

**David Michael Michaels and  
509802 BC Ltd. doing business as Michaels Wealth Management Group**

***Securities Act, RSBC 1996, c. 418***

**Hearing**

<b>Panel</b>	Brent W. Aitken Don Rowlatt	Vice Chair Commissioner
<b>Hearing dates</b>	January 20-24 and 27-31; May 1, 2014	
<b>Date of Findings</b>	August 6, 2014	
<b>Appearing</b>		
Derek J. Chapman	For the Executive Director	
Grant N. Smith	For the Respondents	

**Findings**

**I Introduction**

- ¶ 1 This is the liability portion of a hearing under sections 161(1) and 162 of the *Securities Act*, RSBC 1996, c. 418.

**A Allegations**

- ¶ 2 In an amended notice of hearing issued August 2, 2013 (2013 BCSECCOM 297), the executive director alleges that David Michael Michaels:
- acted as an advisor without being registered to do so, contrary to section 34(b) of the Act;
  - made misrepresentations, contrary to section 50(1)(d); and
  - perpetrated a fraud, contrary to section 57(b).
- ¶ 3 The executive director alleges that between June 2007 and December 2010 (the relevant period) Michaels illegally and fraudulently advised 484 clients to purchase over \$65 million worth of exempt market securities. The executive director alleges Michaels was paid \$5.8 million in commissions and marketing fees by the issuers of the securities which, the executive director alleges, are almost all now worthless.

- ¶ 4 The notice of hearing also alleges that the conduct described in the notice of hearing is contrary to the public interest but did not pursue this allegation in his submissions.
- ¶ 5 Michaels controlled a company called 509802 BC Ltd. That company did business under the name “Michaels Wealth Management Group”. The notice of hearing names the company as a respondent but contains no allegations against it.

### **B Exempt Market Securities**

- ¶ 6 The phrase “exempt market securities” describes securities that are sold in the so-called “exempt market”. This market is called “exempt” because securities sold in this market, due to their inherent features, or the circumstances of their distribution, can be legally distributed under an exemption from the requirement to file a prospectus under section 61 of the Act.
- ¶ 7 During the relevant period, there was also an exemption for trading exempt market securities from the requirement that a person be registered to trade under section 34(a).
- ¶ 8 Those are the only exemptions that applied to trading and distributing exempt market securities. Anyone who advises investors in connection with trading in securities must be registered under section 34(b), and there is no exemption from that requirement for advising in relation to exempt market securities.
- ¶ 9 Neither, for the purposes of determining whether misrepresentation or fraud has occurred, is conduct in relation to exempt market securities treated any differently than conduct relating to other securities.
- ¶ 10 The reader will observe from quotes of Michaels below that he often used the terms “market exempt securities” and “private equity” to refer to exempt market securities.

### **C Evidence**

- ¶ 11 The executive director entered documents and called witnesses, including the Commission staff investigator and some of Michaels’ former clients.
- ¶ 12 Michaels also entered documents, called witnesses, and testified.
- ¶ 13 The evidence includes the transcript of a compelled interview, under oath, of Michaels by Commission staff on January 25, 2012. Michaels was not represented by counsel at the interview. The source of the statements we attribute to Michaels in these Findings is his testimony at the hearing, except where we identify his interview as the source.
- ¶ 14 The evidence includes audio recordings of some radio programs that Michaels aired on Victoria radio station C-FAX 1070.

## II Michaels' Business

- ¶ 15 During the relevant period, Michaels' business was the sale of exempt market securities, life insurance policies, and insurance-based investment products to retail investors. He operated this business through Michaels Wealth Management Group. This hearing is about his sales of exempt market securities in that business.
- ¶ 16 In 1996 Michaels became registered under the Act as a mutual fund salesperson. For substantially all of the time that he was registered under the Act, his registration was restricted to the sale of mutual funds. For a period of seven months, from November 2005 through May 2006, Michaels worked for Integral Wealth Securities, a registered securities dealer.
- ¶ 17 Michaels testified that, for these reasons, he resigned from Integral:
- “I think I resigned in May of 2006. I decided I had enough of this stuff, I really didn't need them because I wasn't selling stocks, I was not selling bonds, I wasn't selling mutual funds, I was selling the bulk at that time is segregated funds [*sic*], so I decided to continue selling those guaranteed investments, and then I started to explore the market exempt world.”
- ¶ 18 Whatever Michaels says motivated him, the choice was not entirely his. Michaels' registration was suspended effective May 31, 2006 by the Investment Dealers Association of Canada (IDA – now the Investment Industry Regulatory Organization of Canada) for his failure to complete a required course. Michaels was never registered after that. In another proceeding, the IDA suspended Michaels in March 2007 for two months and fined him \$60,000 for engaging in off-book transactions with clients of his firm, for unregistered advising, and for misleading IDA staff. Reinstatement of Michaels' registration was subject to certain conditions, including payment of the fine. Michaels did not pay the fine or comply with the other conditions and was never re-registered.
- ¶ 19 Michaels was also licenced under the *Insurance Act* throughout the relevant period.
- ¶ 20 Michaels promoted his business aggressively. Before and during the relevant period he had a 45-minute weekly radio program on C-FAX, hosted by Terry Moore, called “Creating Wealth with David Michaels”. The program started in mid-2005 and continued through the relevant period.
- ¶ 21 Michaels testified that he used the C-FAX program to draw the public to investment seminars that he hosted in Victoria and Vancouver and to appointments in his offices in those cities.

¶ 22 Michaels paid C-FAX about \$2,000 for each weekly program, which he described as an “infomercial”. In his interview, he said the programs, which aired on Saturdays, were pre-taped. The Commission staff investigator testified that Moore told her that Michaels provided him with a script for each program with questions in it. Moore used those questions on the program and occasionally would ask questions of his own.

¶ 23 Michaels testified that the C-FAX program had “never been scripted”; he preferred the word “track” instead of “script”.

¶ 24 Track or script, the content never changed, as he testified at the hearing:

“Every radio program has been consistently the same weekend in and weekend out. And I find it amazing and I say the same thing over and over and my response was better and better. People wanted to know the difference.

...

You could push a button. Everything that I said in my radio program was my seminar [*sic*]. What I said in my seminar I said to my clients. I didn’t have time for another script. I never had time to change. I had an appointment in my office four days a week every hour to hour and a half. I didn’t have time to do anything different.”

¶ 25 Michaels testified that the investment seminars were designed to draw prospective clients to one-on-one interviews in his office.

¶ 26 Michaels also had a website with the URL “920rich.com” on which he described the services he offered investors.

¶ 27 All of this activity was spectacularly successful for Michaels. Michaels testified that his C-FAX program attracted over 20,000 listeners every week. He usually held two seminars a month, a small one at his office that attracted 40 or 50 clients, and a larger one at a hotel venue that attracted 200, 300 or more clients. (Both new and existing clients were invited to the seminars). Michaels was busy. He testified that he spent four days a week meeting clients in meetings typically lasting an hour to an hour and a half.

¶ 28 Michaels’ target demographic was seniors, and that’s what he told his listeners. “I love helping seniors make money,” he said. “The average age of my clients is 72 years of age.”

¶ 29 What Michaels did not tell his listeners, and certainly not the seniors who became his clients, was *why* he “loved helping seniors”. He explained it in his interview:

“Q Did you target seniors?

A A lot of the time. Yes, absolutely I did.

Q And why did you do that?

A Because they had the opportunity to see me during the day, and I wanted to work during the day.

Q Any other reasons?

A That was predominantly it.”

¶ 30 In his interview, Michaels said how much he spent on advertising, including the C-FAX program, promotion, and venue costs for the large seminars. It came to around \$25,000 per month.

¶ 31 It was well worth it for him. It is not contested that Michaels sold \$65 million of exempt market securities to 484 investors for commissions of \$5.8 million.

¶ 32 Michaels characterizes his business as no more than a successful sales operation. That’s all he was, he says, a salesman. He denies that he advised his clients with respect to investment in or the purchase or sale of securities. He denies he made misrepresentations or committed fraud.

¶ 33 In fact, as we find below, what Michaels was running was not a legitimate sales business, but a massive fraud. Through dishonesty and misrepresentation, he put his clients’ money at risk. As a result, they have lost millions of dollars.

¶ 34 Michaels was a skilled salesman, skills he used to devastating effect. He developed a business plan based on deception to sell his clients high-risk exempt market securities, earning millions in commissions and fees in the process. His business was no more than the execution of a \$65 million fraud.

### **III Standard of Proof**

¶ 35 The onus of proof lies on the executive director, who must prove the allegations in the notice of hearing on a balance of probabilities, meaning that “it is more likely than not that an alleged event occurred”. The evidence must be “sufficiently clear, convincing and cogent” to satisfy the balance of probabilities test.” (*F. H. v. McDougall* 2008 SCC 53 at paragraphs 49 and 46).

### **IV Analysis and Findings: Advising Without Registration**

#### **A The Allegation**

¶ 36 The executive director alleges in the notice of hearing that Michaels acted as an adviser, without being registered to do so, when he held himself out as an adviser and advised his clients to purchase exempt market securities.

## **B Law of Advising**

¶ 37 Section 34(b) of the Act says, “A person must not . . . (b) act as an adviser . . . unless the person is registered in accordance with the regulations.”

¶ 38 Section 1(1) defines adviser as “a person engaging in, or holding himself . . . out as engaging in, the business of advising another with respect to investment in, or the sale or purchase of securities . . . .”

¶ 39 British Columbia Interpretation Note BCIN 31-701 was in force during the relevant period until September 28, 2009. This is an excerpt:

“Advising is offering an opinion about the investment merits of, or recommending the purchase or sale of, securities . . . .”

¶ 40 On September 28, 2009, National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and its Companion Policy – NI31-103CP – came into force. The Instrument sets out registration requirements and the Companion Policy contains interpretations by the Canadian Securities Administrators of the Instrument. The Canadian Securities Administrators is comprised of the securities regulators of all of the provinces and territories of Canada.

¶ 41 The following quotes from the Companion Policy cite factors these regulators consider relevant to the determination of whether a person is in the business of advising:

“We usually consider an individual or firm engaging in activities similar to those of a registrant to be . . . advising for a business purpose. Examples include promoting securities . . . .

Frequent or regular transactions are a common indicator that an individual or firm may be engaged in . . . advising for a business purpose.

. . .

We consider regularly . . . advising in any way that produces, or is intended to produce, profits to be for a business purpose. We also consider any other sources of income and how much time an individual or firm spends on all activities associated with . . . advising.

¶ 42 Companion policies are not legally enforceable. Their function is to inform market participants of the regulators’ interpretation of certain aspects of securities law.

¶ 43 Although the Companion Policy did not come into force until September 2009, the concepts in it that are relevant to this hearing are consistent with previous interpretations of registration requirements. We find that the statements of policy in NI31-103CP cited

above to be an appropriate interpretation of some of the factors to be considered in determining whether a person is required to be registered as an adviser under the Act.

- ¶ 44 The Commission considered the meaning of advice in *Donas* 1995 LNBCSC 18. It said this:

“The concise Oxford Dictionary of Current English (1990 ed.) defines ‘advice’ as ‘words given or offered as an opinion or recommendation about future action or behaviour . . . .’

