – Jason Madsen (**Madsen**) – introduced investors to Vesta and he may also have received some credit for doing so even though he had no formal relationship with Vesta.

[30] Morris, a US resident, worked primarily in the construction industry before retiring in 2007. He knew Kitts through a homeowners' association, and was contacted by Kitts in October 2013. Morris said that Kitts was looking for investors for his short-term real estate loans business because the business was "so lucrative" and that Kitts "had exhausted his personal resources". Morris told Kitts that he was unable to invest but he agreed to talk about the investment with some people he knew and to let Kitts know if they had any interest. Morris said that Kitts "was willing to pay somebody . . . to help him raise funds" and offered to pay him a commission.

[31] Morris said that he mentioned the investment to a few good friends who ultimately invested with Vesta.

[32] In February or March 2014, Kitts met with Morris to talk more about his business plan. At that time, Kitts told Morris that a few of the people he referred had invested and they were "very, very happy" and "getting 20 percent on their money . . . per month". He also told Morris that:

- Vesta's business involved "really short-term notes" to obtain money that would be pooled together to fund real estate loans;
- the loans were largely sourced from clients of a Calgary law firm who were in need of money while waiting for real estate transactions to close;
- the Respondents were operating out of Calgary and had all of the licencing that was "required by the province of Alberta"; and
- there was potential for expansion into Vancouver, using a law firm with "a large client list".

[33] Morris said that he could not find any filings for Vesta in Alberta and said that it may not have been "an actual corporation at that time" but that Kitts "would represent himself as" Vesta.

[34] Morris understood that Kitts was charging 30% on "short-term notes", with 20% paid to investors and the remaining 10% retained by Vesta. Kitts offered to split Vesta's profit with Morris for any individuals he "talked to that came on board through funding notes", meaning that Morris would receive 5% on each Note funded by his contacts, including "if they rolled it over".

[35] Morris's arrangement with Vesta was formalized by a March 24, 2014 agreement, which was signed by Kitts as president of Vesta. The agreement recited that Morris had "expressed an interest in introducing [Vesta] to potential short term investors for short term promissory notes", which Morris said was consistent with Kitts's representations as to Vesta's business. The agreement provided:

Compensation will be on a per note basis. [Vesta] will share equally with [Morris], the profit from any note placed with his contacts. Profit sharing will be completed within 5 days of the mature date of said notes.

[36] Morris testified that he made an unannounced trip to Calgary in May 2014 to meet personally with Kitts and to assure himself that "this was on the up-and-up". He said that he asked to see documentation for Vesta's loans to real estate borrowers but that Kitts refused because he had previously provided information to a "client" who then contacted the borrower directly and made a loan "at a lesser rate". Morris said that he believed Kitts, as the explanation "kind of made sense".

[37] Morris characterized his involvement with Vesta as "just a referral system", and said that he simply presented prospective Vesta investors "with an opportunity" that had "been working" and "seemed to be . . . on the up-and-up". Morris also said that his message to prospective investors – that Vesta required investors to make short-term real estate loans – was based on information provided to him by Kitts. He also told prospective investors about Vesta's track record and he occasionally used other Vesta investors as references. Morris indicated that he would provide investors with Kitts's contact information (or he would furnish their information to Kitts) at which

point he would be "out of the picture". He later acknowledged having ongoing communications with Vesta investors in 2014 and the first few months in 2015, and he clarified his evidence to mean that he did not handle any money, was not a "signatory on bank accounts" and was not an officer, director or shareholder of Vesta.

[38] Morris's commissions included transactions where his contacts reinvested their principal or their returns (or both) in other Notes. Morris said that he would receive "credit for anything that people invested . . . through [him] or through one of [his] investors" and he was led to believe that he was the only person helping the Respondents raise investment funds.

[39] Morris estimated that he referred about 22 – 23 "active investors" (including "[f]riends, relatives, and referrals from friends and relatives") to Vesta, although Staff concluded from their investigation that Morris referred approximately 19 investors. Morris's commissions were paid to him either in cash (he said that he received more than \$100,000) or as credit towards Notes. He explained that he continued to "take some cash" since he was "doing this full-time, seven days a week", but that he also "wanted to get into the program because [Kitts's] track record had been, at this point in time, pretty good – excellent, as a matter of fact . . .", and "[i]t would be very difficult to express somebody having an interest in it if I was not an investor". Vesta's bank records showed that Vesta paid Morris about \$230,000 from April 2014 to May 2015, although it was unclear how much was for commissions and how much was for returns from his Notes.