. . .

As indicated by the definition of ‘advice’, the nature of the information given or offered by a person is the key factor in determining whether that person is advising with respect to investment in or the purchase or sale of securities. A person who does nothing more than provide factual information about an issuer and its business activities is not advising in securities. A person who recommends an investment in an issuer or the purchase or sale of an issuer’s securities, or who distributes or offers an opinion on the investment merits of an issuer or an issuer’s securities, is advising in securities. . . .”

- ¶ 45 Today’s definition of “adviser” is broader than it was when *Donas* was decided in 1995. Then, an adviser was a person who was “advising others through direct advice . . . as to the investing in or buying or selling of specific securities”. Today, an adviser is a person who is “advising another with respect to investment in, or the sale or purchase of securities.”
- ¶ 46 Today’s definition encompasses advice “with respect to” investments in, or sales or purchases of securities generally. It includes advice relating to such things as, for example, leveraging in connection with investment in securities. It is also not limited to advice relating to a specific security.
- ¶ 47 Other cases cited by the parties, including two decisions of the Alberta Securities Commission, *Kustom Design Financial Services Inc.* 2010 ABASC 179 and *Wealthstreet Inc.* 2011 ABASC 456, are consistent with the statements in 31-103CP and *Donas*.
- ¶ 48 Based on the law set out above, these are the factors relevant to whether Michaels was holding himself to be in the business of advising, or was actually engaged in the business of advising:
- Was Michaels giving advice, as defined in *Donas*, in his C-FAX radio program, in his seminars, and in his one-on-one meetings?
  - If so, was the advice “with respect to investment in, or the sale or purchase of securities”? Did he offer opinions about the investment merits of securities? Did he recommend the purchase or sale of securities?

- Was he engaging in activities similar to those of a registrant?
- Did he engage in frequent and regular transactions?
- Did his advising activities produce, or were they intended to produce, a profit?
- Did he have other means of income? How much time did he spend on his advising activities?

¶ 49 The test is objective, and is determined solely on the basis of the evidence of what Michaels said and did. Neither his intentions nor his beliefs on the subject is relevant. Whether or not he intended to hold himself out as an adviser, or to actually engage in the business of advising, matters not. Neither does his belief as to whether or not he was actually doing so.

### **C The Evidence**

¶ 50 In his interview, Michaels explained that the purpose of the program was “lead generation” – to have people “come to the seminar, come to his office.”

¶ 51 On his C-FAX programs, Michaels also told listeners about the services he offered. One of the most important of these was the opportunity to have him provide a “second opinion” on their investment portfolio. For example, in his January 3, 2009 program, he said a one-on-one meeting for a second opinion “doesn’t cost anything, that’s the nice thing . . . we will show you how to save hundreds of thousands of dollars.”

¶ 52 For investors wanting a second opinion, Michaels said they should bring in their investment statements and tax returns. “That will give us a footing, and we can go on from there,” he said.

¶ 53 Michaels also described how his office operated. “I have a staff of four others that help us manage our clients’ portfolios,” he said. “It’s not just me.”

¶ 54 Michaels said on his C-FAX program:

“You gotta get educated . . . most people spend . . . three weeks choosing what refrigerator they’re gonna buy. They go store to store and read the manual and all the directions and here they, they come into a stock brokerage firm or a mutual fund salesperson’s office and hand over \$100,000 or \$200,000 in five minutes . . . isn’t that crazy? . . . for a fridge that costs \$1,500 or an investment portfolio that costs \$500,000 . . . it just doesn’t make sense to me.”

¶ 55 In his May 2, 2009 program, Michaels said:

“Very few people in the industry are doing this kind of planning. We are one of western Canada’s largest private equity firms that specializes in



helping seniors and retirees take control and get a rate of return independent of the stock market. That's what separates us versus your stock broker and your mutual fund dealer."

- ¶ 56 In December 2007, two members of Commission staff, L and D, met Michaels and his counsel and asked about the nature of his business. According to a memorandum prepared the next day by L, [D] explained at the meeting that the exemption for exempt market securities "is for trading only, and that Michaels had no exemption to advise." The memo continues:

"It is ok for Michaels to go over any factual information with clients . . . The meeting concluded with [D] stating again that talking about the merits of the investments can be considered advising and Michaels can only talk about factual information."

- ¶ 57 This was Michaels' testimony at the hearing about the meeting:

"Basically, he gave me a warning.

. . .

First off he put the fear of God in me. What I mean by that, he was telling me about . . . prosecutions of salespeople claiming that they were advisers. And I remember [D] telling me as long as you stay to script, meaning the offering memorandum, that you can tell clients the features and benefits but you cannot advise.

. . .

I can't recall specifics, but in generalities I – he made it very specific to me as long as I state to the potential purchasers the benefits and features that's involved inside the offering memorandum I am safe, I'm not giving advice.

. . .

But in generalities he said you cannot make a reference of your personal opinion on these investments, it has to be stated what's inside of the offering memorandum, he told me 'cause what's inside the offering memorandum is not opinion, it's fact. And since that period of time I have referred clients to the offering memorandum of where the features and benefits that clients wanted to purchase, I disclosed that to my clients, so therefore I believed I was not giving advice, I was promoting the features and benefits. That's what I was told and that's what I followed since [D] had a conversation with me in my lawyer's office."

- ¶ 58 Michaels, understanding that he must not be seen to be advising, included words in the script for the C-FAX program to explain that he was not advising. This is an example from his program on May 2, 2009:

“Michaels: ‘Now there’s this word called ‘advising’, Terry. Four years ago, I gave up my licence. The word ‘advising’ is owned by the Investment Dealers Association and the Mutual Fund Dealers. So I am a ‘financial services provider’. We show our clients different alternatives. That’s what we do.

Moore: That simple?

Michaels: It’s just that simple.”

- ¶ 59 Every person attending a seminar received a brochure authored by Michaels. Prominently displayed on the cover was a photograph of Michaels with his name underneath, followed by the initials “CSA”.
- ¶ 60 “CSA” stands for “Certified Senior Advisor”, a designation Michaels obtained from the Canadian Academy of Senior Advisors Inc. (now known as Age-Friendly Business International Inc.). The curriculum leading to the designation is about a host of issues faced by seniors – emotional, social, health, long-term care, estate planning, and so on. It is not about investment *per se*.
- ¶ 61 In his interview, Michaels described how the CSA designation was obtained: “You studied it at home, and then you had a weekend in Vancouver for courses.” For most of the relevant period, Michaels’s letterhead and business card prominently displayed the words, “Certified Senior Advisor”.
- ¶ 62 Michaels testified that he did not explain to his clients what “CSA” or “Certified Senior Advisor” signified, unless asked. He said few did. There is no evidence as to what Michaels told those who did ask.
- ¶ 63 The cover of the brochure also contained a biography of Michaels. These are excerpts:

“Since 1986 David has dedicated himself to his clients’ financial success managing millions in assets. David follows a prudent investment philosophy and the results over the long term are something to behold.

Success to David is quite simply meeting the three objectives of his investment philosophy: (1) preserving your principal over the long term; (2) growing your money at a decent rate; and (3) protecting your investment from the ravages of taxation. Through private equity investing this philosophy has been the key to the preservation and creation of his clients’ and his own family’s wealth.”

¶ 64 These are excerpts from Michaels' website:

"Michaels Wealth Group specializes in effective tax 'compression' combined with effective wealth development. . . . Decades of experience in the financial industry has resulted in the development of a Firm that understands & admits the inherent flaws of 'traditional' financial products."

"David Michaels – Since [1986] David has dedicated himself to his clients' financial success managing millions in assets. David follows a prudent investment philosophy and the results over the long term are something to behold."

"We are one of western Canada's largest private equity firms. Specializing in income generating investments. With our help, you now have the power to finally take control of your immediate financial situation, as well as your financial destiny."

¶ 65 For many clients, the first item of business at the one-on-one meetings was the "second opinion" process. Here is Michaels' description from his testimony:

" . . . I used to ask people do you have any idea how to read your statements. The majority of the prospects or the clients from other firms had no idea even to read a simple investment statement from their investment company which they have been dealing with for years and decades. So I showed them what is a word called adjusted cost base. What you started with. What's its value. And then I used to have a calculator on my desk, and I says, client, do you know your average rate of return on your investment statements? 'I have no idea. All I can tell you, David, they have been doing really well. My broker told me I'm doing well.' I said compared to what. So I went down the numbers at the end of the page. I says, client, right here, it says on line here, it says that you invested, as an example, \$600,000, do you see this? 'Yes, I see this.' If you see this, you get stocks, bonds, mutual funds, GICs, you have everything. And, Mr. Client, down here at this statement you have a value of \$366,000. Do you know what that equals as a rate of return? That's a loss.

And over and over I got those statements and clients had no idea how to read them. So I explained to clients, are you happy losing money in stocks and bonds? 'No, I'm here, David, because your radio show, because you're talking about alternatives I've never heard before. I never knew that I could buy land as an investment. I thought I had to be a

multi-millionaire. I didn't know that I can buy oil and gas investment that provides a rate of return on a monthly basis. . . . No one told me this.' That's what [*sic*] they came in. And that is my second opinion. That's what you have, your value, and this is where it is today. Are you happy? The clients told me the answer."

¶ 66 Michaels kept notes in the one-on-one meetings, many of which are in the evidence. In many of the notes, Michaels says he "told" investors what to do. These are excerpts from some of the notes:

- "Told them to borrow \$ to invest  
300,000 Life settl  
Rogers  
LTC  
+125000 into Walton RRSP"
- "Told him to hold Mineralfields and buy more \$50,000 new"
- "Told them to borrow money from Home Equity L/C for \$100 000 to buy LTC  
Build a foundation  
+ buy at least \$10,000 Mineralfields by March 31/09"
- "[phone back] in 1 month to start a Financial Plan"
- "I told him to buy Walton / Rogers + Long Term Care"
- "I told her to buy Life Settlements and F.T.S in the beginning of next year."
- "Told her to get a L/C for \$100,000 to buy L.T. Care"
- "Told her to . . . Then buy Life Settlements"
- "I told him to [change] entire portfolio to ¼ Real Estate, ¼ Life Settlements / ¼ Aveiro Mosaic, ¼ Seg funds."
- "Told them to diversify into Rogers Oil & Gas 12% + Focused \$ 10% and maybe L.T. Care @ 10%"
- "Told them to Borrow \$ from the House ie \$200,000 @ 4%  
200,000 buy oil @ 12%"
- "I told him to buy Walton Debenture @10% and Bullion fund."
- "Her and her husband want to retire in 15-20 years. I told them to get serious  
Borrow \$ to invest ie) 200,000 and buy Real Estate Investments  
I told her to phone . . . mortgage broker to see what they can get"
- "Told them to buy Walton \$45,000 each x5 kids  
+ 350000 into 2 L.T. Care deals  
150,000 Life Settlements  
Keep 25,000 in the bank accounts"
- "Told them to pay off the mgt of \$60,000 then borrow H.E loan for \$100,000 @  
5% to buy Life Settlements / factoring \$ Debentures  
He is a writer and rights [*sic*] books does not make much \$"
- "Told him . . . to buy Roger 12% inside his RRIF"

- ¶ 67 These notes are consistent with the testimony of the clients who testified at the hearing. None, except one, was sophisticated in investment matters. They testified that they took advice and direction from Michaels.

## **D Analysis**

### **1 Holding out as engaged in the business of advising**

- ¶ 68 The evidence is clear, convincing and cogent that Michaels held himself out as being engaged in the business of advising.
- ¶ 69 Let's start with the name of Michaels' business, and how he described the services he offered. He carried on business under the name "Michaels Wealth Management Group." He said in his brochure that since 1986 he had "dedicated himself to his clients' financial success managing millions in assets." He set out his investment philosophy, and said that "Through private equity investing this philosophy has been the key to the preservation of his clients' . . . wealth."
- ¶ 70 On his website, Michaels stated that "Michaels Wealth Group specialized in effective tax 'compression' combined with effective wealth development" and that he followed "a prudent investment philosophy" and the results were "something to behold."
- ¶ 71 Wealth management, the development of an investment philosophy, and the application of that philosophy to develop and preserve clients' wealth is the essence of advising. These activities involve opinions and recommendations about future investment actions. Clearly Michaels, in describing a business that he said managed millions in client assets, was describing a business engaged in the business of advising.
- ¶ 72 Michaels established his credentials as an expert. He said he had been in the investment business for 20 years, and had held every type of licence available. Before the market crash in 2008 he said he gave up his stock, bond and mutual fund licence because he believed a market crash was coming. After the 2008 market downturn associated with the August onset of the financial crisis, he reminded people repeatedly that he had predicted the crash. He talked about his decision to give up his licence to sell stocks, bonds and mutual funds and, more importantly, his decision to move his clients' money into other investments had saved them huge losses. Michaels' purported level of expertise, plus his "decision" to move his clients' money out of the markets, are consistent with the business of advising.
- ¶ 73 Michaels used the words "Certified Senior Advisor" on his business card and the abbreviation "CSA" on the brochure. Michaels' evidence was that he did not tell people what the designation meant, unless they asked, and that few did. His evidence as to why he included the designation on his business card and brochure was disingenuous.

- ¶ 74 The context in which Michaels' clients saw this designation was at a seminar or one-on-one meeting with Michaels at which the only subject was investment strategies and investment products that Michaels had available for sale. Any reasonable person would assume that the "advisor" reference was about investment advice, that "Certified" meant Michaels was legally authorized by some organization or another to advise, and that "Senior" referred either to his level of certification or to his experience and ranking in the field of investment advising (or, possibly, his specialty of advising seniors about investing).
- ¶ 75 Michaels's evidence was that he knew he was not registered to advise, and was prohibited from doing so. In his C-FAX program, Michaels always took care to explain that the word "advising" was "owned" by IIROC and the MFDA, so that meant he was not an "advisor", but rather a "financial services provider".
- ¶ 76 That explanation was semantic flim-flam. That Michaels chose to tell people that he was not an adviser, even if he actually believed he was not an adviser, is irrelevant if the evidence is otherwise. The test is objective. Clearly Michaels held himself out to be in the business of advising.

## **2 Engaged in the business of advising**

- ¶ 77 The evidence is also clear, convincing and cogent that Michaels was actually engaged in the business of advising.
- ¶ 78 Michaels told his clients to sell their existing portfolios, buy exempt market securities, and to borrowing against their homes to do so. He told clients their traditional investments could offer only poor returns and were subject to "stock market risk". He told them, in essence, that the advisers who sold traditional investments could not be trusted. He told clients that they should "get out of the stock market" – that is, sell their stocks, bonds, and mutual funds – and "try something different." He touted the merits of the exempt market securities he offered (but said little about the risks; more on that below). He showed them brochures citing the securities' "features and benefits", that is, their merits. All of this was tantamount to a recommendation. It is so objectively, and the evidence shows that it was seen as such by his clients.
- ¶ 79 To help clients decide, Michaels offered a "second opinion" about their current investment situation – clearly advice. He required them to bring in current tax returns and investment statements. He reviewed the statements, and used the information in them to demonstrate how inferior their existing investments were to what he was offering.
- ¶ 80 Michaels told his C-FAX listeners that very few in the industry were doing proper investment planning, and that his firm was one of them. He said that's what separated him "versus your stock broker and your mutual fund dealer."

- ¶ 81 Above, we set out the factors for determining whether Michaels was holding himself out to be in the business of advising, or was actually engaged in the business of advising.
- These opinions and recommendations were advice – advice with respect to investment in, or the sale or purchase of securities.
  - His activities were not merely similar, but identical, to those of a registrant.
  - He engaged in frequent and regular transactions.
  - His activities were both intended to, and did, produce a profit (for him).
  - His only source of employment income was advising on, and selling, exempt market securities and insurance products, and he devoted all his working time to that business.

## **D Findings**

- ¶ 82 We find that Michaels acted as an adviser when he held himself out as engaging in, and actually engaged in, the business of advising, as described above.
- ¶ 83 It is not contested that Michaels was not registered as an adviser under the Act during the relevant period. Michaels did not argue that any exemptions from the requirement to register applied, nor is there any evidence that they did.
- ¶ 84 We find that Michaels contravened section 34(b).

## **V Analysis and Findings: Misrepresentation**

### **A The allegation**

- ¶ 85 The executive director alleges in the notice of hearing that Michaels made misrepresentations, contrary to section 50(1)(d), when he repeatedly made false and misleading statements during his radio shows, seminars, and one-on-one meetings with clients.

### **B Law of misrepresentation**

- ¶ 86 Section 50(1)(d) says that “A person . . . with the intention of effecting a trade in a security, must not . . . (d) make a statement that the person knows, or ought reasonably to know, is a misrepresentation.”
- ¶ 87 Section 1(1) defines “misrepresentation” to include “an untrue statement of a material fact” and “an omission to state a material fact that is . . . necessary to prevent a statement that is made from being false or misleading . . . .” That section also defines “material fact” as “a fact that would reasonably be expected to have a significant effect on the market price or value” of the security in question.

## **C The Evidence**

### **3 Exempt market securities that Michaels sold his clients**

¶ 88 Michaels sold \$65 million in exempt market securities of 14 issuers to his clients, although all but \$1.2 million of that was concentrated in the securities of the seven issuers described in this section.

¶ 89 As explained in more detail later in these Findings, Michaels asked his clients if they would like to:

- double their retirement savings every 6 years,
- have their own producing oil wells,
- earn an income without any stock market risk, and
- build wealth by owning real estate.

¶ 90 Not surprisingly, the exempt market securities he sold to his clients largely fit into one of these categories.

#### Aveiro/Mosaic

¶ 91 Michaels sold his clients \$5.7 million of Aveiro from June 2007 to February 2008. Aveiro was an established real estate investment business that expected to go public in 2008. Michaels told his clients that their investment would double in a few months, when that happened. Market conditions related to the 2008 financial crisis delayed the expected public offering for four years. The company went through some re-organizations and is now known as Mosaic.

#### MineralFields

¶ 92 Michaels sold his clients \$4.1 million of MineralFields from June 2007 to December 2010. MineralFields was a flow-through share issuer. Michaels' clients appear to have enjoyed the tax benefits of the investment but it is more or less dormant and has no apparent current value.

#### Walton

¶ 93 Michaels sold his clients \$15.4 million in Walton from June 2007 to December 2010. Walton US is a large established land-banking company. The exempt market securities issued were units in a newly-formed Canadian subsidiary, and debentures issued by that subsidiary. The returns from the holdings in which these clients participated have not yet been realized. To date the clients have received no return nor any return of capital from this investment.

#### Focused Money / Focused Life

¶ 94 Michaels sold his clients \$9 million of Focused Money Solutions and Focused Life Limited Partnership (which Michaels often refers to as "Focused Life" or "Focused Life Settlements") from August 2007 to August 2010. Focused Money was a start-up venture in the life settlements business. The exempt market securities issued were units



consisting of a 20-year 10% unsecured Focused Money debenture with a warrant to purchase common shares of that issuer, or a limited partnership unit with a distribution entitlement of 10% per year. It turned out to be a fraud – the company’s president ran off with all the money.

#### Rogers Oil & Gas

- ¶ 95 Michaels sold his clients \$5.4 million of Rogers Oil & Gas from November 2008 to March 2010. Rogers was a start-up venture proposing to take advantage of then-current low prices for producing oil and gas assets by acquiring them at a discount, holding them, and reselling them later at a profit. The exempt market security issued was a three-year 12% unsecured participating debenture. The company paid distributions for a time then became insolvent.

#### Bethel Care

- ¶ 96 Michaels sold his clients \$11.8 million of Bethel Care from January to November 2009. Bethel Care was a new society constructing a senior long term care facility in the town of Sidney on Vancouver Island. The exempt market security issued was a promissory note paying 12% per annum. The project encountered financing problems during construction and went bankrupt.

#### Pepper Creek

- ¶ 97 Michaels sold his clients \$13.8 million of Pepper Creek and its RRSP-approved affiliate named Treadwell from August 2009 to December 2010. The businesses described as Pepper Creek consisted of limited partnerships just formed for the purpose of acquiring producing oil and gas wells. The exempt market security issued was a limited partnership unit. The limited partnerships paid some distributions for a while, but encountered operational and other problems and are currently not operating. They have no apparent value.

### **D Analysis**

#### **1 Intention to effect a trade in securities**

- ¶ 98 The evidence is clear, convincing and cogent that Michaels had an intention to effect a trade in securities when he made the statements and omissions that the executive director alleges are misrepresentations. Michaels testified that the whole object of the C-FAX radio program and the seminars was to draw potential and existing clients to his office for a one-on-one session.
- ¶ 99 What happened in those sessions, in part, we have described above (more follows later in these Findings). Once the clients were in Michaels’ office, his objective was to sell them products he had on offer, which included exempt market securities.

¶ 100 Michaels had marketing agreements with some of the issuers of exempt market securities that he sold to his clients. The whole point of these agreements was to effect sales of those securities to Michaels' clients.

¶ 101 Michaels' only income in relation to his sale of exempt market securities was the fees he earned under those agreements and the commissions he earned on the securities he sold. Indeed, it was all about the commission. As he so eloquently stated in testimony we quote later in these Findings, he would be satisfied, no matter what product the client purchased. Whatever product the client chose, insurance-based investment or exempt market security, he said, "I got paid . . . I got paid . . . I got paid."

## **2 Untrue statements and omissions related to the exempt market securities Michaels sold**

### **Aveiro**

¶ 102 An investment in Aveiro was completely contrary to everything Michaels ostensibly stood for. It was an investment in a security with the objective of profiting through its going public. The evidence of both Michaels and the clients who testified on this point, is that he told his clients that, when Aveiro went public, the value of their investment would double within a few months. This turned out to be untrue, and Michaels, of all people, had to have known when he told his clients this that there was a significant risk that it would not be true. This is the man who had been predicting for months that the market would crash. This investment was rank with "stock market risk".