[40] Morris considered Vesta investors to be generally happy with their investments through January or February 2015 but that in March or April 2015, Kitts started making excuses as to why he could not make payments to investors. He also recalled being told by Kitts around this time "that there were going to be no more rollovers" and "that this was the last month that we could actually invest money".

[41] Morris testified that it was around this time that things "went south". He said several investors were having difficulty with Kitts's stall tactics, that investors were contacting him because they were not receiving their payments as promised, and he "felt a responsibility to the people that [he] brought on board". Morris thought that Kitts was running out of money and attempting to buy some more time, and at one point he and some of the investors knew that the Notes "were fake or fabricated".

[42] Morris said that his communications with Kitts ended by at least June 7, 2015, and that Kitts unilaterally terminated the agreement between Vesta and Morris on June 15, 2015, alleging that Morris was "undermining the business of Vesta" by "making false statements" and "encouraging Vesta clients to cancel" their investments.

[43] Morris said that by June 2015, once "we found out that everybody thought this was a scam that was going on", he reported the Respondents to the U.S. Securities and Exchange Commission and to the RCMP in Calgary.

C. Vesta's Business Investments

[44] Based on their review of Vesta's bank records, Staff determined that Vesta was not "running any sort of active business". Specifically, Vesta was not financing real estate developments or sales transactions in a manner consistent with representations to investors nor was it receiving money from real estate industry participants. Staff acknowledged that they could

not account for all of the funds paid out from Vesta's bank accounts (such as payments to law offices or other "unknown payments") or "smaller drafts" deposited into such accounts.

[45] We received some evidence that Vesta provided funds to an entity referred to as "Clutch Sports" or "Clutch Sportz LLC", as well as to an entity referred to as "Cock Diesel" or "Cock Diesel, LLC".

1. Clutch Sports

[46] According to Madsen, Kitts sought investments for "Clutch", "a gaming company in the US that was trying to sell their game". Kitts told Madsen that "it was a home run". Madsen invested (indirectly, through a company he and his spouse controlled) approximately \$65,000 in Clutch, funded from ostensible proceeds of a Note. He said he used money owed to him from Vesta to invest in Clutch Sports because he was "fairly sure . . . that there was no money coming back" on his Vesta investments. On June 8, 2015, Kitts (on behalf of Vesta) emailed Madsen a share certificate for 15 shares in "Clutchability, Inc.", a Delaware incorporated company. Madsen said that he did not receive any payment from this investment and that "it just vanished" without any explanation from Kitts.

[47] The Vesta bank records indicated that during the Relevant Period, Vesta transferred \$162,760 to "Clutch Sportz LLC" from the CDN Account, plus an additional US\$226,278 from the US Account.

2. Cock Diesel

[48] According to a Staff investigator, "Cock Diesel, LLC" owned a restaurant or bar called "Cock Diesel Country Rock Bar & Grill" located in Peoria, Arizona. The evidence included an investigation report prepared by the State of Arizona's Department of Liquor Licenses and Control in relation to the establishment, which stated that Vesta had paid US\$254,940 to Cock Diesel, LLC from November 7, 2014 to January 16, 2015, and that the Respondents were reasonably believed to be undisclosed owners.

[49] Staff concluded from their investigation that Vesta paid "significant" funds to Cock Diesel, LLC. The Vesta bank records indicated that during the Relevant Period, Vesta transferred \$46,113 to Cock Diesel, LLC from the CDN Account, plus an additional US\$485,495 from the US Account.

3. Other Uses of Vesta Funds

[50] The Vesta bank records revealed numerous transactions consistent with investor funds being diverted to Kitts's personal use. For example:

- Kitts received \$424,300 from the CDN Account, plus US\$1,500 from the US Account;
- Kitts's spouse paid \$46,985 into, and she received \$165,500 from, the CDN Account;
- cash withdrawals from the CDN Account totalled \$80,811; and
- expense transactions from the CDN Account totalled \$219,641, including debit card purchases, credit card and utility payments, and a cheque in the amount of

\$17,535 made payable to a construction company (with a notation "driveway paving" for Kitts's residence).