¶ 103 It could not be more obvious that the doubling of a security's value within a few months is a fact that would reasonably be expected to have a significant effect on the market price or value of that security.

¶ 104 We find that Michaels' statement that the Aveiro security would double in value within a few months was an untrue statement of a material fact, and therefore a misrepresentation.

### **Walton**

¶ 105 Walton is the investment Michaels was referring to when he offered clients the opportunity to build wealth by owning real estate. Michaels, using a handout relating to Walton USA, told his clients that Walton "had never had a loss".

¶ 106 That was misleading. What Michaels was selling was a new company in the Walton group. What Michaels did not tell his clients were the risks. They were disclosed in the subscription agreement:

- an investment in the securities is highly speculative and involves a high degree of risk,
- the issuer has no previous operating history,
- there are risks inherent in any real estate based investment,
- there is no market for the units, and

- the securities are suitable only for investors who are willing to rely solely on management and to risk a total loss of their entire investment.

¶ 107 That an investment is speculative and has no market for resale is extremely significant to an investment decision. So is an understanding of the risks associated with real estate investments, that the issuer has no operating history, and that the investor is relying on a management team with no proven track record with the issuer. We find that all of these are facts that would reasonably be expected to have a significant effect on the market price or value of that security.

¶ 108 We find that Michaels' omission to state the serious risks associated with an investment in Walton, especially in light of his emphasis that it was free of stock market risk, was an omission to state material facts, and therefore a misrepresentation.

### **Focused Money**

¶ 109 This is one of the investments Michaels was referring to when he offered clients the opportunity to earn income without any stock market risk. Focused Money / Focused Life was one of the investments that Michaels described in what Michaels regarded as an example of a less-risky security than stocks, bonds or mutual funds. It also, he said, would produce superior returns – 10%. On top of that, Michaels told his clients, it had no risk. The cover of the issuer's brochure stated “. . . Tax Advantaged Return! Guaranteed By Reinsurance Bond.

¶ 110 Michaels interpreted this to mean that the return paid to investors was guaranteed. This was untrue. In fact, the offering memorandum stated, “The units are not guaranteed by any entity or person.” What the brochure was referring to was a reinsurance arrangement that covered payment of the life settlement by the vendor of the settlement. It was not a guarantee that Focused Money or Focused Life would pay the investors the promised return.

¶ 111 We find that Michaels' statement that the promised return on the Focused Life security was guaranteed by insurance was untrue. That a return is guaranteed is a significant feature of an investment. Debt securities guaranteed by an insurance company are priced much higher in the market compared to those without guarantees. A guarantee is a fact that would reasonably be expected to have a significant effect on the market price or value of that security.

¶ 112 We find that Michaels' statement that the Focused Life securities were guaranteed by insurance was an untrue statement of a material fact, and therefore a misrepresentation.

¶ 113 Equally important is what Michaels did not say about this investment. The sections of the offering memoranda for Focused Money and Focused Life disclosed these risk factors:

- the securities were highly speculative

- the issuer has no previous operating history
- there was no market for the units
- investors were reliant solely on management

¶ 114 Michaels focused his clients' attention on the need to avoid stock market risk, and pointed out that this was an investment offering a 10% annual return "with no stock market risk". That statement was true, but the investment involved these other far more serious risks.

¶ 115 That an investment is speculative and has no market for resale is extremely significant to an investment decision, that the issuer has no operating history, and that the investor is relying on a management team with no proven track record with the issuer. We find that all of these are facts that would reasonably be expected to have a significant effect on the market price or value of that security.

¶ 116 We find that Michaels' omission to state the serious risks associated with an investment in Focused Money and Focused Life, especially in light of his emphasis that they were free of stock market risk, was an omission to state material facts, and therefore a misrepresentation.

#### **Rogers Oil & Gas**

¶ 117 This is one of the investments Michaels was referring to when he offered clients the opportunity to earn income without any stock market risk and to double their retirement savings every 6 years.

¶ 118 As with Walton and Focused Money / Focused Life, Michaels did not tell his clients about the risk of this investment.

¶ 119 The financial statements in the offering memorandum showed cash of \$747,000, mostly attributable to the issue of \$606,000 principal amount participating debentures. Oil and gas properties were shown on the balance sheet at cost at \$117,000. They show a net loss for its first six months of operation \$313,000. These numbers show that, if Rogers were unable to successfully execute its strategy, it had no means of funding payments on the debentures.

¶ 120 The offering memorandum also discloses significant risks:

- the investment was risky and highly speculative,
- there was no market for the units,
- the issuer has no previous operating history,
- there were risks associated with the oil & gas business, including exploration risk, drilling and operational risks, and volatility in oil and gas prices,
- the company's strategy may not succeed,

- investors would be reliant on management, which did not include “a large technical team with a proven track record”.

¶ 121 These risk factors are obviously facts that would reasonably be expected to have a significant effect on the market price or value of that security, and we so find.

¶ 122 We find that Michaels’ omission to state the serious risks associated with an investment in Rogers Oil & Gas, especially in light of his emphasis that it was free of stock market risk, was an omission to state material facts, and therefore a misrepresentation.

#### **Bethel Care**

¶ 123 This is one of the investments Michaels was referring to when he offered clients the opportunity to earn income without any stock market risk and to double their retirement savings every 6 years.

¶ 124 An investment in Bethel Care obviously entailed serious risks that Michaels did not disclose to his clients. The issuer was a new entity formed solely to develop the project. It had no track record. As with all of the exempt market securities Michaels sold, there was no market for the securities. Investors were entirely reliant on management. There are serious risks associated with real estate construction, including sufficiency of financing to see the project through to completion.

¶ 125 All of these risks are facts that would reasonably be expected to have a significant effect on the market price or value of that security, and we so find.

¶ 126 We find that Michaels’ omission to state the serious risks associated with an investment in Bethel Care, was an omission to state material facts, and therefore a misrepresentation.

#### **Pepper Creek**

¶ 127 This is the investment Michaels was referring to when he offered clients the opportunity to have their own producing oil wells.

¶ 128 Michaels told clients this about Pepper Creek:

- 26 producing oil wells
- 2 water injection wells
- 4 mile gas gathering system
- over 6,000 acres leased
- 100 developmental infill well program in progress
- track record of growth “through the drill bit”

¶ 129 None of this was true. The offering memoranda for the Pepper Creek investments state that they are “newly formed with no previous operating history.”

- ¶ 130 Neither was it true that investors would “have their own producing oil wells”. They would have units in a limited partnership whose business plan was to use the investors’ funds to acquire producing assets.
- ¶ 131 We find that these untrue statements by Michaels’ went to the heart of the investment being offered. His clients were not investing in company with producing assets, infrastructure, leaseholds, and a drilling program. There was no track record. Nor would his clients have a producing oil well. We find that these were facts that would reasonably be expected to have a significant effect on the market price or value of the Pepper Creek securities.
- ¶ 132 We find that Michaels’ statements were untrue statements of material facts, and therefore a misrepresentation.
- ¶ 133 As with all of the other exempt market securities Michaels promoted to his clients, he also omitted to state the risks that were disclosed in the offering memoranda, including:
- the investment is risky and highly speculative,
  - an investor should purchase units only if able to bear the entire loss of the investment
  - there is no market for the units,
  - the issuer has no previous operating history,
  - there were risks associated with the oil and gas business, including exploration risk, drilling and operational risks, and volatility in oil and gas prices,
  - the company’s strategy may not succeed,
  - the producing wells acquired may not ultimately produce as expected, and
  - the investors will be solely reliant on management to execute the strategy.
- ¶ 134 These risk factors are obviously facts that would reasonably be expected to have a significant effect on the market price or value of that security, and we so find.
- ¶ 135 We find that Michaels’ omission to state the serious risks associated with an investment in Pepper Creek was an omission to state material facts, and therefore a misrepresentation.

## **5 Michaels’ submissions in defence**

### ***Not advising***

- ¶ 136 Michaels, in his submissions relating to the allegation of misrepresentation, essentially repeated his mantra that he was prohibited from advising, and did not do so. He was not advising, he said, because all he did was relay to his clients facts about the exempt market securities. His point, presumably, is because he was not advising, he could not have made any statements that were misrepresentations.

- ¶ 137 We have found that Michaels was advising, but Michaels' argument is no answer to the allegation, even had we found otherwise. Section 50(1)(d) makes no reference to advising. The issue of whether Michaels was advising is irrelevant to the allegation that Michaels made misrepresentations. All that is relevant to section 50(1)(d) is whether Michaels, with the intention of effecting a trade in a security, made untrue statements of material facts, or omitted to state material facts.

***Statements came from documents supplied by the issuer***

- ¶ 138 Michaels says that he made no statements of his own. All that he told clients, he says, came from investment brochures and offering memorandum supplied to him by the issuer.

This is no defence to the allegation. Michaels chose to sell the exempt market securities for these issuers. As soon as he decided, in the course of doing that, to talk to clients about the merits, or, to use his words, the "features and benefits", of these securities, he was making statements about them.

- ¶ 139 Michaels was then roaming within the ambit of section 50(1)(d). It was his responsibility to ensure that, in making those statements, that none of them was an untrue statement of a material fact. Likewise, it was his responsibility to ensure that he did not omit any other statements that were necessary to ensure that the statements he did make were not misleading. In other words, he ought to have taken due diligence measures to ensure that what he was telling his clients was the whole truth about the securities he was selling. If he failed to do so, it was at his peril.

- ¶ 140 Michaels also argued that his job was merely to present the merits of the investments and then give the offering memoranda to the clients so they could figure out the rest of it and decide for themselves whether to invest. In his testimony he stated repeatedly that was in fact how the investment process worked with his clients.

- ¶ 141 The argument is ridiculous. He testified that clients were unable to interpret their own investment statements when they brought them in for him to provide a second opinion. The clients testified that they depended on him for advice. In his aggressive promotion of exempt market securities, he emphasized their so-called benefits, including their high returns and freedom from "stock market risk", but never mentioned their other significant risks. In his warped and self-serving view of what advising meant, telling them about the so-called merits was not advising, but telling them about the risks was. Later in these Findings we quote Michaels' testimony when he said, "clients love the sex appeal of exempt market securities." No wonder. By the time he was finished with them, they would have had eyes for little else.

***Disclaimers***

- ¶ 142 Michaels' argues that his clients were not misled, because he provided them with the offering memoranda, and they signed subscriptions agreements containing risk

acknowledgement forms. He even made them initial notations he made on the offering memoranda that they understood the risks, as disclosed in the offering memoranda.

- ¶ 143 Asked how the meeting with Commission staff affected how he dealt with clients, Michaels testified:

“Oh, we took more time with clients. On many, many occasions when a client purchased a market exempt security I got clients to initial the offering memorandum. . . I put down ‘I have received the offering memorandum and understand the risks.’ I’ve got clients to initial the OM, which was not a requirement in the standard form of the Province of British Columbia. So I want to make crystal clear, I even have clients initialized [*sic*] on the form 45-106F4 form that they can lose all their money that they invest into. In my presentations to clients on a one-on-one basis or in seminars I handed out the offering memorandum and the brochures from the companies. So I took it very serious, because if investigators come over from the BC Securities Commission you better stand notice, and I did.”

- ¶ 144 This argument is no defence to the allegations. The requirements that issuers provide investors with offering memoranda including risk disclosure, and that investors sign risk acknowledgement forms, are an attempt to ensure that investors know what they are getting into when they invest in exempt market securities. That is their sole purpose.
- ¶ 145 Having held himself out as an adviser, and having advised his clients about the merits of these securities, Michaels cannot rely on these requirements as some sort of safe harbour.

## **D Finding**

- ¶ 146 We have found that Michaels, with the intention of effecting trades in the exempt market securities that he sold to his clients, made misrepresentations, and therefore contravened section 50(1)(d).

## **VI Analysis and Findings:**

### **Fraud**

#### **A The Allegation**

- ¶ 147 The executive director alleges in the notice of hearing that Michaels perpetrated a fraud, contrary to section 57(b), when he repeatedly made misrepresentations and other false and misleading statements during his C-FAX program, seminars, and one-on-one meetings with clients.



## **B Law of fraud**

¶ 148 Section 57(b) of the Act says:

“A person must not, directly or indirectly, engage in or participate in conduct relating to securities . . . if the person knows, or reasonably should know, that the conduct

...

(b) perpetrates a fraud on any person.”

¶ 149 The British Columbia Court of Appeal in *Anderson v. British Columbia (Securities Commission)*, 2004 BCCA 7 set out the elements that must be proved to establish a finding of fraud under the Act, citing *R. v Théroux*, [1993] 2 SCR 5 (at p. 20):

“... 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).”

¶ 150 In *R. v. Cuerrier* [1998] 2 SCR 371, the court stated (at para. 116) that the element of dishonesty in fraud “can include non-disclosure of important facts.” *Cuerrier* seems at first to be a case of little application to securities regulation: it was a sexual assault case. The accused was HIV-positive and failed to disclose that fact to individuals with whom he had consensual sex. It was necessary for the court to consider whether the non-disclosure was fraud, within the meaning of the *Criminal Code*, and thus vitiated the consent.

¶ 151 However, the Court noted (at para. 117) that “The principles which have been developed to address the problem of fraud in the commercial context can, with appropriate modifications, serve as a useful starting point . . . .”

¶ 152 That brings us back to familiar territory. That non-disclosure can constitute dishonesty is fundamental to the public interest purposes of the Act. It is consistent with the disclosure obligations imposed by credible securities regulation regimes everywhere. The requirement for complete and accurate disclosure so that investors can make well-informed investment decisions is fundamental to the fostering of confidence in our capital markets.

¶ 153 It follows that, in the context of fraud under the Act, an “important fact” would be one that would affect a reasonable investor’s investment decision.

¶ 154 In *R v. Zlatic* [1993] 2 SCR 29 the Supreme Court of Canada stated:

“The fundamental question in determining the *actus reus* of fraud is whether the means to the alleged fraud can properly be stigmatized as dishonest . . . . In determining this, one applies a standard of the reasonable person. Would the reasonable person stigmatize what was done as dishonest?”

### **C The Evidence**

¶ 155 In his C-FAX program, Michaels employed the techniques of the old-time tent-revivalist: demonize sin, terrify the assembled with the retribution surely to follow, and then offer the road to salvation.

¶ 156 The sin was investments in stocks, bonds, and mutual funds, which Michaels excoriated on the program. He asked listeners, “Are you tired of losing money on stocks, bonds and mutual funds?” He described to his listeners the evil of “stock market risk”. Retribution would come in the form of carnage to their investment portfolios. He told listeners that these forms of investment yielded pathetic returns. He told them about mutual fund salespersons and stockbrokers who churned accounts, the fees consuming portfolio values.

¶ 157 Michaels told listeners how they could not trust their mutual fund salespeople or stockbrokers because they cared only about their fees, not their clients. For example:

“When was the last time your advisers ever told you about buying bullion? Never, because they don’t get paid on it – they want you to stay in some low-class mutual fund or stock portfolio because they get paid a fee. And that’s what this life is all about – it’s not looking after your stock broker because he’s not the one looking after you.”

¶ 158 Michaels then offered salvation – a promised land flowing with the milk of insurance-based investment products and the honey of exempt market securities, which he sometimes labelled with the more glamorous term, “private equity”. Investors in exempt market securities could protect their capital, double their money every six years, and earn “rates of return independent of stock market risk.” But first, they must repent – they must sell their stocks, bonds, and mutual funds.

¶ 159 Michaels’ spoke with the zeal of the converted, telling the tale of his own enlightenment and repentance, complete with a vision of the apocalypse, as he told it thus to his listeners on April 24, 2009.

“I was one of Canada’s largest mutual fund salespeople in this country – so I’ve been around in this industry since 1985. . . . Four years ago starting in June, I gave up my mutual fund licence and my stock licence, because I saw the writing on the wall: this market could not keep on continuing. All I can tell you Terry, a monkey could have made money in the market up to that time. . . . So I was one of the monkeys. Then I took all my money, and all of my clients’ investments, out of stocks, bonds and mutual funds and I referred clients to look at these alternatives.”

¶ 160 Moore told listeners that Michaels “got out of the mutual fund and the stock market business over three years ago and he’s been . . . doing a lot things with investments . . . that will protect you from the incredible problems that you see within the stock markets today.” Moore went on, “Is there a way to protect your money? That’s what David Michaels does, that’s why we’re on this program, ‘Creating Wealth’.”

¶ 161 In his C-FAX programs, in his seminars, and in his one-on-one meetings with clients, Michaels would close with his dominant theme:

“Usually the last subject that I always close out with all clients . . . and this is predominantly the catch phrase that I’ve used on my radio programs, ‘are you tired of losing money to stocks, bonds and mutual funds.’ And in my presentations, one-on-one and groups, this is why my seminars kept on filling up. . . .”

¶ 162 A key part of Michaels’ message was fear-mongering. For example, in his January 3, 2009 C-FAX program, Michaels said he could “show people how to secure their portfolios against the coming depression”:

“Moore: Are you going to talk about this at the seminar coming up . . . ?

Michaels: We are going to show clients how to take the money out of publicly-listed equities and how to secure their portfolios for the coming depression.

Moore (his tone aghast): Say that again?

Michaels: We’re gonna show people how to protect their portfolio from the coming depression . . . depression number 2.

Moore: Are we talkin’ dirty thirties here, all over again?

Michaels: Well, Terry, take a look. Back when the Dow hit its all-time low in 1929, the Dow fell by 34% the first year.

Moore: Yes.

Michaels: Well, do you know the TSX just went through? Minus 40%.

¶ 163 In the same program, Michaels told listeners that pension plans were unsafe, because they were invested in stocks, bonds and mutual funds:

“Moore: What’s happening with people’s pension plans, people that are in companies right now, where they’re in some kind of pension plan . . . ?

Michaels: Oh, these people with these auto industries, like, for example, if you were a pensioner with GM, or, or Chrysler, guess what? On the waiting list, they’re fifth in line.

Moore: They are indeed.

Michaels: Creditors have to be paid first.

Moore: Sure.

Michaels: Preferred shareholders have to be paid. Bond holders have to be paid.

Moore: Right, and then the pensioner plans.

Michaels: And then, common shareholders have to be paid. And the last person on the page?

Moore: Pension.

Michaels: Pensioners! So these people might just lose everything.

. . .

So if you belong to a private pension plan, there’s no guarantee. Terry, count on your fingers – and your toes – how many companies have been around for over a hundred years in Canada?

Moore: Half a dozen.

Michaels: That’s it! Okay? In Canada, out of every company that starts, in the first 10 years, 92% are failed!

Moore: So what happens to the people's pension plans, where does that money – does it go into mutual funds investment, where does it go?

Michaels: Mutual fund investment, stock investment, bond investment.

Moore: And we know where that's goin'.

Michaels. It's in the toilet. Terry, get out, do something different."

- ¶ 164 Just in case that was not enough to unsettle his listeners, Michaels added his views on the then-latest potential global political crisis:

"Moore: Israel moved into Gaza today, you think this is going to have some major financial ramifications . . . ?

Michaels: Oh, Terry, I just think, you know what, I'm just afraid to say this, could it be the beginning, could it be the beginning, of World War III? . . . you know what, there's a guy out there in Iran, he doesn't like Israel, he just has to, I don't know man, that's just scary stuff."

- ¶ 165 When Moore signed off the program, saying, "We'll watch the opening [of the markets] on Monday," Michaels replied, "Let's pray that we're not in World War III by then."
- ¶ 166 Michaels' main objective for the program was to entice listeners to one of his seminars or to an appointment in his office. Every program was designed to cast doubt in the listeners' minds about their existing portfolios of mutual funds, stocks, and bonds, and about the registrants who were advising them.
- ¶ 167 "You will walk away empowered by education," Michaels said, referring to the seminars. "You're no longer succumbing to stock market portfolio volatility."
- ¶ 168 Michaels' seminar brochure goes on to describe investments in exempt market securities:

"Are you tired of losing money in stocks, bonds and mutual funds? There is an alternative to traditional investments that the wealthy have always known... 'Private Equity'. Ask yourself these questions: 'Are you meeting all of your financial goals by listening to your stock broker or mutual fund salesperson? Do they have your best interest in mind or theirs? [emphasis in the original]

In Canada, there are +1000 different mutual fund managers to choose from. How many managers added any value to their clients' investment?

Are you aware that only 7 mutual funds [*sic*] managers earned over 12% per year over the last 20 years!”

- 7 managers earned +12% per year
- 20 managers earned +10% per year
- 66 managers earned 8% per year
- 213 managers earned 6% per year

If you agree that their returns are not acceptable ~ **Welcome to a new way of investing! Private Equity** is today’s way of investing without stock market volatility; returns not tied to the day to day non-sense [*sic*] on Wall Street or Bay Street.

**Michaels Wealth Management Group** is one of Canada’s Premier Private Equity firms and we specialize in helping retirees earn monthly incomes without taking on the uncertainty of the day to day stock market!”

¶ 169 Michaels told his listeners in his C-FAX program on August 11, 2007 that one of the main reasons to sell their stocks, bonds and mutual funds was because they were not diversified:

“Michaels: The stock market is run by a manic-depressive. He gets very elated and he gets very depressed. He’s very depressed, Terry. . . . It’s going to get messier.

Moore: . . . are they over-reacting?

Michaels: Terry, I think this is just the beginning. . . . There is still an over-reaction still waiting to happen. The world is so shaky right now, what’s happening in, in Venezuela, what’s happening in eastern Europe, in north Africa, everything today is correlated no matter where it is. Now Terry, I am going to take a step back. This is over 21 years in this industry. Now Terry, I have had my securities licence, I have had my mutual fund licence. And this is what the association assumes what proper diversification is, is take the client’s portfolio and buy some stocks or buy some mutual funds . . . . Here, here and here, but it’s the same asset class.

Moore: Buy a little energy, buy a little financial, buy this, buy that, and you’re saying . . .

Michaels: But you know what, it's the same asset class. So no matter what happens if all the stock market goes down no matter where you have what you thought was proper diversification is going down the same sinkhole.