[51] Vesta also paid \$85,290 towards the purchase of a condominium in Vancouver, British Columbia. The property had been acquired for \$852,900 on December 19, 2014 and was registered in the name of Kitts's spouse. It was later sold on April 26, 2016 for \$1,025,000.

[52] Staff also identified a payment of \$156,750 from Vesta to a Vancouver notary public's trust account. The recipient told Staff that Vesta was not his client, and the purpose of this payment remains unknown.

D. Vesta Investors' Experiences

[53] We received evidence from several Vesta investors, both direct testimony and also indirectly through a Staff investigator, who communicated with Vesta investors and recounted their investment experiences.

[54] In general terms, Vesta investors were initially content with their investments, with many reinvesting in further Notes. By May 2015, Vesta was unable to make payments to most investors within the promised timeframe, for which Kitts offered a variety of excuses. Morris characterized Kitts's excuses as a way to avoid "having to pay any money", and allowed him "to buy some more time to make up a note" and "keep people in the game".

[55] For example, Kitts frequently told investors that he had reinvested their principal or purported profits (or both) into new Notes, either because the funds were not being used or that Kitts needed to cover a shortage in a "float" that he used to "fund new opportunities". Morris said that he saw "numerous examples" where an investor had requested payment from a maturing Note but was told by Kitts that he had "already rolled the note over". A few investor witnesses said that Kitts's excuses were inconsistent with their understanding on how their invested funds were to be used.

[56] Vesta investors invested substantial amounts with the Respondents and many suffered significant financial losses, although some appeared to have received some or all of their investment back and a few may have profited on their investment. We summarize the evidence of investor witnesses, who generally provided consistent evidence regarding the circumstances surrounding their Vesta investments and communications with Kitts.

1. Morris

[57] Morris testified that he personally invested in Notes. He considered Kitts's track record to have been "pretty good – excellent, as a matter of fact", which made him want to "get into the program". He "reinvested" some of the commissions owed to him by Vesta into Notes, and borrowed \$20,000 from his credit card to invest in a \$25,000 Note. The CDN Account indicated that Morris paid Vesta \$9,985 on April 2014. As mentioned, Morris received approximately \$230,000 from Vesta between April 2014 to May 2015, but we do not know how much of this was for commissions or how much represented returns from his Notes.

[58] Morris also said that his family members also made Vesta investments, including his mother, his sister and his niece.

[59] Morris gave evidence concerning his mother's investments in Vesta, testifying that she redeemed an annuity of about \$65-70,000 to invest in Notes. Vesta's banking records did not show any deposit attributable to Morris's mother, although the CDN Account showed aggregate payments to her of \$16,030 and the US Account showed aggregate payments to her of US\$29,482.14.

[60] Morris also provided evidence as to his sister's investments with Vesta. Vesta's banking records did not show any transactions for her, although other evidence showed payments to Vesta Equity Partners of US\$5,000 on September 15, 2014 and US\$2,475 on December 29, 2014.

[61] There was evidence of two payments from Morris's niece to the CDN Account totalling \$42,220.76, and a payment to her from the US Account of \$6,057.45.

2. Madsen

[62] Madsen operated a business in which he (along with his sister) was a director, officer and shareholder. Madsen (and his sister) was also a director and shareholder of an Alberta numbered company, 1625818 Alberta Ltd. (**162**), and he (along with his spouse) was officer and director of a third company, 1365801 Alberta Limited (**136**).

[63] Madsen's investments in Notes were made in his personal capacity, as well as through 136 and 162, and jointly with his spouse.

[64] Madsen first learned of Vesta from a January 2014 telephone conversation with Morris, who told Madsen that Kitts "had some interesting investments" and that he might receive a call from Kitts. Kitts subsequently telephoned Madsen to explain the investment opportunity, and he also sent Madsen an introductory email similar to those mentioned earlier. Madsen said that he also received a PowerPoint presentation from Kitts.

[65] Madsen understood from Kitts that the Vesta investment involved a loan of money to Kitts, who would lend those funds to others. Kitts told him that Vesta's loans were made to real estate industry participants, such as "developers, general contractors, private individuals that are renovating and flipping properties, as well as real estate agents looking for advances on commissions".

[66] Madsen's first investment – a \$25,000 investment in a 30-day Note, with a stipulated return of \$5,000 – occurred in February 2014. Madsen received payment of his principal and return, which made the Vesta investment opportunity seem legitimate and played a "very big role" in his decision to continue investing in additional Vesta Notes.

[67] From February 2014 through April 2015, Madsen invested, directly and indirectly through 136, in at least 29 Notes. The Notes were initially issued to Madsen personally, but by around January 2015 they were issued to 136 (apparently based on the advice of Madsen's accountant). The aggregate principal amount of these Notes was \$1,482,500, with promised returns of \$619,280. Many of these Notes were ostensibly funded by rolling over amounts owed to him from maturing Notes.

[68] Madsen also invested in several Notes through 162 in 2015. The aggregate principal amount of these Notes was approximately \$722,000, with promised returns of \$364,400.

Similarly, many of these Notes were ostensibly funded by rolling over amounts owed to 162 from maturing Notes.

[69] Madsen and his spouse jointly invested in Notes with US funds following the sale of a US-based property, after Kitts told Madsen "that he had people in the US that were looking for money as well". In January 2015, Madsen and his spouse paid US\$150,000 for their first 30-day Note and they were repaid their principal when the Note matured. The promised return from this Note was rolled into additional Notes.

[70] Madsen identified several investors (including his sister) whom he had introduced to Kitts and Vesta, for which he was compensated. He said that he was paid "a share on the amount invested", which were "mostly rolled back into notes".

[71] Madsen estimated that he invested, directly and indirectly through his companies and with his spouse, approximately \$1 million and was repaid about \$400,000. Vesta's bank records documented the following cash flows between the company and Madsen (and his spouse and companies):

- from March 2014 to the end of April 2015, Madsen paid (often indirectly through one of his companies) more than \$910,000, and he received approximately \$554,000; and
- from January 12, 2015 until May 2015, Madsen and his spouse paid approximately US\$150,000, and they received about US\$162,000.

[72] Madsen testified that he was satisfied with his investments until "the money stopped coming". He said that by mid-May 2015, Kitts seemed to lack the funds to repay outstanding Notes, and that payments from Kitts had stopped. He also said that Kitts proposed to roll over the amounts owed to Madsen into a single Note in the approximate amount of \$400,000. Kitts provided Madsen with a form of Note consistent with this proposal, which Madsen declined. He said that Kitts appeared to be rolling over unmaturing Notes into new Notes without having received payment from the ultimate borrower. Madsen thought that Kitts "was just making up a note to not [make] payment".

3. Investor GI

[73] GI is a Calgary resident who invested in Notes indirectly through a numbered company that he owned and controlled with his spouse.

[74] Madsen introduced GI to Kitts in about January 2015. GI's initial communications with Kitts was from an introductory email dated January 29, 2015 that attached a PowerPoint document. GI said that he also talked to Kitts "about what he was doing".

[75] From their communications, GI understood that Kitts used invested money for specific "bridge financing" transactions involving "firm sales" of residential or other real estate projects where contractors borrowed from Kitts to start a new project while waiting for a completed project to close. Kitts said that he would be repaid by the borrower's lawyer, and that he would pay up to 20% per month on money lent to him. Kitts also told GI that privacy laws precluded him from

disclosing the borrower's identity. GI was never told where the projects were located or who was receiving the money.

[76] GI invested in three Notes. For his first investment, Kitts sent GI an email on January 31, 2015 listing available Notes with "the amounts and the payout dates". GI said that he invested in one of the Notes – a \$65,000, 30-day Note that returned \$13,000. Kitts sent another email on February 3, 2015, which included wire transfer instructions for GI's payment along with a "simplistic" Note signed by Kitts on behalf of Vesta. GI signed the Note and returned it to Kitts. Kitts told GI that these funds would be used for a completed construction project and that the individual required funds to start a new project.

[77] GI testified that he "was always skeptical" that "someone's going to be paying 20 percent in 30 days" and he was "reluctant to be involved". For that reason, he insisted on being repaid the full principal amount along with the promised interest so that he knew he was not receiving "\$13,000 of my 65". GI was paid out on his first Note as expected, which gave him "an increased comfort level that it was maybe real", although he remained "reluctant". At one point Kitts told GI that he was not looking for more investors even though he had ongoing investment opportunities, but that GI would be allowed to invest again because he had been referred to Kitts. GI said that this gave the impression ". . . like it's a privilege" to be able to invest with Vesta.