Moore: Because they all caught the same disease.

Michaels: Absolutely

...

that's what we've been telling people here in Victoria . . . for the last six months is to take some money off the table, buy something that is a different asset class. Get out of stocks. Get out of mutual funds.

...

So, Terry, let's take control. Let's buy an investment that has absolutely nothing to do with the day-to-day stock market, so therefore we can live."

¶ 170 This is what happened in the market during the relevant period. Between June 2007 (the start of the relevant period) and June 2008, the S&P TSX Composite Index was fluctuating between 13,000 and 14,000, having crossed 13,000 at the beginning of 2008.

¶ 171 In mid-June 2008 the Index reached an all-time high of 15,073. By the end of August, it had fallen back to around 13,000, where it was at the start of the year. In only 12 trading days starting on September 25, 2008, it plunged from about 12,500 to just over 9,000. (About this time, Michaels changed his seminar title from "Financial Seminar" to "Emergency Financial Seminar".) For the rest of 2008 the decline continued, slowly but surely. At the beginning of January 2009 the Index stood at 8,700.

¶ 172 The decline continued until early March, when it reached a low of 7,500.

¶ 173 A recovery ensued and by December 2010, the end of the relevant period, the Index was back to the mid-13,000s, where it had been in June 2008, two-and-a-half years earlier.

¶ 174 On page 1 of Michaels' seminar brochure Michaels emphasizes his theme:

**"HOW MUCH LONGER WILL YOU TOLERATE. . .**

- Low (2%?) returns on guaranteed products (GICs)?
- The volatility of mutual funds?
- Dozens of companies all selling the same products?
- Stocks, Bonds and Mutual Funds that offer no guarantees, just empty promises?
- Income taxes so high they hamper your lifestyle?"

¶ 175 This is how page 1 of the brochure described the opportunities:

**“WOULD YOU LIKE TO . . .**

- Have a guaranteed income that will last the rest of your life?
- Double your retirement savings every 6 years?
- Have your own producing Oil Wells?
- Earn an income without any Stock Market Risk?
- Pay less capital gains tax on the sale of a property?
- Build your wealth by owning Real Estate?”

¶ 176 Michaels structured his presentations to clients in seminars and in one-on-one meetings around these points. As he discussed each opportunity, he referred the client to information about the exempt market security he was selling that embodied that opportunity. He testified how he did it:

¶ 177 He testified how he followed these points in his presentations to clients:

“Well, I’ve been using a very similar sheet for a year so I just – we talk about annuities, so I refer back to page 1, and I ask the client do you understand how you can have a guaranteed income for the rest of your life? Once I get a confirmation, great. Then I go on to number 2. It’s called how to double your retirement savings every five to six years by having your own producing oil wells. . . . Then in my presentation . . . I talk about the oil investment, and this reference is to Pepper Creek. In each one of my presentations I used to hand out the brochures from the companies that were provided to me.

. . .

And we just go over the highlights of this investment. I talk about a low risk business strategy. Where I get that information is from the marketing material.”

¶ 178 Michaels testified about how potential clients could “double their retirement savings every 6 years”, as promised in his seminar brochure:

“Well, during my presentation I’d ask the potential seminar attendees or the one-on-one prospect meetings, I says: ‘Have you ever heard of the rule of 72 in the area of finance?’ And the clients say ‘I have never heard of the rule of 72’. Well, the rule of 72 tells the investor how long it takes money to double. And then I ask the client and the seminar attendees just a point of question, do you have any idea what you get paid on your bank account in your savings and chequing? And people have no idea. Then I



open up with what the major banks pay. It's I think 0.15% . . . . And I told the people 'do the math. If you take 0.15 divided by [sic] 72 it tells an investor how long it takes money to double. It's 388 [sic] years.' So I say to the client 'how many years do you have alive to double your money if you leave your money in the bank. 388 years.' We have a chuckle. Then I talk about if you can find an investment that doubles every six years. How do I do that? Well, you take 12 into 72 says six years. So how do you double your money in six years? By looking at the oil and gas investments that shows a 12% rate of return. That could be a potential investment."

¶ 179 Michaels went on:

"Then I would bring them back onto page 1, and then we talk about reducing your income tax . . . and then I would show an example of a \$10,000 contribution through a company called MineralFields as a flow-through share investment. That's what I would do.

. . .

The other bullet that we talk about is how to earn income without any stock market risk. . . . And . . . I would be highlighting the oil and gas 12% notes without any stock market risk, and in addition to that I would be starting to promote the features and benefits of life settlements through a company called Focused Life Settlements or Focused Life."

¶ 180 Asked whether "he would promote that product", Michaels testified:

"Well, I would take out the – it's no different – you're going to find a pattern here. I take out the marketing brochure that was given to me from Focus Life Settlement, then I talk about what the investment is. It's the purchase of senior life insurance policies from people over the age of 80 that have at least two medical impairments, and these policies are purchased in the US from US citizens as an investment so they can liquidate to get some liquidity from a death benefit while they're alive, and the life insurance industry has a product called life settlement. Then I would make reference to the company that provided this investment opportunity to Canadians called Focused Life and we go over how this works."

¶ 181 Michaels also told investors that he had personally invested in the same exempt market securities that he was offering them. The evidence shows this is true. This is from his C-FAX program on April 24, 2009:

"Moore: But you buy this – you're invested in all these areas?

Michaels: Hey, what do you think I'm doin' here?

Moore: Exactly.

Michaels: If I can tell my clients about a great investment, why should I not want to buy this for myself and for my own family?"

¶ 182 At the hearing, several of Michaels's former clients, including a former client called by Michaels, testified that he told them he was invested in the exempt market securities he sold them, and that the fact of his investment was an important factor in their decision to buy.

¶ 183 In his interview, Michaels was asked about what he told clients about his investment in Rogers Oil & Gas:

“Q . . . With respect to Rogers investment, when you were telling people about the company, you did tell them that you were invested, you did tell them that you would receive a fee?

A Yes.

Q Did you tell them that you believed that Rogers was a good investment?

A Well, people said, ‘Well, David, I just assume that it’s a good investment ‘cause you put your money to it.’

Q Did you tell people that Rogers Oil & Gas was a good investment?

A I don’t believe I told them it was a good investment. I told them the options, the availability of why you might want to look at this for yourself.

...

Q You believed that Rogers was a good investment?

A Yes.

Q Was that why you were telling people about Rogers?

A Yes.

Q Because you believed it was a good investment?

A Yes.

Q And, therefore, would it not make sense that you would have told people that it was a good investment?

A I would have told them – to make up their own minds. If they wanted to hear now – this is how Rogers works, this is why I invested, these are the reasons.”

¶ 184 In his interview, Michaels was asked about what he told clients who were interested in investing, but did not have enough cash:

“Q And what would you – what – would you counsel that person at all in respect of how they might get some money?

A I’m not sure about counselling, but I told them how they can possibly get some more cash if they’d like to.

Q And how would that – did it happen?

A They always asked me, ‘So David, what do you think? I’ve got a big asset here. It’s called a house.’ So I told them how a home equity loan works. It’s their decision if it works for them.

...

Q Did you explain the risks of leveraging to an investor?

A I think I had, but I can’t recall if I did it all the time.”

¶ 185 At the hearing, this was his testimony about leveraging:

“Q . . . One of the things that you were touting at your seminars was borrowing money to invest?

A Well, in fact, I had a few broker – one or two different mortgage brokers. You know, they must have come out to between five and ten different presentations, as well as myself, showing options about getting cash as an option.

Q The term is ‘leveraging’?

A Leveraging is, is a choice, yes.

Q And the average age of your clients was 72, correct?

...

A The average age of the clients was 72, correct.

Q Did you honestly believe that leveraging was a good idea for a 72-year-old client?

...

A Myself personally?

Q Yes.

A It all depends on the situation.

Q Well, as a former registrant, you certainly knew that leveraging was much riskier than investing money people already had, didn't you?

A As a former registrant?

Q Yes.

A That was one of the risks, as a former registrant, to know the client, yes.

Q And so you knew, that's because that if you lose your money from your investment, you still have the debt?

A Correct. I understand that concept.

¶ 186 Michaels testified that in many cases he believed an insurance-based product was a better choice for a client, but they preferred exempt market securities:

"The majority of my clients their comment was well, you know what . . . It's pretty boring buying an annuity, it's pretty boring buying a life insurance policy, but I really like what you talk about with the oil and gas, I really like what you're talking about on how to save money to income tax, I really like you talking about life settlements, I really like you – what you mentioned to me about land. So even though that I talk about annuities, segregated funds and insurance, clients love the sex appeal of market exempt securities."

¶ 187 In fact, Michaels testified, he did not care what his clients bought. In his interview, he said:

"Q Tell me about 'Know Your Client' obligations.

A There isn't any inside the market exempt securities industry prior to September 28.

...

Q What does that mean to you? Does that mean you can –

A Not supposed to be advising . . . as an adviser.

. . . As an adviser – if you were and adviser, you were supposed to know the client's history, background, everything, to make an informed decision. Well, I was selling financial services products. I didn't think I had to do that . . . .

...

Q So does that mean that when you sat across from a client who possibly was already an insurance client, that when you presented to them the

exempt market securities, you did not put your mind to ‘Know Your Client’ at all? Is that fair to say?

A That’s fair to say.

Q So if you sat across from somebody who was 90 years old, you didn’t put to your mind, ‘Is it appropriate for this person to put their money into an exempt market product?

A No. The client made the choice if they wanted to or not.”

¶ 188 At the hearing, Michaels was even more blunt:

“Run on the same track, gave the same information, get the clients to tell me what they wanted, and that’s what they got based on the information I disclosed. Here it is. What do you want, client? It didn’t matter to me. I got paid on the life insurance policy. I got paid on a seg fund. I got paid on an annuity. If you wanted land I’ll refer down to Walton, I got paid. If you wanted Focused Life Settlements I got paid. It doesn’t matter, client, which one do you want? If you want a GIC I get paid. I was a financial services provider, and that’s what I nailed down on my radio program.”

¶ 189 For his C-FAX program listeners who might be considering a switch from their stocks, bonds and mutual funds in favour of what Michaels was offering, Michaels made sure they need not be concerned about the mechanics:

“Moore: Is it going to be efficient for them to move, let’s say out of a stock market portfolio?

Michaels: It takes a stroke of a pen to transfer accounts . . . it’s just [sound of snapping fingers] like that.”

¶ 190 In Michaels’ office were the brochures describing the exempt market securities he had for sale, the related offering memoranda, subscription agreements, and everything else necessary for clients to invest. All clients had to do was write a cheque payable to the issuer and leave it with Michaels’ staff. Michaels testified that sometimes clients took materials home to review, and other times they invested on the spot. This is consistent with the clients’ testimony.

## **D Analysis**

### **1 Conduct in relation to securities**

¶ 191 Under section 57(b), the conduct alleged to be fraudulent must be “relating to securities”. Clearly it was – the allegation relates to his conduct in relation to his sale of exempt market securities to his clients.