[78] Kitts then emailed GI on March 9, 2015 with another list of available Notes, from which GI selected a 45-day, \$45,000 Note that paid \$13,500. GI signed the Note and paid the principal to Vesta. Kitts told GI that these funds would be used to fund "a specific project that had made the requirement of bridge financing to start a second project".

[79] Upon the maturity date of GI's second Note, Kitts met with GI and gave him a Vesta cheque for the Note's profit, and GI agreed with Kitts' suggestion that the principal be rolled over and reinvested with Vesta.

[80] Kitts emailed GI attaching "new notes" for GI's review and signature, from which GI invested in a 60-day, \$50,000 Note that was to be repaid in two installments. Kitts told GI that this investment "was to be used as bridge financing or an overlap of financing to a project that had been a firm sale and that the individual required funds to start or complete the next project". GI funded this investment by reinvesting the principal from his second Note and by providing Kitts with a \$5,000 cheque.

[81] GI did not receive payment on this third investment. When the first instalment was due, GI telephoned Kitts, who said that one of his investors was in a personal crisis and needed to pull out a million dollars, which made things "a little tight" and meant that Kitts was not able to make the payment. Because Kitts had represented that the projects "were individual" and not "linked", GI did not think that another investor pulling out his money should have affected GI's investment. Kitts promised GI that he would pay out the total amount on the second instalment date plus "additional interest". GI did not receive payment on the second date. He was contacted by Madsen, who indicated that he had not been paid out and inquired whether GI had all of his money out.

[82] The CDN Account records showed that GI's numbered company paid about \$110,000 to Vesta and it received \$91,620 from Vesta during the Relevant Period. GI testified that he now knows that Kitts took his money knowing "that it wasn't going into projects" as he had represented.

4. Investors HS and CR

[83] HS and CR are married to one another, and each invested in Notes.

[84] HS first met Kitts in late November 2014, after a family acquaintance who was working with Kitts had suggested that Kitts "had a really good investment business, and they were doing very well". HS contacted Kitts and they met in person on two occasions to discuss Vesta. In those meetings, Kitts told HS that the investment was "very safe", the expected returns would be 20% per month, and the business involved financing real estate renovation projects or providing advances to realtors who were waiting to receive commissions. Kitts also told HS that he would not disclose where the "money was going" out of concern that an investor might steal Vesta's business.

[85] Kitts sent HS an introductory email, which described Vesta's business "in the way he had virtually described it to me" in their two meetings, along with a PowerPoint document. Kitts also gave HS some names of other Vesta investors. HS spoke with one of those investors, Madsen, who told HS that he "was doing really well" and that he had "friends in the program that were also doing well".

[86] Kitts sent HS emails setting out available Notes. HS understood that his investments were being used for specific projects, because each Note had an identification mark, from which he inferred "that [the] identification mark identified that project, and that's where the money that we had put into it would go".

[87] HS first invested \$35,000 in Vesta on December 1, 2014 through his company and was repaid in full about a month later.

[88] The evidence included ten HS Notes, although he may have invested in as many as 17 Notes. Many Notes were in his name, with some in his company's name or in the joint names of HS and CS. At least one Note was in the name of HS's daughter – HS said he had invested in Vesta on her behalf. HS testified that his investments were "technically" with Vesta, but all documents were signed by Kitts as Vesta's "only officer".

[89] HS told CR about Kitts and Vesta in December 2014. Because her husband had been repaid on his initial investment, and having "heard there was some good things to be said about the investment potential", CR decided to "try it myself". She first wanted to ensure that Kitts "was trustworthy and that I could go ahead with this", and she spoke with Kitts by telephone. While CR could not recall specifics of their conversation, she said that Kitts set her mind "at ease" and she "went ahead and invested with him". CR also met with Kitts on January 12, 2015, and understood from him that the money she invested would be used "like a bridge financing", in that funds would be advanced to builders or real estate agents who were not able to obtain funding "until they got their payouts".

[90] CR did not receive an introductory email or a copy of a PowerPoint document, but Kitts sent her emails listing available Notes. These emails usually came "when a note would become due" and she would select a Note from these lists to invest.

[91] CR invested, directly and indirectly through her company, in 12 Notes from January through May 2015. The aggregate principal of these Notes was \$457,000 with stipulated returns of \$161,900, and a US\$30,000 Note with a US\$18,000 stated return. Many of HS's and CR's Notes were funded by rolling over promised returns from expiring Notes into new Notes.

[92] Some of HS's and CR's investments were made in US currency. HS had told Kitts that he had US funds available for investment, and Kitts responded that he had similar investment opportunities in the US. CR understood from Kitts that he also "had borrowers down in the US that he worked with".

[93] The CDN Account records showed that HS, either directly or through his company, paid Vesta approximately \$300,000 and received \$41,050 during the Relevant Period. The US Account records also showed that HS paid Vesta approximately US\$25,000 in February 2015. HS acknowledged that he also received US\$34,500 on May 25, 2017 as payment on his second Note, although he said that Kitts delivered a cheque that "was short \$900". HS said that this was "the last penny we ever saw" from Vesta and Kitts.

[94] According to Vesta's bank records, during the Relevant Period, CR paid Vesta \$240,955, plus approximately US\$105,000, and she received approximately \$25,000.

[95] Neither HS nor CR were fully paid on their investments. Kitts continued to promise that they would get paid but he "kept pushing the dates", at one point stating that all of the investors wanted their money back so he "had to dip into his float to pay them". HS testified that by mid-May 2015, "we were getting concerned about not getting paid" and "we knew . . . that [Kitts] was lying" because "the excuses didn't make any sense".

[96] HS estimated that he incurred over \$100,000 in legal fees to obtain a judgment against the Respondents for his and CR's Vesta investments, but he has not realized anything on the judgment. He also learned that Kitts bought a condominium in Vancouver (which had Kitts's spouse's name on title) and that the property was sold while the lawsuit was "proceeding" for an approximate \$400,000 profit.

5. Investor NW

[97] NW, a British Columbia businessman, met with Kitts in February 2015, after being introduced to Vesta by HS. Kitts told NW that he was seeking money to finance real estate industry participants – builders or realtors – for example, a builder that had sold a house or had an unconditional deal on a house that was to close in a few months but required funds from the sale to keep building. Kitts also told NW that each project was separate and that investment funds would go towards a specific project. He was not specifically told where his capital was to be used, other than for a specific investment in the "real estate industry". After their meeting and before investing in Vesta, NW viewed a PowerPoint document that Kitts had referenced in their meeting.

[98] NW described Vesta's management as a "one-man show" – his communications with the company were by telephone and email with Kitts.

[99] NW selected his first two Notes from an email he received from Kitts on February 21, 2015, and he funded those Notes with a payment of \$85,000. In sum, NW invested in five Notes with an aggregate principal amount of \$337,000. NW paid Vesta \$170,000 for his first three Notes, with the remaining two Notes funded by reinvesting the ostensible returns from his first and third Note. NW did not receive any payment on his final two Notes. NW initially testified that he received payment of \$42,000 from his second Note, although he later seemed uncertain about that – Vesta's banking records did not reflect any such payment to NW.

[100] NW said that he attempted to communicate with Kitts in early May 2015 when his third Note was about to mature so that his investment could be repaid, but found Kitts to be "quite evasive" in responding to his emails and phone calls. Kitts eventually told him that "instead of it sitting around, he took the initiative to roll it into" NW's final investment. In an email to NW dated May 12, 2015, Kitts (on behalf of Vesta) stated:

I had not heard from you regarding your note W3 which matured on May 3rd. So, as I always do, rather than let the money sit and not earn profit, I re invested it into a new 60 day note which is attached. Although the new note pays the profit one time when the note mature, I can arrange a profit payment for you at the 30 day mark.

[101] NW did not understand that Kitts had the right to decide to roll over Notes into another Note. Kitts stopped answering his phone calls and NW did not receive any further payments.

V. ALLEGATIONS AND THE LAW

A. Allegations

[102] Staff alleged that from February 2014 to June 2015, Vesta raised approximately \$5.3 million from 20 investors by issuing Notes (each a "security" as defined in the Act), that the Respondents represented to investors that their invested capital would be used to finance real estate developers or others in the real estate industry, and that contrary to such representations, most of the investors funds were used to pay principal and interest to existing investors in a manner consistent with a Ponzi scheme or were otherwise used for unauthorized purposes, including making payments to Kitts and his spouse.