## **2 Prohibited acts**

¶ 192 Michaels engaged in numerous acts of deceit. Indeed, his entire business of selling exempt market securities was based on deceit, and depended on deceit for its success. His deceit falls into four areas:

1. His foundation deceit was dishonestly convincing clients of the false premise of his business model. He told his clients that:
  - traditional investments like stocks, bonds, and mutual funds produced only losses or, at best, inadequate returns and were subject to “stock market risk”; they were therefore inferior, and more risky, compared to the exempt market securities he was selling;
  - an investment portfolio comprised of traditional securities was less diversified, and therefore more risky, compared to one comprised of the exempt market securities he was selling; and
  - the advisors who recommended they buy stocks, bonds and mutual funds were less trustworthy than he was.
2. He encouraged his clients to leverage their investments by borrowing money against their homes to buy the exempt market securities he sold them, without explaining the risks of that strategy.
3. He instilled trust in his clients and then betrayed that trust.
4. He made misrepresentations about the specific exempt market securities he sold.

### ***False premise***

#### **General**

¶ 193 Michaels’ tag line was, “Are you tired of losing money on stocks, bonds, and mutual funds?” He told his clients returns on these investments were inadequate which, it appears, meant any return under 12%. He spoke incessantly about “stock market risk”. He said that investment in traditional securities did not offer adequate diversification because they were all “the same asset class”. If the stock market goes down, “no matter where you have what you thought was proper diversification is going down the same sinkhole,” he said.

¶ 194 Michaels had been predicting a market crash in his C-FAX programs for some time. After the market crash in the fall of 2008 he gloated: he had predicted it, he said. He had left the industry because he saw it coming, he said. He had taken clients out of the market and saved them millions of dollars, he said.

¶ 195 There is no evidence that Michaels predicted the timing of the crash, and little that he ever identified the factors that led him to believe a crash would come. Nor is there any

evidence to support his assertion that by taking clients out of the market, if he did, that he saved them millions of dollars.

- ¶ 196 The only evidence of his thoughts about why there would be a crash was in his C-FAX program from August 11, 2007, when he talked about events in Venezuela, eastern Europe and north Africa, none of which are mentioned by knowledgeable observers as factors leading to the late 2008 crash.
- ¶ 197 Markets correct on a regular basis, often dramatically. A mere prediction of a crash, with no time frame specified nor any factors identified to explain why it is coming, doesn't exactly demonstrate prescient insight. Even a stopped clock is accurate twice a day.
- ¶ 198 Michaels was not one to let a crisis go to waste. After the late 2008 crash, he reminded his C-FAX program listeners that he had predicted the crash.
- ¶ 199 Neither, after the crash, did Michaels' message change. If anything, it became more shrill. He said the market would only go lower. A depression was coming. Pensioners depending on private-sector pension plans were going to lose all their money. Heck, World War III could start at any moment.
- ¶ 200 All of this was grossly misleading. It amounted to no more than a cynical attempt, unfortunately successful, to scare people into selling perfectly sound investments so they could purchase the high-risk exempt market securities he was selling.

Stock, bonds and mutual funds "lose money"

- ¶ 201 Michaels told his clients that they could only lose money on stocks, bonds, and mutual funds. These investments were "in the toilet".
- ¶ 202 This is demonstrably false. All of these investment vehicles are capable of yielding solid real returns, of both income and capital, on a consistent basis through a market cycle. If what Michaels said were really true, the financial system as we know it would collapse.

Stock market risk

- ¶ 203 Michaels used the term "stock market risk" to vilify traditional investments. He appeared to include two kinds of risk in that phrase. One was the market crash scenario.
- ¶ 204 This was a bogeyman. Market corrections happen, but do not necessarily entail losses. Those who continue to hold their investments (or indeed add to them – a correction can represent a buying opportunity) through a down market are often rewarded for their patience.

- ¶ 205 A chart entered in evidence shows the year-end value of the Dow Jones Industrial Average from 1934 through 2007. Michaels sent the chart to his clients in one of his routine emailings for their information.
- ¶ 206 Using the values in that chart, we calculated that during the period covered by the chart, the change in the Average between the end of a given year and the end of the year 10 years later was higher in all but six of those years. In the years where it was higher, the increase in value averaged 143%. In the eight years where it was lower, the decrease in value averaged only 11%.
- ¶ 207 The fact is that the investors who are certain to lose following a market crash are those who panic and sell their securities at the bottom of the market, thereby realizing their losses. This is exactly what Michaels was urging his clients to do in 2009 and 2010 after the crash. For many who followed his advice, sold their stocks and mutual funds, and bought exempt market securities from him, the results were disastrous. Had they simply remained invested in stocks and mutual funds, they would likely to have been back where they were in early June 2008 after a recovery of only two and a half years.
- ¶ 208 The other kind of market-related risk that Michaels referred to was what he called “day-to-day” market volatility. Volatility, in the context of the stock market, is merely a synonym for price movement. Volatility can be high or low. The level of volatility varies among individual stocks and varies between any given stock and the market as a whole. It is misleading to imply that volatility is risky. For day traders, periods of high volatility are a significant risk for them to manage. For long-term investors, day-to-day volatility, even when high for some periods, is not generally a significant threat to long-term returns.
- ¶ 209 In his trashing of traditional securities, Michaels misled his clients because he did not distinguish between those that are listed and those that are not, nor between securities whose correlations differ in their sensitivity to changes in stock market valuations.
- ¶ 210 Equities are generally listed. So are the equities in the portfolios of many mutual funds, and so their value is tied to stock market behavior. However, bonds are not listed, and some mutual funds are invested in bonds and other non-listed securities. Even among listed securities, prices do not correlate uniformly to fluctuations in stock market indices. The prices of real estate investment trusts, for example, correlate more closely to interest rates than to equity prices.
- ¶ 211 Michaels ignored all this in his C-FAX programs, his seminars, and his one-on-one meetings with clients. He just lumped stocks, bonds, and mutual funds all together.



#### Exempt market securities are less risky

- ¶ 212 No client could have listened to Michaels for more than five minutes without realizing that he was saying the exempt market securities he was selling were less risky than traditional securities. He told them traditional securities had “stock market risk”. As we have just explained, that was misleading in itself.
- ¶ 213 What was more misleading by far, in fact was grossly misleading, was his failure to tell them about the much greater risks associated with the exempt market securities he sold them. These are among the risks we described in the section on Misrepresentation. These are some of the risks relevant to a risk comparison between traditional securities and exempt market securities:
- Listed securities have liquidity; exempt market securities do not. Prices of listed securities are quoted in real time on public markets, in which buyers and sellers participate. Not all listed securities enjoy absolute liquidity because the ratio of buyers to sellers does not always favour the buyer. However, in theory, a buyer is always available provided that the seller is prepared to sell at the price the buyer is willing to pay. In contrast, exempt market securities generally have no liquidity.
  - In order to become listed in the first place, the issuers of listed securities are subject to a regulatory regime that requires minimum standards relating to stock distribution, capitalization, operational history, corporate governance, and other factors. The issuers of exempt market securities are not subject to any of these requirements.
  - Public issuers must make ongoing public disclosure mandated by the securities regulatory regime. Issuers of exempt market securities have no ongoing disclosure requirements.
  - Exempt market securities are often issued by start-up ventures. Pepper Creek, Rogers Oil & Gas, Focused Life, and Bethel Care were all in this category. Issuers such as these have no operational history and no performance track record that investors can use to assess the operational and management risk associated with the business.

#### Diversification

- ¶ 214 Michaels told clients that traditional securities provided no effective diversification because they were all subject to “stock market risk” – “it’s the same asset class.”
- ¶ 215 This was nonsense. An asset class is not determined on the basis of whether the securities are listed or unlisted. It is determined by the nature of the investment – corporate equities (business sector, geography), debt (corporate, business sector, government, rating, geography), real estate (residential, commercial, geography),

commodities, and so on. The form of investment can also be a factor (direct or indirect ownership).

- ¶ 216 More to the point, Michaels offered investments in only four sectors: real estate, life settlements, oil and gas, and senior long term care, but that was illusory, because he offered only one investment in each of those sectors, except for oil and gas, where he had two (counting the two Pepper Creek issuers as one, since they had the same general partner).
- ¶ 217 Diversification is a tool to hedge against over-concentration of risk. To be effective, investment diversification seeks to diversify both by sector and by issuer within each sector.
- ¶ 218 Michaels offered no meaningful diversification whatsoever. He offered only half a dozen investments, all of which were high-risk start-ups. One way to measure effective diversification is to compare the standard deviation of a portfolio to that of a market index. It is generally accepted in the industry that to replicate the standard deviation associated with a market index, a portfolio must contain at least 25 securities, with weightings corresponding roughly to the weighting of the index.
- ¶ 219 Michaels' statement to his clients that investing in his pathetic basket of high-risk exempt market securities offered diversification in any way, shape or form, was grossly misleading, never mind compared to the diversification opportunities available in the world of traditional securities.

#### Untrustworthy advisers

- ¶ 220 He misled his clients into believing he would act in their best interests by stating that advisers who sell traditional securities did not act in their clients' best interest and instead are motivated only by fees.
- ¶ 221 This is beyond misleading. The hypocrisy is stunning.
- ¶ 222 Michaels told listeners on his C-FAX program that "it just doesn't make sense to him" that people spent more time on buying a fridge than an investment. Yet that is just what he encouraged. He testified that he sent clients home with materials to read, which some did, but that usually consisted more an exercise of choosing which of his products to buy, than doing an analysis of whether they should buy anything he was offering. Some clients bought on the spot (so much for reading the offering memorandum first). What Michaels was facilitating his clients to do was just what he had criticized on his C-FAX program.
- ¶ 223 Michaels was adamant that he ignored any considerations of know your client and suitability. He thought it was ill-advised for investor C to put all his savings into Pepper

Creek but said nothing. He told clients to borrow against their homes to invest in high-risk exempt market securities when it was inappropriate to do so. It did not matter to him what clients bought, because whatever they bought, he got paid, he got paid, he got paid.

#### Subjective knowledge

- ¶ 224 Michaels was a registrant for 20 years. During that period he was registered to trade for both mutual fund firms and securities dealers. The curriculum he completed to be qualified as a registrant covered comprehensively the nature and scope of the risks potentially associated with various forms of both traditional and alternative investments. Michaels testified that he understood the risks of non-liquidity and the relationship between risk and return. Michaels knew that the risks associated with investments in exempt market securities were significantly greater than the risks associated with investments in traditional securities. Michaels knew that markets tend to recover losses over the long term – he sent his clients a chart demonstrating that fact.
- ¶ 225 Michaels also had to have known that it was misleading to associate “stock market risk” to all of stocks, bonds and mutual funds, just as he had to have known that the so-called diversification was a mockery of what that term signifies in the world of investment management.
- ¶ 226 Michaels knew that he was not acting in his clients’ best interest because he was adamant that he could not advise them, and therefore not disclose risks to them.