[103] Staff also alleged that Kitts authorized, permitted or acquiesced to Vesta's fraudulent acts, practices and conduct.

B. The Law

1. Fraud

[104] During the Relevant Period, s. 93(b) of the Act prohibited any person or company from "directly or indirectly, engag[ing] or participat[ing] or attempt[ing] 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 . . . perpetrate a fraud on any person or company".

[105] The analysis and legal test to establish fraud under the Act was described in *Re Capital Alternatives Inc.*, 2007 ABASC 79 at para. 309 and has been applied in several subsequent ASC decisions:

The term "fraud" is not defined in the Act. The gist of the meaning is not, however, difficult to discern. Johnston and Rockwell [in *Canadian Securities Regulation*, 4th ed., Markham: LexisNexis,

2007)) point to the elements of fraud as enunciated at common law by the Supreme Court of Canada in *R. v. Théroux*, [1993] 2 S.C.R. 5 at 27 [*Théroux*], which has been adopted in the context of securities regulation (for example, in *Anderson v. British Columbia (Securities Commission)*, 2004 BCCA 7 at para. 27):

. . . 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 some 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.

Correspondingly, 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).

[106] The Supreme Court in *Théroux* (at 17) explained that an act of deceit or a falsehood has occurred if someone has "represented that a situation was of a certain character, when, in reality, it was not". "Other fraudulent means" refers to dishonest acts which are not necessarily deceit or falsehood, but are assessed objectively based on what a reasonable person would consider to be a dishonest act; examples cited in *Théroux* (at 16) included "the use of corporate funds for personal purposes, non-disclosure of important facts, exploiting the weakness of another, unauthorized diversion of funds, and unauthorized arrogation of funds or property".

[107] The *mens rea* for fraud arises from the "subjective awareness that one was undertaking a prohibited act (the deceit, falsehood or other dishonest act) which could cause deprivation in the sense of depriving another of property or putting that property at risk" (*Théroux* at 19). The focus is on whether the offender "intentionally committed the prohibited acts (deceit, falsehood, or other dishonest act) knowing or desiring the consequences proscribed by the offence (deprivation, including the risk of deprivation)" (*Théroux* at 19).

[108] As stated in *Re Arbour Energy Inc.*, 2012 ABASC 131 (at para. 983): ". . . subjective knowledge can be inferred from the prohibited act and surrounding circumstances".

VI. ANALYSIS AND FINDINGS

A. Threshold Issue: "Security"

[109] A preliminary issue is whether the alleged fraud was in relation to a "security", a term broadly defined by s. 1(ggg) of the Act to describe various types of documents that fall within the meaning of security. These include "any bond, debenture, note or other evidence of indebtedness . . .", "any agreement under which money received will be repaid . . ." and "any investment contract".

[110] The Notes documented receipt of principal amounts paid by a Vesta investor in exchange for Vesta's promise to repay that principal amount to the investor at a future date and to pay "profit sharing", either in a single payment or instalments, as specified in each Note.

[111] We find that the Notes constituted either "evidence of indebtedness" or an "agreement under which money received will be repaid", and were therefore "securities" within the meaning of s. 1(ggg) of the Act.

B. Fraud

1. *Actus Reus*

[112] Staff argued that the Respondents deceived investors about the use of their investment funds and that they operated a Ponzi scheme. Staff submitted that the Respondents falsely represented to Vesta investors that their capital would be applied to fund short-term, high-interest loans to real estate industry participants, and that they would be paid their principal and profit in accordance with the terms of the Notes. Staff also asserted that most, if not all, of the invested capital was not used for real estate financing but was instead used to distribute funds in a manner consistent with a Ponzi scheme and for other unauthorized uses, such as investments in other business ventures (such as Cock Diesel and possibly Clutch Sports) and for personal expenses of Kitts and his spouse. Staff acknowledged that the alleged prohibited acts "were, of course, related, as the non-authorized use of investor funds included significant payments to other investors, which enabled the Ponzi scheme".

[113] We find that the Respondents engaged in prohibited acts within the meaning of *Théroux*. The Respondents actions included:

- falsely misrepresenting to prospective Vesta investors that invested funds would be used to provide short-term financing to real estate industry participants;
- diverting invested funds to businesses ventures (Clutch Sports and Cock Diesel) that were not identified or otherwise within the reasonable expectation of Vesta investors;
- misappropriating investor funds to the personal use of Kitts and his spouse; and
- using investors' capital to repay principal and to pay imaginary profits to Note holders.

[114] Collectively, these actions constituted prohibited acts – deceit, falsehoods or other fraudulent means – and we find that these acts clearly placed investors' pecuniary interests at risk. Kitts (and through him, Vesta) operated an unsophisticated Ponzi scheme, while diverting investors' capital for personal and other unauthorized uses. There appears to be no money remaining to repay investors their principal or the promised "profit sharing" on the Notes. In other words, Vesta investors clearly sustained financial losses due to the Respondents' prohibited acts.

[115] Kitts, as Vesta's guiding mind throughout the Relevant Period, authorized and permitted Vesta's actions.

[116] We therefore find that the *actus reus* for fraud has been established in respect of both Respondents.

2. *Mens Rea*

[117] We have no doubt that Kitts orchestrated the scheme and knew full well the consequences; he represented to investors that funds provided to Vesta would be used for short-term, high-return

loans to real estate industry participants. He also knew that the investment opportunities he presented to Vesta investors were fictitious.

[118] Kitts controlled the CDN Account and US Account, and he therefore knew that he was not using the invested funds as represented to investors but that most of the funds were being misapplied for unauthorized uses. As mentioned, they included transfers to Clutch Sport and Cock Diesel, payments of principal and nonexistent profits to investors, and transfers to Kitts and his spouse for their personal benefit.

[119] We attribute Kitts's knowledge and state of mind to Vesta as the company's guiding mind. Accordingly, we find that Vesta also knew that it was undertaking the same prohibited acts as Kitts

[120] Pecuniary loss was clearly a foreseeable risk – Kitts could not have believed otherwise. He knew the reality differed markedly from the falsehoods he communicated to Vesta investors. He also knew that Vesta could not sustain continued payments to investors of high rates of returns. It became clear to investors, and is clear from their evidence, that Kitts made a variety of risible excuses to avoid payment of their principal and the promised returns. He told Note holders about an imaginary "float" or the "personal crisis" of other investors to forestall the inevitable collapse of his Ponzi scheme. On occasion, he purported to reinvest principal and profit payments into new Notes (at times, against the express wishes of the investor) to avoid repaying investors. In short, Kitts knowingly and repeatedly lied to his investors and misappropriated their money.

[121] We therefore find that Kitts, and by extension Vesta, had subjective knowledge that investors' pecuniary interests were placed at risk through their prohibited acts.

VII. CONCLUSIONS AND NEXT STEPS

[122] Having found the Respondents contravened Alberta securities laws, this proceeding will now move into a second phase to determine what (if any) orders for sanctions and costs ought to be made against them.

[123] We direct Staff to provide to the panel (through the ASC Registrar) and to the Respondents any written submissions that Staff wish to make on the issue of appropriate orders by 4 pm on June 28, 2019.

[124] The Respondents may respond in writing to Staff's written submissions. Any such written submissions by the Respondents must be provided to the panel (through the Registrar) and to Staff by 4 pm on July 19, 2019.

[125] Staff may reply in writing to any such written submissions by the Respondents, such reply to be provided to the panel (through the Registrar) and to the Respondents by 4 pm on July 26, 2019.

[126] If any of the parties wish to make supplementary oral submissions or to adduce evidence on the issue of appropriate orders, an in-person hearing session will be held on August 2, 2019 beginning at 9 am. Any party requesting such an in-person hearing session must so advise the Registrar by 4 pm on July 22, 2019, indicating whether that party proposes to adduce evidence (via witnesses or otherwise) and the amount of hearing time that party expects to require. If a requesting party does propose to adduce evidence, under section 2.3 of Rule 15-501 *Rules of*

Practice and Procedure for Commission Proceedings we direct that party to provide to the other parties at least ten business days before the in-person hearing session: (i) the names of all proposed witnesses; (ii) summaries of the proposed witnesses' anticipated evidence; and (iii) copies of all documents intended to be entered as evidence. Even if no party requests such an in-person hearing session, one may be required by the panel. The Registrar will inform the parties as to whether an in-person hearing session will proceed.

June 3, 2019

For the Commission:

"original signed by"

Tom Cotter

"original signed by"

James Oosterbaan

"original signed by"

Maryse Saint-Laurent