#### ***Leveraging***

- ¶ 227 Michaels advised his clients to borrow against their homes to leverage their investments. Unfortunately, many clients had existing bank lines of credit secured by a mortgage against their homes, which made them very vulnerable to succumbing to Michaels’ pitch. No time needed to apply for a loan, no awkward questions from a loan officer. For clients who did not already have mortgage-secured funding in place, he referred them to a mortgage broker.
- ¶ 228 Michaels testified he was aware of the risks of leveraging. Clients testified that he did not warn them about the risks. This is consistent with the weak answer he gave in his interview when asked if he explained the risks of leveraging to his clients: “I think I had, but I can’t recall if I did it all the time.”
- ¶ 229 The evidence is that Michaels both knew of the risks of leveraging and that he did not disclose those risks to many clients.

#### ***Betraying trust***

- ¶ 230 Michaels instilled trust in his clients by portraying himself as a knowledgeable adviser – not just any adviser, but one who had worked inside the industry, and knew all its dirty little secrets. He was on the radio every week, giving advice about how bad an idea it

was to invest in traditional securities because the market was going to crash. When it did crash, it was only going to get worse. By implication, he compared himself to those untrustworthy advisers from the dark side who were interested only in getting their fees.

- ¶ 231 Michaels held out his Certified Senior Advisor designation to build trust in him as exactly what the words of the designation suggested, in the context in which he used it.
- ¶ 232 Michaels instilled trust in his clients who were seniors, repeatedly saying that he “loved helping seniors make money”.
- ¶ 233 Michaels instilled trust and confidence in his clients when he told them he was invested in the very same investments that he was selling them.
- ¶ 234 Michaels betrayed that trust, because none of it was true, and he knew it.
- ¶ 235 As we have found, he knew his advice about exempt market securities compared to traditional securities was deceitful, as he did about what he said about advisers from brokers and mutual fund firms.
- ¶ 236 His Certified Senior Advisor designation had nothing to do with giving investment advice. Michaels had to have known that he was misleading people. In the context in which clients observed the title, what other conclusion could they reasonably draw? Indeed, why else would he display it so prominently? If Michaels wanted his clients who were seniors to know that he had a designation tailored to a broader understanding of their needs, he would have taken care to explain to them what it meant. He did not do that. If someone asked about it, he responded, but mostly he just let it hang out there, knowing people would draw the inevitable conclusion.
- ¶ 237 He knew he liked helping seniors only because they could show up during the day, not because he had any affinity for helping them financially. Indeed, most of these people were the last people for whom Michaels’s high-risk exempt market securities were suitable investments.
- ¶ 238 Michaels was too clever a salesman not to know that telling clients he was invested in the same investment as he was selling them was a powerful incentive for them to buy. They could have interpreted that only as a testimonial from the person in whom they had placed so much trust. His investments in the exempt market securities he sold his clients were dwarfed by the fees and commissions he earned from those issuers.

### ***Misrepresentations***

- ¶ 239 We have found that Michaels made misrepresentations about the exempt market securities he offered to his clients. We find that these misrepresentations constituted deceit, and therefore are a prohibited act, under the *Théroux* criteria.

¶ 240 We find that a reasonable person would stigmatize Michaels’s misleading statements to his clients about the risks of investing in traditional securities, and his failure to tell his clients about the far more significant risks in investing in the exempt market securities he sold them, is conduct that a reasonable person would stigmatize as dishonest. We find this conduct was deceitful and therefore a prohibited act under the *Théroux* test.

¶ 241 The evidence is clear, convincing and cogent that Michaels knew the risks associated with the exempt market securities he sold his clients (the following summary is based on his own testimony) and therefore he had to have known that in advising his clients to purchase those securities he was putting their pecuniary interests at risk:

- He had been a registrant for almost 20 years. From his training and experience he knew all about suitability and know-your-client obligations. It is inconceivable that an individual of his training and experience was not aware of the risks associated with these investments.
- He testified that he knew that “some of” the exempt market securities he was selling were high-risk.
- He knew the offering memoranda for the exempt market securities he sold to his clients were full of risk disclosure that he never discussed with this clients. He had to know the investments were risky because he did not stop at ensuring that his clients signed the mandated risk acknowledgement forms. He took the extra step (not mandated by regulation) of writing by hand on the top of the subscription forms “I have received the offering memorandum and understand the risk” and required his clients to initial it.
- He testified that he thought it ill-advised when he invested all of one investor’s funds into Pepper Creek.
- When asked in his testimony whether he thought the exempt market securities that he sold to clients and invested in himself, were good investments, he answered, “Yes, for me. I cannot infer that to any other person.” The clear inference was that he was not saying he thought the investments were necessarily good investments for his clients.
- Michaels knew about the importance of liquidity in investing, and the relationship between risk and return. Asked in his interview whether he would prefer an investment in a public company or a private company, Michaels replied: “Depends on what I’m looking for. If I need liquidity, obviously with a public company. If I’m looking for maybe a better rate of return, I would go . . . private, cause it’s a higher risk, higher rate of return.” He knew the exempt market securities he sold his clients had no liquidity, and he had to have understood that these securities, which were offering returns of 10% to 12%, carried higher risk than traditional securities whose returns were lower.

¶ 242 Neither is there any doubt whatsoever that he knew he did not disclose these risks to the investors. To the contrary, he testified that he believed that to do so would have been

giving advice. He was insistent in his testimony that he could not, and did not, give advice. It was his explanation to any question put to him in his interview or during the hearing about why he did not explain the risks or suitability of a given security to a given client.

***Subjective knowledge of prohibited acts***

¶ 243 It was Michaels who reviewed their portfolios, tax returns, and overall financial position. It was Michaels who advised them to sell their stocks, bonds, and mutual funds. It was, as we have found, Michaels who advised them to buy exempt market securities. It was Michaels who told some of them that he, too, was an investor in these securities. It was Michaels' own notes from his client files that show he told them to sell their existing stocks, bonds and mutual funds, to buy high-risk exempt market securities, and to mortgage their homes to do so.

¶ 244 For the reasons set out above, we find that Michaels had subjective knowledge of his prohibited acts.

**4 Deprivation**

***Pecuniary interests at risk; actual deprivation***

¶ 245 We have found that Michaels deceived his clients when he sold them exempt market securities because he made misrepresentations to them. We have found that Michaels deceived his clients when he sold them exempt market securities because he emphasized the ostensible merits of the investments, including the absence of "stock market risk", without disclosing to them the equally, if not greater, risks associated with an investment in these securities.

¶ 246 As a result, Michaels' clients assumed substantial risks associated with those investments – risks unknown to them because he dishonestly failed to tell them. These investors also lost the returns that they may have enjoyed from traditional securities they owned before Michaels advised them to sell them, and from other traditional securities they may have purchased, had Michaels not advised them otherwise.

¶ 247 Michaels' clients have also suffered actual deprivation. The following table summarizes the distribution of the \$65 million Michaels raised from 484 clients among the exempt

market securities he sold them:

ISSUER	AMOUNT SOLD (000'S)
Aveiro / Mosaic	\$ 5,745
Focused Life	9,090
Bethel Care	11,800
MineralFields	4,072
Pepper Creek / Treadwell	13,797
Rogers Oil & Gas	5,377
Walton	15,430
Other issuers (seven in total)	1,177
Less Michaels and spouse investment	(1,249)
	<b>\$ 65,239</b>

The information in this table is drawn from hearing exhibit 1602. Due to rounding, the total differs from that in the exhibit (\$65,237).

¶ 248 As noted in an earlier section of these Findings, Focused Life, Bethel Care, Pepper Creek / Treadwell, and Rogers Oil & Gas, are all dormant or defunct. The \$40 million attributable to them is lost. Michaels says his clients got tax benefits equal to their investment in MineralFields, and that Aveiro/Mosaic and Walton have potential value although there is no objective evidence of any of this.

¶ 249 To the extent the exact degree of actual deprivation is relevant to sanction, the parties can produce the relevant evidence at that time. We find that Michaels' deceit caused deprivation to the 484 of his clients who purchased exempt market securities from him by putting their pecuniary interests at risk. They also suffered, as a group, substantial actual deprivation.

#### ***Subjective knowledge of deprivation***

¶ 250 We have found that Michaels had subjective knowledge of the investment risks that he failed to disclose to his clients. With that knowledge, he had to have known that advising them to purchase the exempt market securities, and facilitating those purchases, that he was putting their pecuniary interests at risk.

### **D Findings**

¶ 251 We have found that Michaels committed prohibited acts when he made misrepresentations about the exempt market securities he sold and when he deceived his clients as described above. We have found that as a consequence, his clients have suffered grievous deprivation, and that he was greatly enriched. We have found that Michaels had subjective knowledge, both of his prohibited acts, and that those prohibited acts could have as a consequence the deprivation of his clients.

¶ 252 We find that Michaels perpetrated a fraud, contrary to section 57(b), when he sold \$65 million of exempt market securities to 484 clients.

## **VII Summary of Findings**

¶ 253 We have found that Michaels:

1. acted as an advisor without being registered, contrary to section 34(b) of the Act;
2. made misrepresentations, contrary to section 50(1)(d); and
3. perpetrated a fraud, contrary to section 57(b).

¶ 254 A central feature of this fraud was Michaels's use of the media to lure clients into his web. In his interview, Michaels said that, of all the media he tried out to promote his business, the most successful was radio. Indeed, the C-FAX programs were central to Michaels' sales strategy. Michaels testified he had "over 20,000 listeners every week."

¶ 255 Securities transactions involve a high degree of what the economists call moral hazard. Selling securities is not like selling cars or furniture. Indeed, that is why there is regulatory regime for trading in securities. We wonder whether Michaels, without his access to the airwaves through C-FAX, would have been as successful in duping so many clients into buying his high-risk exempt market securities.

¶ 256 This is a textbook example of improper sales practices that so violate the principle of investor protection and so seriously damage the integrity of our markets. Michaels preyed on clients by frightening them and misleading them into leaving the comparative safety of traditional capital markets for the far riskier part of the exempt market. In doing so, he damaged the confidence of investors in both traditional markets and the exempt market. He damaged confidence in the traditional market, because he portrayed himself as an insider whose experience had taught him to mistrust that market. He damaged confidence in the exempt market, because of his misrepresentations and deceit.

¶ 257 The exempt market, although risky, plays a vital role in capital raising for venture-stage companies. The risks associated with investments in those companies can be formidable, but they are known and understood as features of the market. What is not expected by participants in that market is fraudulent activity. People like Michaels put at risk the confidence held in those markets, and ultimately threaten their availability to those seeking venture capital.

## **VIII Submissions on Sanction**

¶ 258 We direct the parties to make their submissions on sanctions as follows:

- |                |  |
|----------------|--|
| By August 29   | The executive director delivers submissions to the respondents and to the secretary to the Commission. |
| By September 5 | The respondents deliver response submissions to the executive and to the secretary to the Commission.  |



Either party seeking an oral hearing on the issue of sanctions so advises the secretary to the Commission. The secretary to the Commission will contact the parties to schedule the hearing as soon as practicable after the executive director delivers reply submissions (if any).

By September 12      The executive director delivers reply submissions (if any) to the respondents and to the secretary to the Commission.

¶ 259 August 6, 2014

¶ 260 **For the Commission**

Brent W. Aitken  
Vice Chair

Don Rowlatt  
Commissioner